

Economists: Tough measures needed to cure economic ills

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(PhysOrg.com) -- An ailing financial industry is going to need strong medicine to pull out of a deepening credit crunch brought on by risky loans and deregulation, Purdue University economists said Monday.

Economists from Purdue's Department of Agricultural Economics, Krannert School of Management, and the Department of Consumer Sciences and Retailing said the \$700 billion federal bailout package should provide short-term help for lenders but won't cure the nation's economic ills. They prescribed tighter regulation of the banking industry and derivatives markets, combined with a culture that saves more and spends less.

Philip Abbott, Michael Boehlje, Sugato Chakravarty, Larry DeBoer and David Hummels spoke about the financial crisis during a panel discussion on Purdue's West Lafayette campus.

Despite the governmental intervention, tough economic times are ahead, said Abbott, an agricultural economist.

"We are going to go into a recession, regardless," Abbott said. "It's just a question of how severe and how long-lasting it will be."

If bad mortgage assets were the only problem, \$700 billion likely would cover it, Abbott said. But once derivatives are added to the mix, the bailout price tag grows exponentially, he said.

Hummels, a Krannert economist, said Congress acted appropriately by passing financial rescue legislation. He said it was "absolutely necessary" for Washington to remove the bad assets from the balance sheets of major financial institutions because the Federal Reserve would have done it anyway. The issue now, he said, is getting cash flow moving.

"You can lead a bank to liquidity but you can't make them lend," he said.

The bailout plan will be successful if international investors decide the United States is again a safe place to put their money, Hummels said.

"We need to watch foreign investors," he said. "For a very long time now, banks, Asian in particular, have been lending incredible amounts of money to the U.S. economy. We run a current account balance of \$700 billion to \$800 billion a year, which means that every year our economy has to absorb \$700 billion to \$800 billion worldwide.

"In fact, the dollar actually rose against the euro in the last few days. I think what we may see over the next coming months is whether Asian lenders would rather pull their money out of euros or pull their money out of dollars, and which one happens more quickly."

Housing markets also need to stabilize, said Larry DeBoer, an agricultural economist. He said markets have been steadily declining since about 2002, but could rebound in the next 12 months.

"It looks like we're about two-thirds of the way back to where we were at the end of 2001 and beginning of 2002," DeBoer said. "At the rate that the real price of housing is declining it will take another year to get back to where we were in November 2001 when the last recession ended.

"If we have a recession, however, people may not be able to pay back their mortgages."

The agriculture industry might be in the best financial shape - for now, said Boehlje, an agricultural economist.

"So far, availability of credit is not a big concern," Boehlje said. "At this point we don't have the freezing of credit markets for the ag sector. The more serious issue for agriculture is the potential recession."

A recession could hurt the sale of agricultural products here and abroad.

On the consumer side, it will be more difficult and expensive to borrow money, affecting everything from big-ticket purchases to paying for college, the economists said. People within a few years of retirement stand to lose more from their retirement savings than those with 10 years or more of employment remaining because younger workers will have time to recoup those lost dollars if the market rebounds, said Chakravarty, a retail and consumer economist.

"Short term bad, long term better," Chakravarty said.

"We've been living beyond our means for quite some time," Hummels said. "Our savings is essentially zero. But the last thing you want in a recession is for people to stop buying cars or couches."

Abbott said there is one bright spot amid the dark news.

"The most positive note I've seen is Wells Fargo and Citibank are fighting it out over Wachovia," he said. "They both want to buy those assets at the fire-sale prices now available."

Provided by Purdue University

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