

Aftermath of  
financial crisis

Roots of the  
crisis

Fault lines

# 金融海嘯

2013.4

1 **Aftermath of financial crisis**

2 **Roots of the crisis**

3 **Fault lines**



# Effects on Taiwan

Aftermath of  
financial crisis

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- 金融海嘯對台灣銀行業的直接影響似乎不大

# Effects on Taiwan

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- 金融海嘯對台灣銀行業的直接影響似乎不大
- 台灣 GDP 的波動幅度更甚於 G20
- Why?

# Effects of financial crisis

## A long, hard slog

Peak-to-trough changes in severe financial crises\*

	Cumulative change, %	Duration, years
House prices	-36	5.0
Equity prices	-56	3.4
Unemployment <sup>†</sup>	7.0	4.8
GDP per person	-9.3	1.9

Percentage of years spent in banking crises

	Advanced economies	Emerging economies
Since 1800 or independence	7.2	8.3
Since 1945 or independence	7.0	10.8

\*Argentina (2001), Colombia (1998), Hong Kong (1997), Indonesia (1997), Korea (1997), Malaysia (1997), Philippines (1997), Thailand (1997), Japan (1992), Finland (1991), Sweden (1991), Norway (1987), Spain (1977), US (1929)

<sup>†</sup>Excludes Japan <sup>‡</sup>Percentage points, trough to peak

Source: Reinhart and Rogoff, *The Aftermath of Financial Crises*, 2009

- Rogoff and Carmen (2009): results from 14 severe banking busts

# Spend to save

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- “Drastic times”, *Economist*, Jan 20, 2009
- “Nearly all were agreed that a massive fiscal stimulus was needed to stop a deep recession turning into something worse. But there was not much consensus about the form of a package should take.”

# Effects of fiscal policy

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- Robert Hall: tax rebates?  
there is no guarantee that they will be spent
- Direct government purchase?  
Much of the benefit maybe captured by  
producers



# A dissenting voice

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## John Taylor (Stanford University)

- “there was scant evidence that tinkering with tax and spending policies does much to lift the economy”
- Taylor: **Debating Stimulus and Harvard and Stanford**
- America's 2008 tax rebates had little discernible impact
- 台灣發放消費券有何效果?

# An example

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- “Mr Taylor’s scepticism may well be shared by other academic economists but **the scale of economic meltdown leaves them reluctant to rule out any options.**”
- Rogoff: A terminally ill patient who is offered a risky treatment that may cure the disease but is sure to have nasty long-term side-effects

# An interpretation on the crisis

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- US's Dot com bubble in late 1990s — spending in information technology
- A bust in early 2000 and US and Taiwan were in recession (Taiwan was a major supplier)
- 911 attacks (2001)

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- In 2001, Fed lowered interest rate to induce investment
- Loose money:

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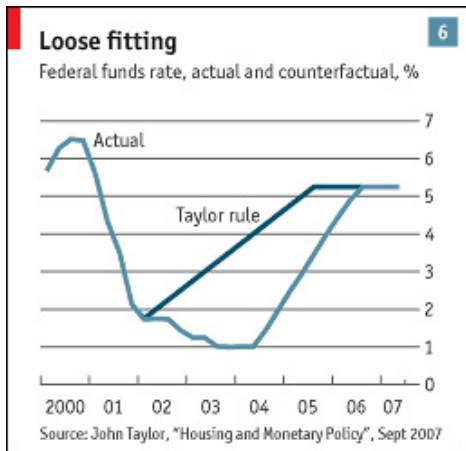
Roots of the  
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- Loose money: **How big and how long?**

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- According to **Taylor Rule**, Fed should start raising interest rates (reduce money supply) in 2002–2005

$$R = \pi + 2.0\% + 0.5(\pi - 2.0\%) + 0.5(\text{GDP gap})$$

where  $R$  is short-term nominal interest rate (Federal funds rate),  $\pi$  is inflation rate, and

$$\text{GDP gap} = \frac{\text{RGDP} - \text{trend RGDP}}{\text{trend RGDP}}$$

- When inflation or GDP are higher, Fed should raise interest rate
- debate: **rule vs. discretion**

# Interest and investment

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- However, firms had already invested too much
- Lower interest rate prompted U.S. consumers to buy houses



# Interest and investment

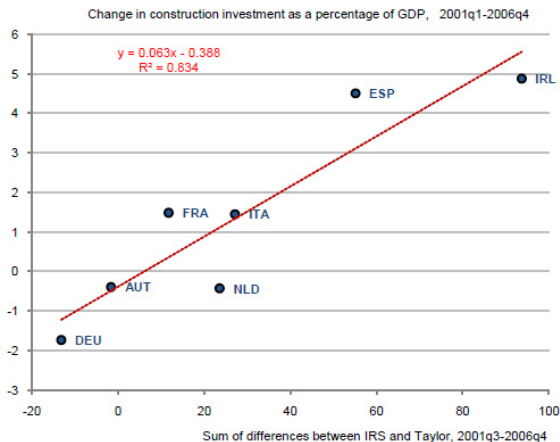
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- Not only US, but also European countries

# Loose money and housing



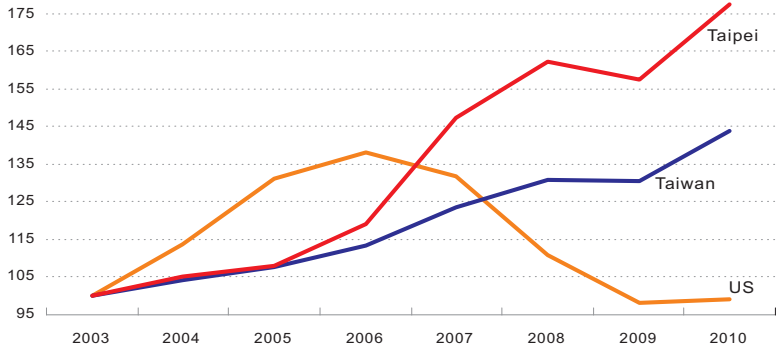
- Rudiger Ahrend et al. (2008), **Monetary Policy, Market Excesses and Financial Turmoil**

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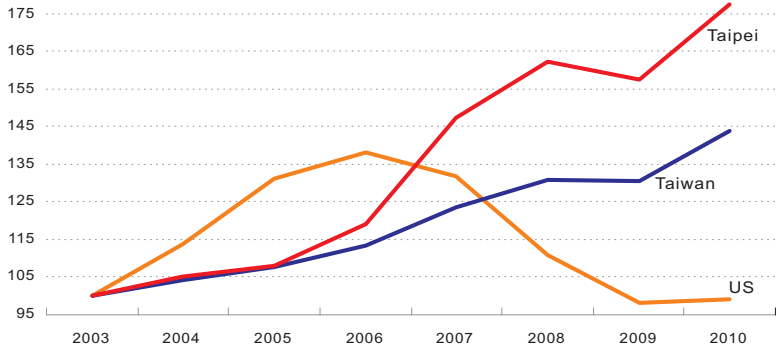
● 房價指數

# Loose money and housing

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- 房價指數
- If there was a financial crisis in the US and the Europe, why there is none in Taiwan?

# Who were the lenders?

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- Who lends to the US house buyers?
- Not only the US Fed, Germany, Japanese, Chinese, and Taiwanese all supply loans to the U.S. firms and consumers

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- What happens if there were no lenders from abroad?

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# If there were no foreign lenders

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- Interest rate would be much higher, and there would be fewer buyers
- Consider an example: both US Treasury and families want to borrow
- If many foreign lenders buy a lot of US government bonds, and US domestic lenders lend to the domestic borrowers, then US interest rate would be much lower

# International credit market

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- How to Taiwan's foreign lending or borrowing?

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- How to Taiwan's foreign lending or borrowing?
- **lending**: current account surplus (or trade surplus)  
**borrowing**: current account deficit

# Fault lines (斷層線)

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In summary, the financial tsunami was caused by two policy distortions:

- the push for universal home ownership in the US
- the push for export-led growth in some countries such as Germany, China, Japan, and Taiwan

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“This crisis has resulted from a confusion about the appropriate roles of the government and the market. We need to find the right balance again, and I am hopeful we will.”