Still more losses to come, says Volcker

Ex-Fed chief says slew of rescue measures distasteful but necessary

[SINGAPORE] Back in 2005, when the US and global economies were fairly booming, former US Federal Reserve chairman Paul Volcker warned of “disturbing trends: huge imbalances, disequilibria, risks” under the placid surface.

“Altogether, the circumstances seem to me as dangerous and intractable as any I can remember, and I can remember quite a lot,” he had said at a conference at Stanford University, and warned of an impending financial crisis.

“What really concerns me is that there seems to be so little willingness or capacity to do much about it,” he added.

There is now the capacity – and, given the state of affairs today – greater willingness, if not anxiety, to deal with what has indeed become a full-blown crisis.

Said the 81-year old right off the bat at a talk at the Centre for Economic Policies and Finance: “I have been around for a while. I have seen a lot of crises but I have never seen anything quite like this one.”

While previous financial crises might have passed without inflicting too much harm beyond the financial sector, “this crisis is an exception”, he said. “I don’t think we can escape damage to the real economy.”

The United States and European economies face serious recession, he told his audience who packed the University Cultural Centre Hall at the National University of Singapore.

US home prices are still falling, with “still more losses” to come. A quick strong recovery would be “beyond reasonable expectation”, he added.

Now chairman of the trustees of the Group of Thirty, a global body of central bankers, leading economists and finance specialists, Mr Volcker was speaking at a talk organised by the Lee Kuan Yew School of Public Policy.

The top priority in tackling the credit crisis is to stabilise the financial system – which he described as likely to remain in “intensive care” for some time – even if it means heavy government intrusion, he said.

And ongoing measures by US and European governments to pump billions of dollars to shore up beleaguered banks will boost investor confidence and help mitigate the effects of the economic downturn.

“These kinds of measures – government guarantees and interventions – are distasteful,” said Mr Volcker. “However distasteful, I’m afraid they’re necessary in this emergency to restore some sense of stability and confidence.”

Asked during question time if the huge infusion of liquidity could lead to inflation or stagnation, he said: “It’s not going to be a problem in the short run. Inflation doesn’t flourish in the face of recession. It’s something we have to worry about when we get out of this recession.”

He added: “Inflation will be a problem in the medium to the longer term, and we need to prepare for it.”

Known as Inflation Slayer for defeating double-digit inflation in the US during his Fed tenure from 1979 to 1987, Mr Volcker took a dig at himself, saying: “I just made a speech without mentioning the word inflation! That would be one of the first times in my life!”

As to why the Wall Street brainiacs failed to see the crisis coming, especially after his clear warning in 2005, he said: “They were so busy making money!”

The audience obviously regarded him as a Mr Know-All wise man, not just on the global economy and finance but a little beyond, it seems. They queued to ask him all manner of questions, from “should governments identify housing bubbles”, the whys and wherefores of China’s privatisation policy, to the impact of the financial crisis on social cohesion, and how should Singapore deal with recession. As well too, his assessment of successor Alan Greenspan’s job performance, and the Fed’s role in the making of the crisis. Most of which he deftly skirted.

When pressed to elaborate on what he meant by serious recession in US and Europe, how deep and how long, he replied: “I believe we are entering a recession of unknown duration.”