

Nouriel Roubini's Global EconoMonitor



Video Interview and Article in the Financial Times: Economic Outlook and Exit Strategies for Monetary Policy

Nouriel Roubini | Apr 6, 2009

John Thornhill of the Financial Times had a video interview with me and Jim O'Neill, head of global macro at Goldman Sachs, while we both attended a conference in Italy this past weekend.

The video of this interview is available at this link at the Financial Times.

In a separate article John Thornhill elaborates on some of the views that I presented to some extent in the interview on the exit strategies for the Fed and other central banks when the crisis is over – some time 2011 and after - and there is a need to mop up liquidity to avoid a rise in inflation and/or another asset and credit bubble. Here is that FT article:

Long-term recession exit strategies carry high risk

By John Thornhill

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The good news is that even some of the world's most enthusiastic economic pessimists, such as Nouriel Roubini of New York University, are beginning to discuss "exit strategies" from the worst global recession in generations. The bad news is that many of these exit strategies appear as toxic as a bunch of subprime mortgage assets.

At the Ambrosetti finance forum over the weekend, where leading economists, policymakers and business leaders debated the state of the world, a surprising consensus emerged that the global economy would recover from recession next year, if not before. In spite of the calamitous collapse in global output and world trade, the huge monetary jolts and fiscal stimuli administered by the authorities in the US and elsewhere would surely revive economic life.

The agreement reached last week at the G20 meeting of global leaders in London had also boosted investor confidence, while the additional funding provided to the International Monetary Fund would support vulnerable emerging market economies.

But the question that then arose was: to what extent would today's unprecedented economic interventionism undermine tomorrow's recovery?

To be sure, this debate is somewhat premature. The world first has to fight its way through the current economic turmoil. While many participants at the forum welcomed the outcome of the G20 meeting, some argued that global leaders had ducked two main challenges: the lopsidedness of global trade and capital flows and the toxic assets that poison many banks' balance sheets.

Many policymakers still seem to believe the global economy will revert to its previous pattern. One glorious morning US consumers will begin borrowing and spending again while the Chinese will continue to manufacture and save. But with US households having lost an estimated \$12,000bn of wealth, the world is desperately in need of a new consumer. "The only region that is mathematically capable of replacing US consumer demand [Europe] is the least likely to do so," grumbled one participant.

Fiscal stimuli – even on a huge scale – would also be limited in effectiveness until toxic assets had been thoroughly cleansed from the banking system.

Even so, many economists predict a rebound in the global economy as a result of the impact of cheap money and large-scale government spending.

Jim O'Neill, head of global economic research at Goldman Sachs, emphasised the glimmers of hope, especially in China and even in the UK, as financial conditions normalised. "It is unlikely that the world will continue decelerating at the rate at which it has been doing since October," he said in a Financial Times video debate with Mr Roubini.

But even when the global economy does revive, policymakers will face some daunting dilemmas. Pressure will increase to lift interest rates quickly to prevent the emergence of more damaging asset price bubbles. That, though, would sap the strength of any incipient recovery and raise borrowing costs for many governments, which are struggling to restrain runaway public finances.

"The exit issue is a serious issue: how you mop up this liquidity, how you sell back to the market all these illiquid and toxic assets you bought, how you make sure these fiscal deficits are shrinking so you don't have to monetise them so you don't cause longer-term inflationary pressures," Mr Roubini said. "This question is not for today or next year, but by 2011 we will have to start thinking about those questions."

The four options to redress public finances – default, inflation, increased taxes, or decreased spending – are also economically unpalatable and, in political terms, potentially lethal.

For the moment, labour militancy has been relatively restrained as many employees fear losing their jobs. But as economic prospects brighten so will employees' demands for higher pay and greater protection.

The danger is that things will grow worse politically just as they improve economically.

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