

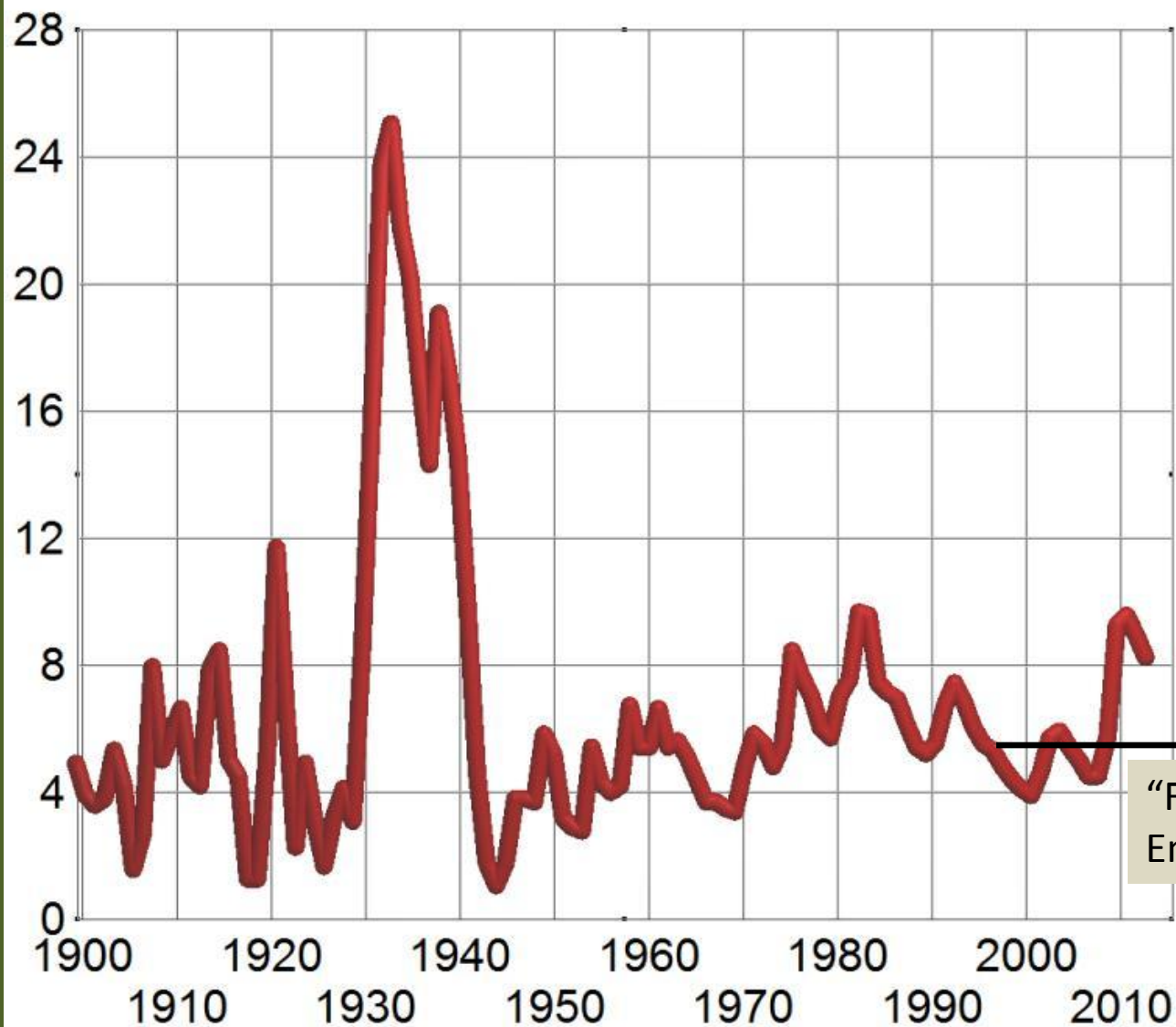
Understanding Today's Economy: When Thrift is Not a Virtue

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The Sad Shape We're (Still) In

	September 2007	At its Worst	February 2012
# People Employed	146 million	138 million	142 million
# People Officially Unemployed	7 million	15 million	13 million
# People Not Fully Employed who want Jobs	13 million	27 million	23 million
Total Annual Value of Goods & Services Produced in U.S. Economy (Real GDP)	\$13.3 trillion	\$12.6 trillion	\$13.4 trillion

Unemployment Rate, 1900 - 2012



Source: Historical Statistics, Econ Report of the President, & www.bls.gov

"Full
Employment"

The Plan For This Talk

- The Pre-2007 Boom
- The 2007-2009 Bust
- The 2009 – 201x Recovery

A Little Bit of Macroeconomics

- **Jobs (employment)**
 - Depend upon how much output firms produce
- **Output (GDP, gross domestic product)**
 - Depends upon how many goods & services are purchased
- **Purchases of U.S.-produced output are by**
 - Households: “**Consumption** Spending”
 - Businesses: “**Investment** Spending” (machines and construction)
 - Government agencies: “**Government Purchases**”
 - Rest of the world: “**Net Exports**”

Shares of total spending

Jobs
(employment)

depend upon

Output (GDP)

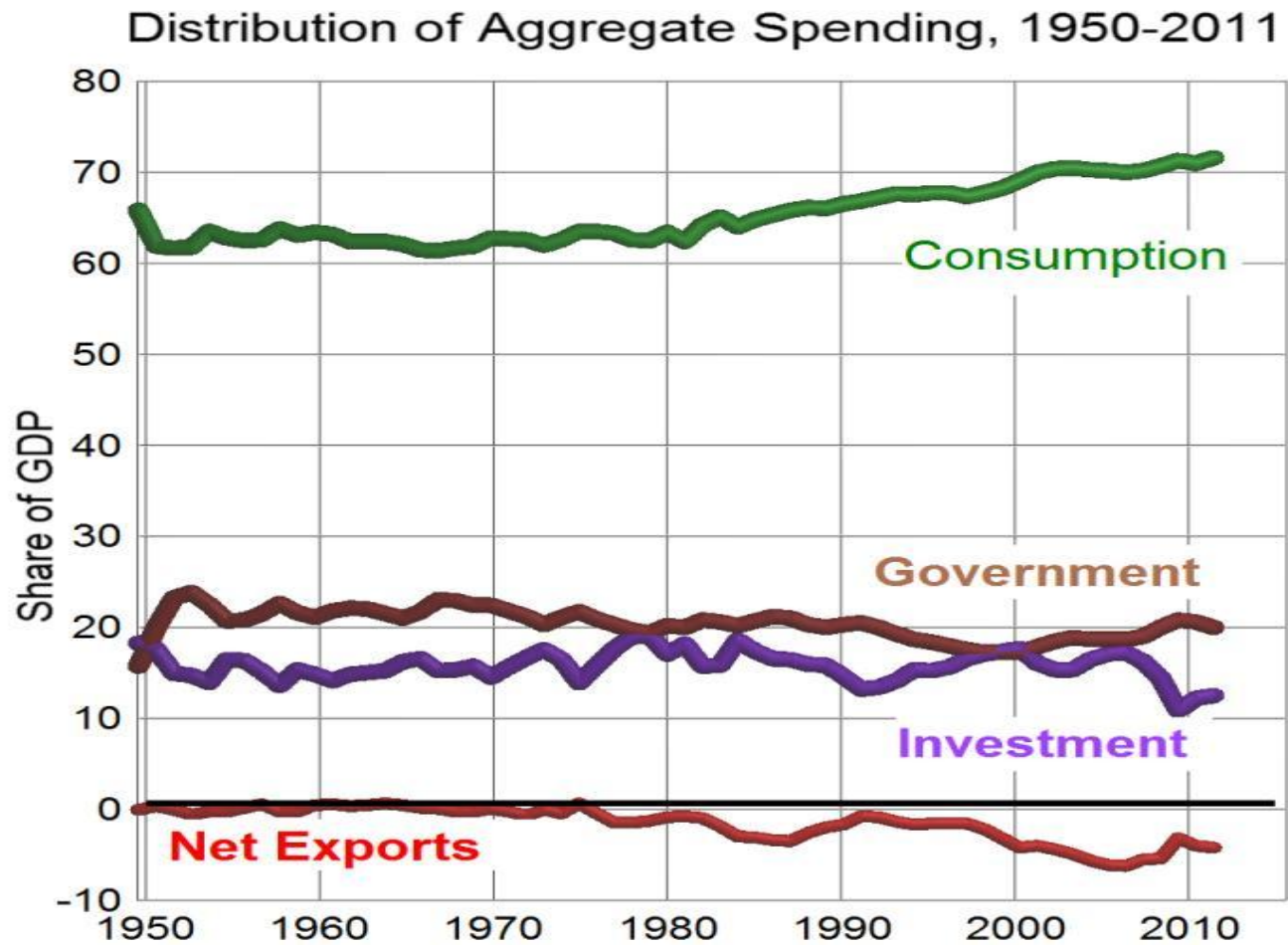
*which depends
upon*

Consumption

Investment

**Government
Purchases**

Net Exports



Source: National Income & Product Accounts, Table 1.1.10

The Pre-2007 Boom

Jobs
(employment)

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**Government
Purchases**

Net Exports

- Debt-financed Consumption spending
 - Some: credit cards
 - Most: home equity lines of credit (HELOC)
- Housing Construction Boom
 - And remodeling boom
- Result? Jobs! Jobs! Jobs!
And granite countertops to boot!

The 2007-2009 Bust

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Purchases**

Net Exports

- Different than previous recessions
 - Not due to Federal Reserve raising interest rates
- Instead, a financial crisis
 - Banks & other lenders insolvent
 - Credit markets froze up
- So?
 - Businesses need \$ to pay workers
 - Many depend upon loans for working capital

Without Lending . . .

Jobs
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Purchases**

Net Exports

- Businesses can't make payroll: **Layoffs!**
- Contractors can't buy materials:
Layoffs!
- Businesses can't buy equipment:
Layoffs!
- ~~Consumers can't feed their debt habit:~~
can't buy goods & services: **Layoffs!**

Sources of Financial Crisis

Jobs
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Purchases**

Net Exports

- Home mortgage lending
 - Sub-prime lending
 - Bundling of mortgages
 - “Mortgage backed securities” (MBS)
 - Easy lending had caused soaring prices
 - Soaring prices required to pay back loans
- But! Prices never soar forever

And furthermore. . .

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Net Exports

- Credit Default Swaps
 - Much like betting on the “No Pass” line in craps!
 - Anyone can buy a bet that someone else will default on a loan
 - Actually default? Buyer of bet wins!
 - But if something systematic happens so (almost) everyone defaults at once. . .
 - Seller of credit default swaps can’t pay

AIG (American Int'l Group)

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Purchases**

Net Exports

- Largest seller of credit default swaps
- Many (many) financial institutions worldwide insured through AIG
- When financial crisis began, AIG was running out of funds
- Without AIG, lending stops. Period.

How Extensive Were Job Losses?

Jobs
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**Government
Purchases**

Net Exports

- <http://tipstrategies.com/interactive/geo-jobs-2011-04/>
- Worldwide recession
 - First since 1930

“Can’t We Stop This Thing?!”

Jobs
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**Government
Purchases**

Net Exports

- Fed dropped interest rates rapidly
- Federal government (TARP) tried to keep lenders lending
- Federal government (ARRA) tried to boost spending
- But collapse too big & fast to reverse

The Long, Slow Recovery

Jobs
(employment)

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Investment

**Government
Purchases**

Net Exports

- Most optimistic estimate:
 - 2016 before back to 2007 employment levels
- Why so slow?
 - Because there's no source of renewed spending

Exports

Jobs
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Investment

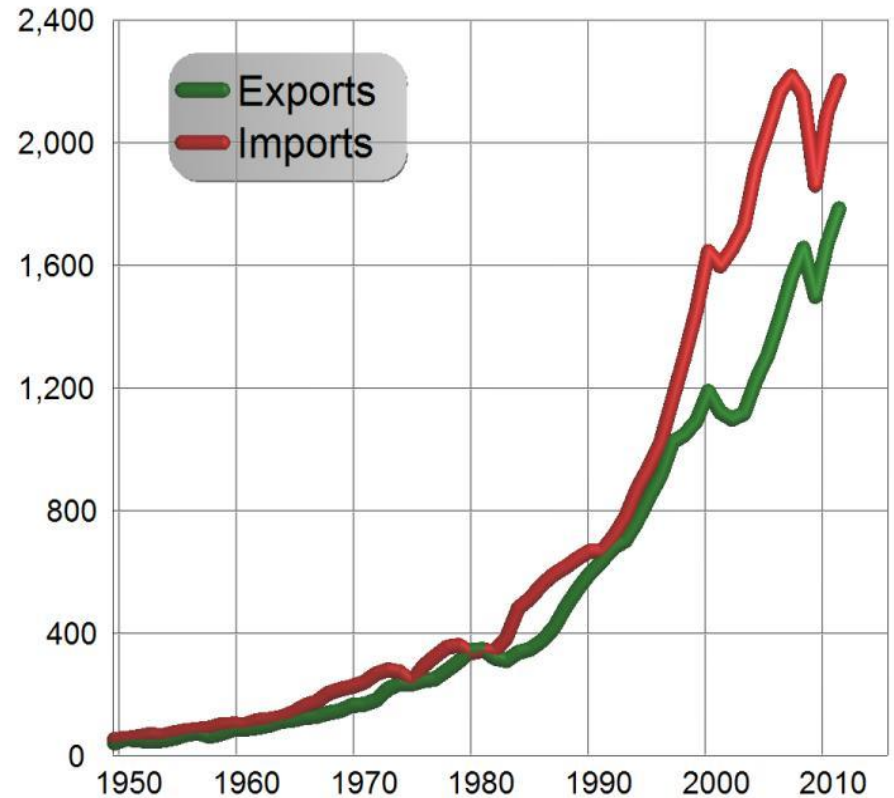
**Government
Purchases**

Net Exports

- Recovered from lowest point
- But imports rebounding, too

Exports and Imports 1950-2011

Billions of chained 2005 dollars



U.S. BEA Table 1.1.6

Government Purchases

Jobs
(employment)

depend upon

Output (GDP)

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Investment

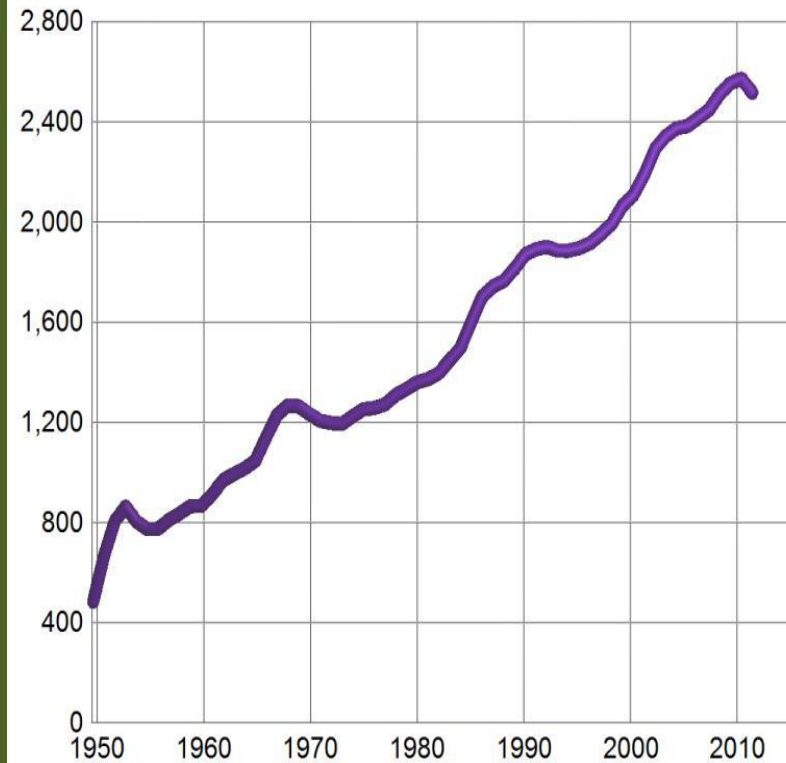
Government Purchases

Net Exports

- Federal, State, & Local
- Federal politics
 - Lower the deficit!
 - Cut spending
 - Raise taxes
- State & local requirements
 - Balance budgets
 - Cut spending

Government Purchases of Good & Services 1950-2011

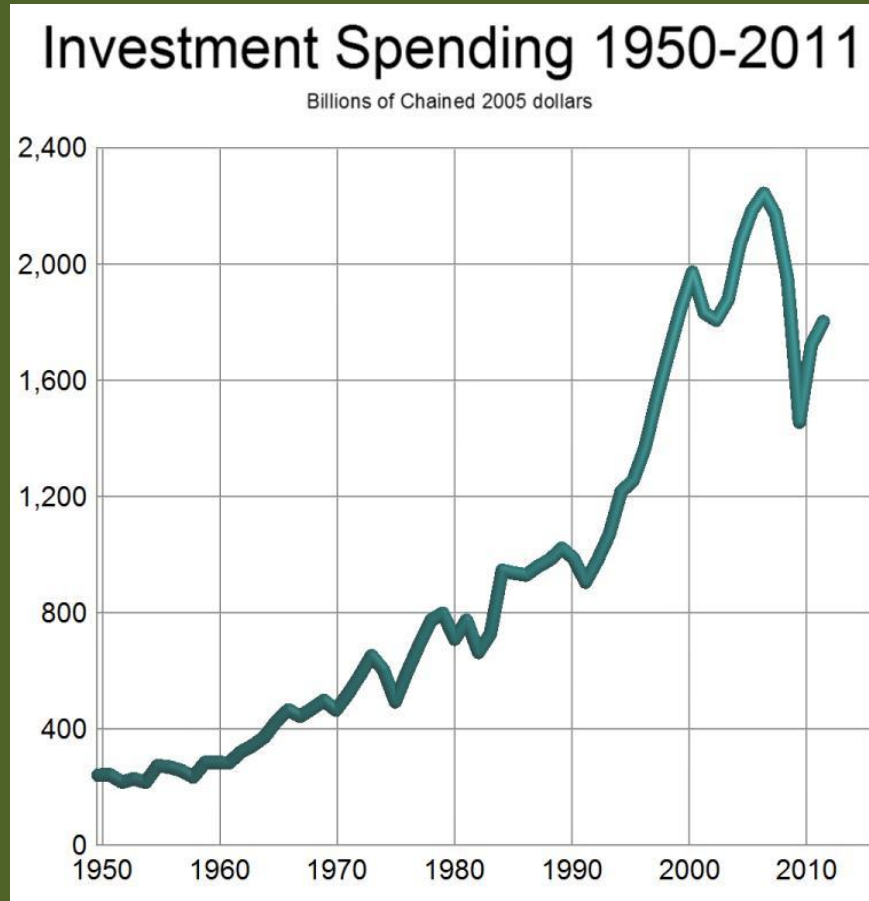
Billions of Chained 2005 dollars



U.S. BEA Table 1.1.6

Investment Spending still weak

- Why expand capacity when sales still slow?
- And lenders are still tight-fisted with funds



Jobs
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Output (GDP)

which depends upon

Consumption

Investment

Government Purchases

Net Exports

Housing Going Nowhere

Jobs
(employment)

depend upon

Output (GDP)

*which depends
upon*

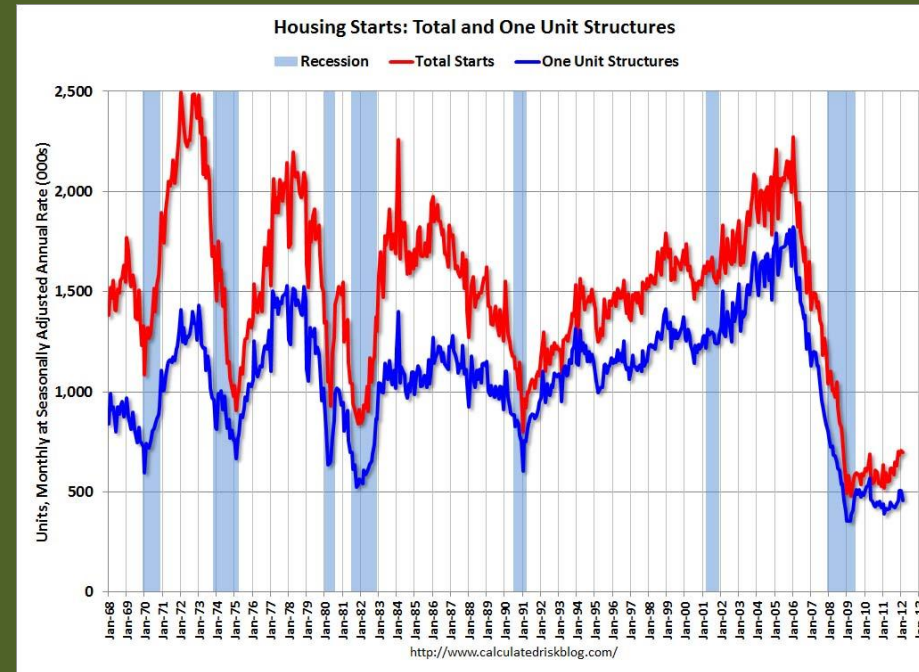
Consumption

Investment

**Government
Purchases**

Net Exports

- Housing starts may be “up”
 - But from where?
 - From the bottom
- Huge inventory of unsold homes
 - Underwater homeowners
 - Few buyers
- Difficult to get loans



Housing Going Nowhere (graph starts in 1968)

Jobs
(employment)

depend upon

Output (GDP)

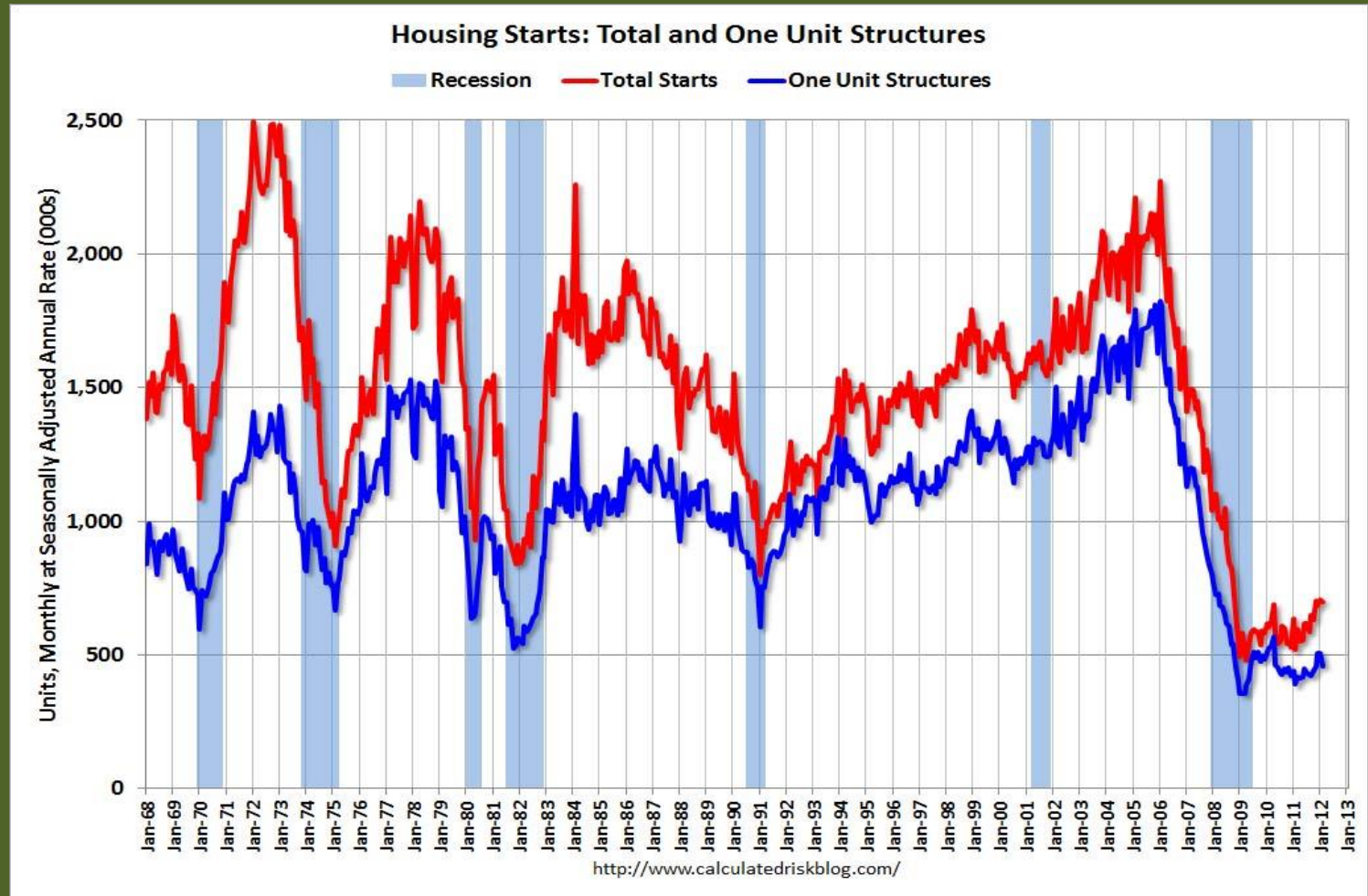
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Purchases**

Net Exports



New York is unusual

Jobs
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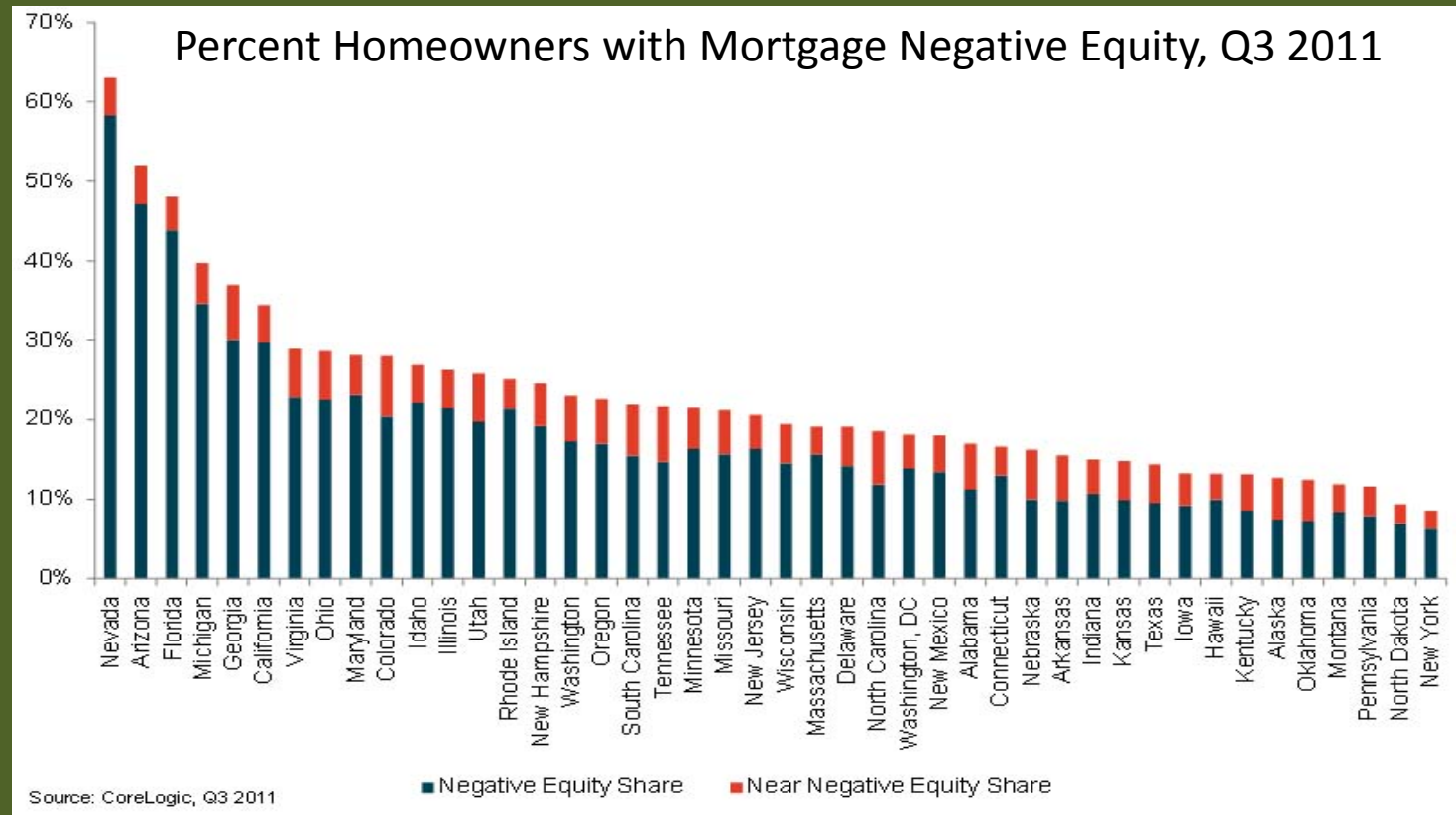
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Investment

**Government
Purchases**

Net Exports



“The top five states combined have an average negative equity ratio of 41.4 percent, while the remaining states have a combined average negative equity ratio of 17.6 percent.”

Consumption spending is up, a bit

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Investment

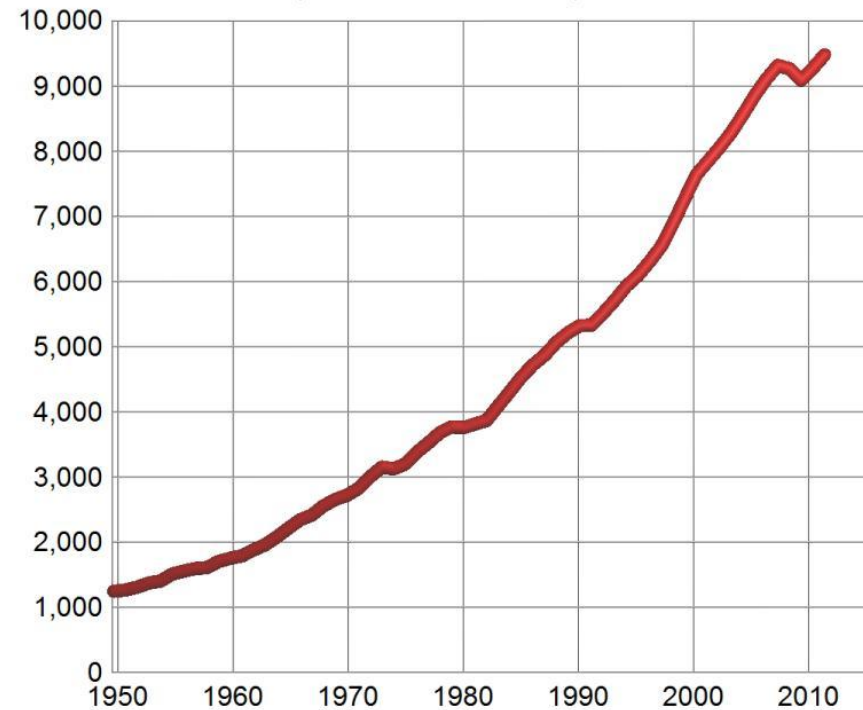
**Government
Purchases**

Net Exports

- Families have been “repairing their balance sheets”
 - Paying off debt
 - Building up saving
- “Thrift is a virtue”
 - For a family, anyway

Consumption Spending, 1950-2011

(Billions of chained 2005 dollars)



US BEA, NIPA Table 1.1.6

Paying back home equity loans

Jobs
(employment)

depend upon

Output (GDP)

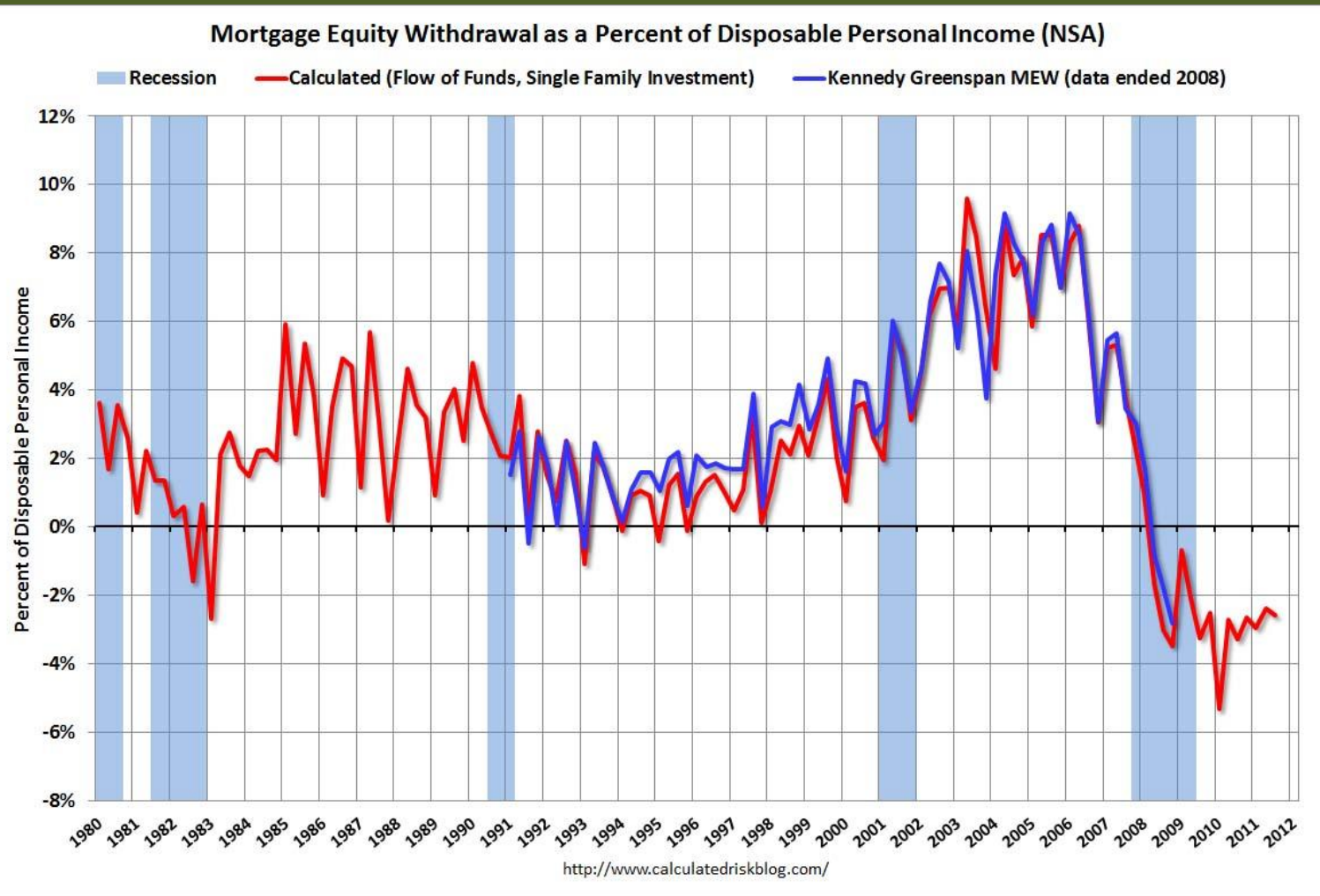
which depends upon

Consumption

Investment

Government Purchases

Net Exports



Being Thrifty

Jobs
(employment)

depend upon

Output (GDP)

which depends upon

Consumption

Investment

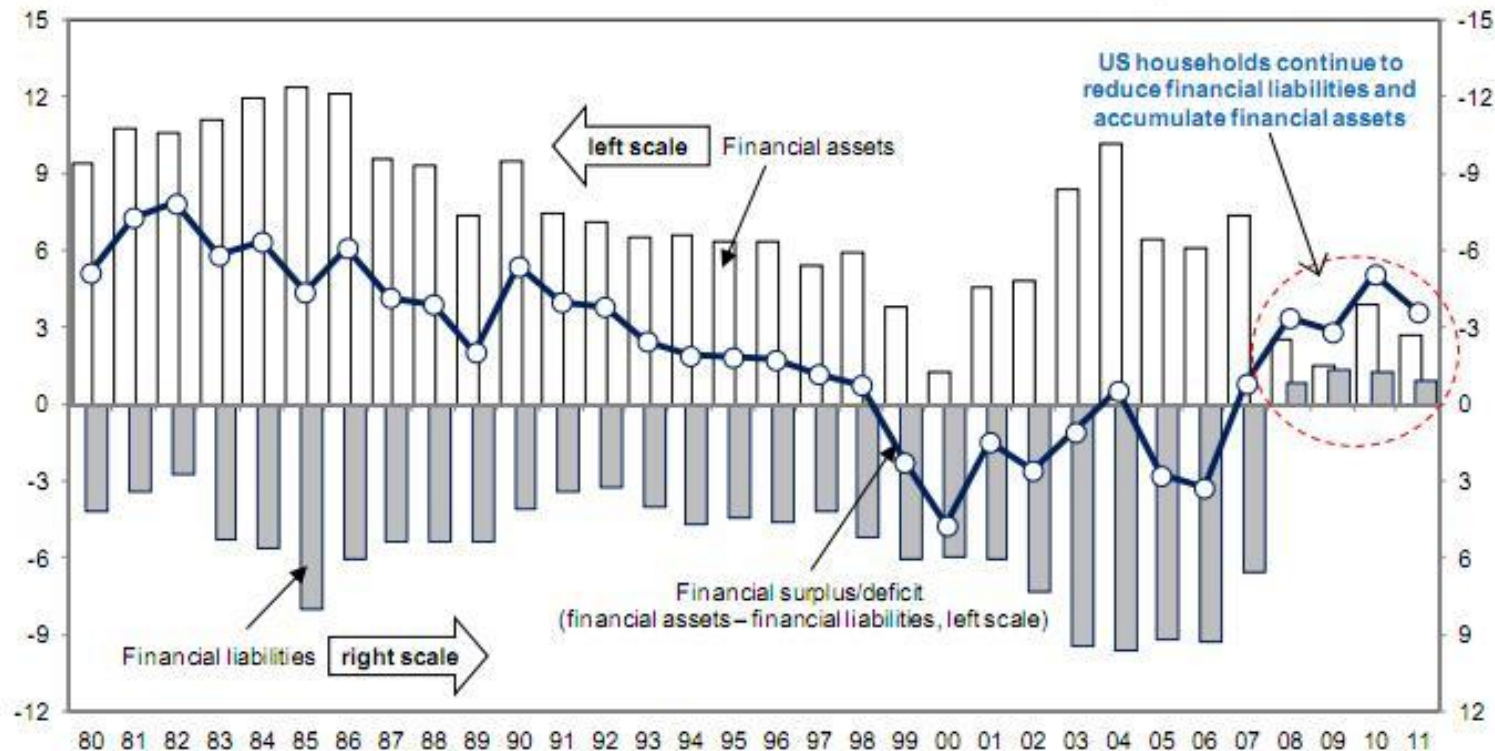
Government Purchases

Net Exports

Fig. 4: Financial assets and liabilities at US households

(as % of nominal GDP)

(as % of nominal GDP, inverse)



Source: Fed, US Department of Commerce

And So We are Saving More

Jobs
(employment)

depend upon

- We are more thrifty!
 - Yay for us!

Output (GDP)

which depends upon

- But . . .
 - Without spending
 - No gains in output
 - No gains in jobs

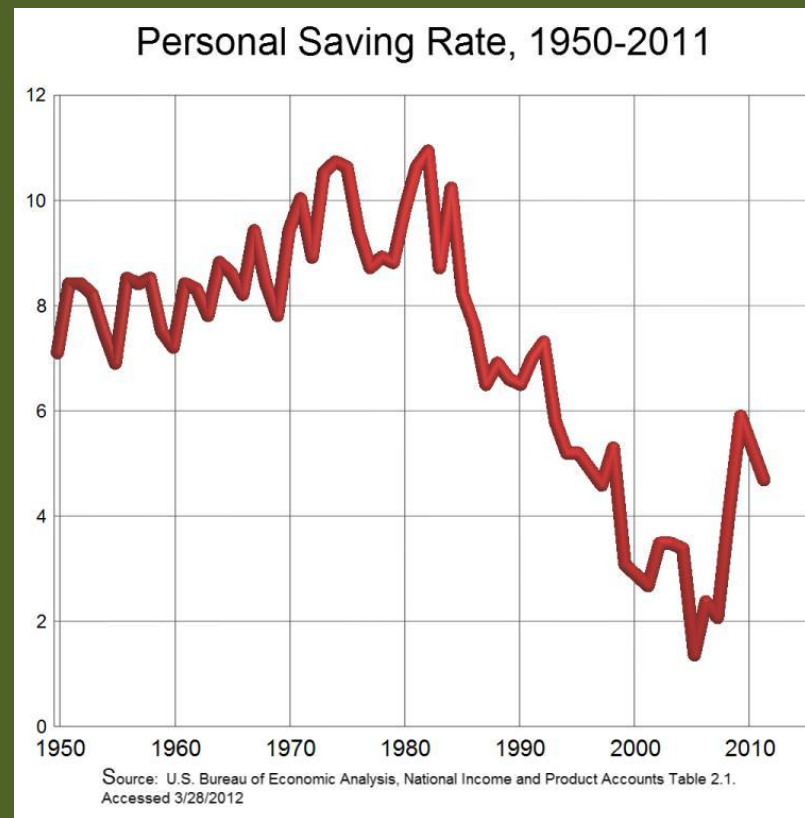
Consumption

Investment

Government Purchases

Net Exports

- Is thrift truly virtuous?



Better . . . But we have a ways to go

Jobs
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Investment

**Government
Purchases**

Net Exports

- **Families** will be increasingly thrifty
 - Even though that's not helpful to economy
- **Businesses** will wait for buyers
- **Governments** are required (state & local) or under political pressure (federal) to reduce spending
- And did I mention there's a little problem in **Europe**?

"This too shall pass," mother always said. But this time, it'll take awhile.