# INTERVIEWING Greenspan

# Capital Leaders' Forum 20/5/2008

Gikas A. Hardouvelis

Professor, Department of Banking & Financial Management, University of Piraeus

& Chief Economist, Eurobank EFG

1

**Gikas Hardouvelis** 



### 18<sup>1/2</sup> years & 4 presidential administrations 11/8/1987 – 31/1/2006



His recent book: The Age of Turbulence: Adventures in a New World (ISBN 1594201315)

# **Questions in the post-Greenspan era:**

- How long will the financial crisis last? Any surprises in the horizon?
- Is global inflation getting out of control? Will global hunger persist? Are we going to see a quick reversal in US monetary policy once the crisis is over?
- Will stock market euphoria come back soon?
- Will the dollar strengthen in 2009?
- How much stricter will the regulatory framework be in the future: Will it affect bank profitability?
- Will emerging economies follow the US fate, or have they decoupled?
- Are we in a world of increasing inequalities?
- Should we worry about supply constraints and the environment?
- Can the US manage to keep its leadership in global economic policy making?

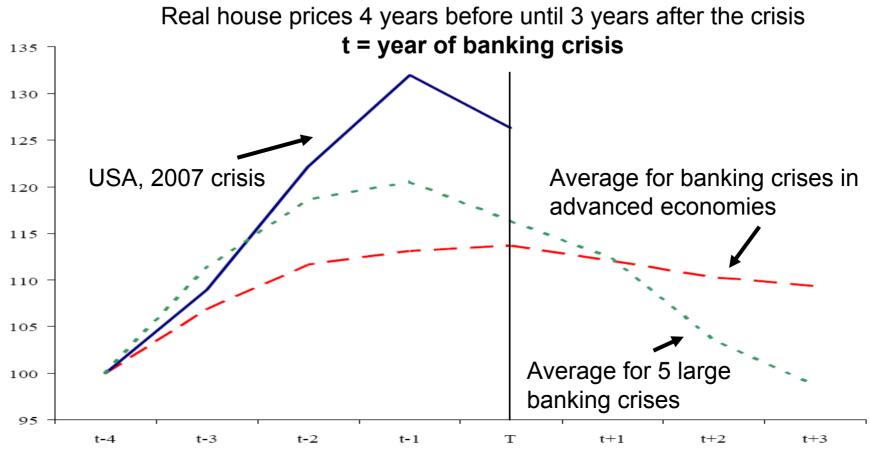
- ... because of the simultaneous development of three factors:
- 1) An earlier bubble in house prices in the US
- 2) The rapid expansion of subprime mortgages
- *3)* The transfer of risk from the banks' balance sheets to third party investors through securitization

Note: Greenspan is careful not to call the rise in house prices a "bubble"

### **Crisis is problematic because it began**

- ➢ in the US, which produces 25% of 2007 world GDP
- > in the financial sector, which is highly levered

### The house price bubble is larger than before



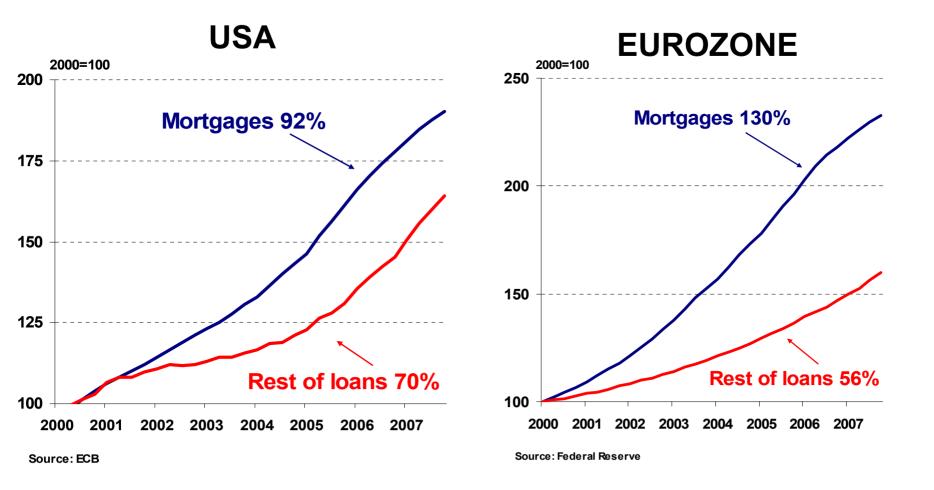
Source: Reinhart & Rogoff (2008)

Categorization of banking crises according to Reinhart-Rogoff:

- 5 «big» banking crises: Spain (1977), Norway (1987), Finland (1991), Sweden (1991), Japan (1992).
- Smaller banking crises in developing economies: Australia (1989), Canada (1983), Denmark (1987), France (1994), Germany (1977), Greece (1991), Iceland (1985), Italy (1990), N. Zealand (1987), Un. Kingdom (1974, 1991, 1995) και USA (1984).

#### **Gikas Hardouvelis**

# ... with a rise in credit expansion

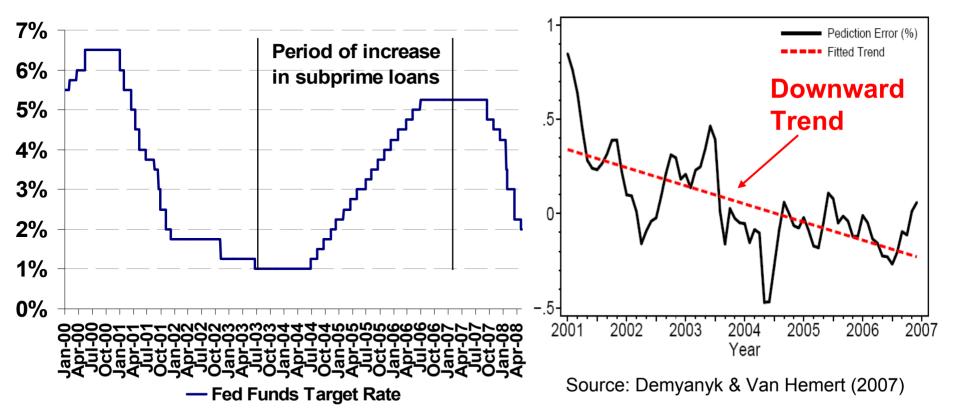


### ... especially in subprime loans in the US

Subprime: From 9% of total mortgages in 2003 to 24% by mid-2007 (subprime & Alt-A)

### Subprime-Prime spread

after controlling for loan characteristics

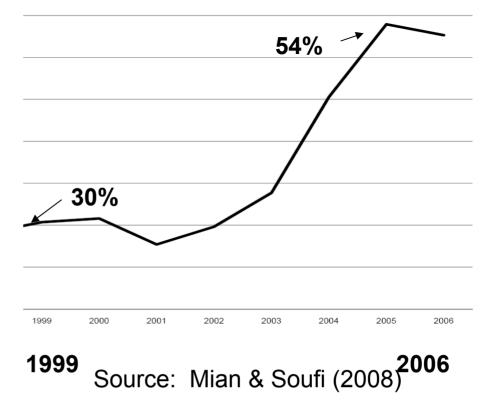


# ... due to the cannibalization of a useful market innovation: Securitization

Banks have three options:

- 1) Keep the loans on their balance sheets
- 2) Sell the loans to state controlled agencies (FNMA, FHLA, etc.), which in turn securitize them, a practice since 1939. So banks acquire the necessary liquidity in order to give new loans.
- 3) Sell the loans to private agents, which also securitize them.

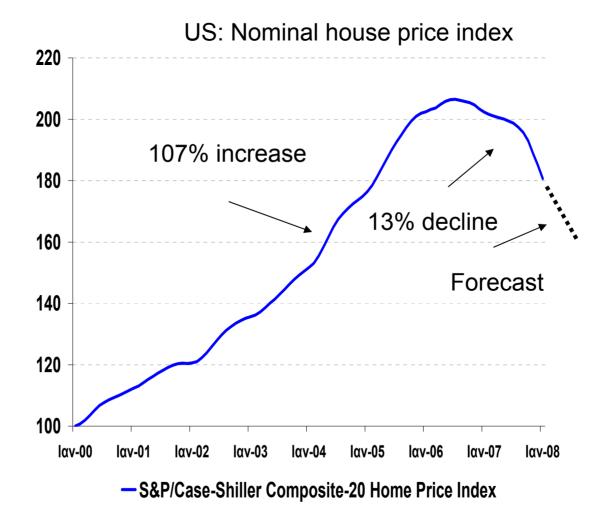
# Share of mortgages securitized by non state agents



#### > 77% of new subprime loans were securitized

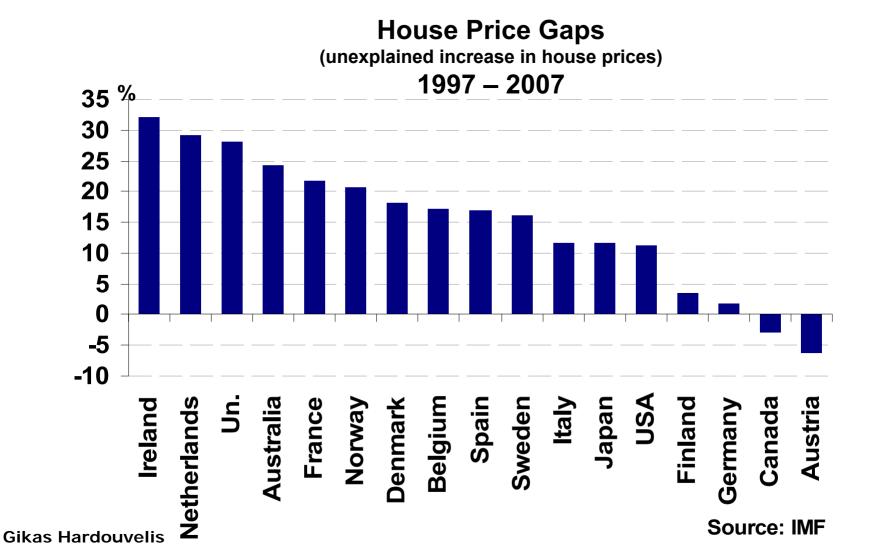
### The fall in home prices continues in the US ...

- The largest fall in the history of the indices, in some areas as large as 40%
- > They are expected to fall by an equal percentage in the future



### ... and follows around the globe

Europe will probably follow USA experience, with most of the effect to come in the future ...



## The crisis spread as ...

### 1. Structured products are present everywhere

- in portfolios across the entire financial system, in US, European and Asian banks, funds, insurance companies, etc.
- 2. Counterparty risk increased (lack of transparency & complexity)
- Interbank market liquidity problems
- **3. High leverage** of hedge funds, investment banks:
- Increased the need for liquidity & pressures for selling
- (Near) defaults of Investment Banks, Insurers, Hedge funds
- 4. Supply of credit insurance by single entities
- Credit Default Swaps (a \$62 trill. market), Monoline Insurers

### 5. Securitization had expanded into non-mortgage loans

- Asset Backed Commercial Paper
- 6. Rating agencies became more strict
- Further write-downs
- 7. International Accounting Standards: Mark-to-Market
- Banks are forced to show PV losses
- ▶ Increased pressure for selling assets  $\rightarrow$  fire sales  $\rightarrow$  lower prices

# **THANK YOU FOR YOUR ATTENTION!!**

My thanks to the research department of Eurobank EFG for able research assistance and support

For more info, please consult the Eurobank website: http://www.eurobank.gr/research

Frebank Research	
New F	urope
Energy Concept Press	ion ope
	Commentary
initian of Research & Promoting	Dotate performance in the support of free Europe are sense in C1.000. Free event with 7.001 org, Universe related with EOS phy and Network each PC phy detecting at mappinghi law, Turing not Detect improved at a free stress integri- entiate lawest down. The way teached lawes has 1 to their manuscream a disparat
Denter Bien Kenternie glarbenskalen gl	Santes and United it formation in Priced and its field append in Survey, Senat- dend control/sponter share in all recorded of New Europe. As a result, stabil sites enorogic hash time man stability has select
	Hence a second query, Sander Dy Yong Lowery gynerosis, Inform is Strong in Neuron Tortin, and Torty: in Income, the Sand Query processor in Information information in Strategy Internet, Additional processor in State Suggests for his income on 144. In the Neuronal 2010, patient and/of incomes disautional processor.
Desili Adar	In posinial, The merels is United, Turing and Sarkar excessibles engine particle is done thermost law ins. Mattice is Felling, Therearie and Register and women accord Mean-statem, the empirical in New Garge based for the ended in the primes
learne Sliver Research Excerning Mannaging direct gr	uphenest Auction scalarity of process in the huge names at the probability of the scalarity of process in the huge Sarahy. The Laurest attracts official statistical SE(F) of SG(F) is Salapine, 11(F), is Sarahata, 1(4) in Laurest, SCA in Tubers, The scalar in the scalarity attracts attracts attracts
eller solidating adhers:	are to be good, goes to property time had vestal compared by the spit
Des Seet Demis Kopf annensissentes p	+gaintais (10 lation is 24 d32", An 10 lation trained a significant properties of the spaces property distribution is degree (in the Carlow data), and the start (if this), An emispifician it another start and an another proceedings that in the origination decrement is the spaces anticuse additis takenings by rest 723 related train 30% is 2028.
	6. T/S is 527-100 with T/S Weak Recommend (s), 20% prop. Registric Responses to constant in -(1) (20% is it in channels of New Youngs, Recogning it is 20%-online) promise and thermology (inclusion) explanates the inginese to table (productions in TVG, and T20; proj. explanation), Two Selengt of versioning Kudwates is in 
	Lappie and Janes in two rates Represente we environce optimes to stream to likelihood and provided framedia, takes to interest testings of the list to take provide environd strength in the list testing of the list testing of the list environd strength is consister with testing of the list testing of the environd strength is consister with testing of the list testing of the environd strength is consistered with the list testing of the environd strength is consistered with the list testing of the programme strength is fully allowed 2016. It is bring of the list testing of the list testing of the list testing of the list testing of the list testing of the list testing of the list testing of the list testing of the list testing of the list is followed to its testing of the list testing of the list test of the list testing of the list testing of the list testing of the list testing of the list of the list testing of the list testing of the list test of the list testing of the list testing of the list testing of the list testing of the list test of the list testing of the
	No. 0 101
Machine Andreas, presented	Pol. Skan A, Hardonetts Chaf Freeworks and Greater of Security

ECONOMY & MARKETS GLOBAL ECONOMIC & MARKET OUTLOOK **Greek Hotel Employees'** Education Level and Company Main Views and Market Strategy Performance Duisse of Research and Forecasting Director Class Austroperia Front of a hard landing of the LD eccessry have guarantly dissigned them market initialized, making stem for the scenario of a "toppy considered as the market," localize forecast. Costas E. Vorlow Research Economist According to Eurobank EPG's summer 2006 hotel survey, 40% of the workers in the hotel industry hold a higher education (HE) degree. We drapper with the view that markets gradually o new ordering much entropy instant we observe the stand many of strated for here over an factory with the first finites of her and other and reasony years need occase . Western in A and C star held with account for held the sector's labor force and of those, more than 50% are HE graduates. Desits Mallampsi Research Advice father that current spending and production data suggest disaty-ring pail initiate of GDP data, we find fluid belts for GDP aveil and proof tota face faces syntheticitize revised discovered by the 2008. New hotels (post 2000) employ more HE degree holders than older establishments. Olga Ramma Economic Analysi Lite faire been systematically recease an exercise since 2000. The SA BE adrength of the SZ economy to in our view benavory, to been all prices and the fold weather: Hotels that employ more HE degree holders exhibit higher tamovers and lower operational costs (as a percentage of tamover). for fail unics marinet having pagents that on it is an it stimule of the sales point into the search had been Econometric estimations suggest that workdocs education is a statistically significant factor in explaining variations in terrover and operational profits, and has a positive contribution. to converse that has most of the owner and dealine has 75 Apr in 197 In mean har to make in the pair and another by 250m mm. Each analy grawth search semillarit to the US standards an domestic demand and engineering semillaries are improving ISDI to take stars to 2.75% in March and to 62% in June Outwin for Japanese experience metales, pectrue, despite self \$2 peak For other all lists are but in both out out of search@eurobank.gr Division of Research & Personalities

New Europe:

Οικονομία & Αγορές:

**Global Economic & Market Outlook:** 

**Gikas Hardouvelis** 

A quarterly analysis of the countries of New Europe

Μηνιαία έκδοση με θέματα για την ελληνική και παγκόσμια οικονομία

A quarterly in-depth analysis of major market and economic trends across the globe with our detailed forecasts