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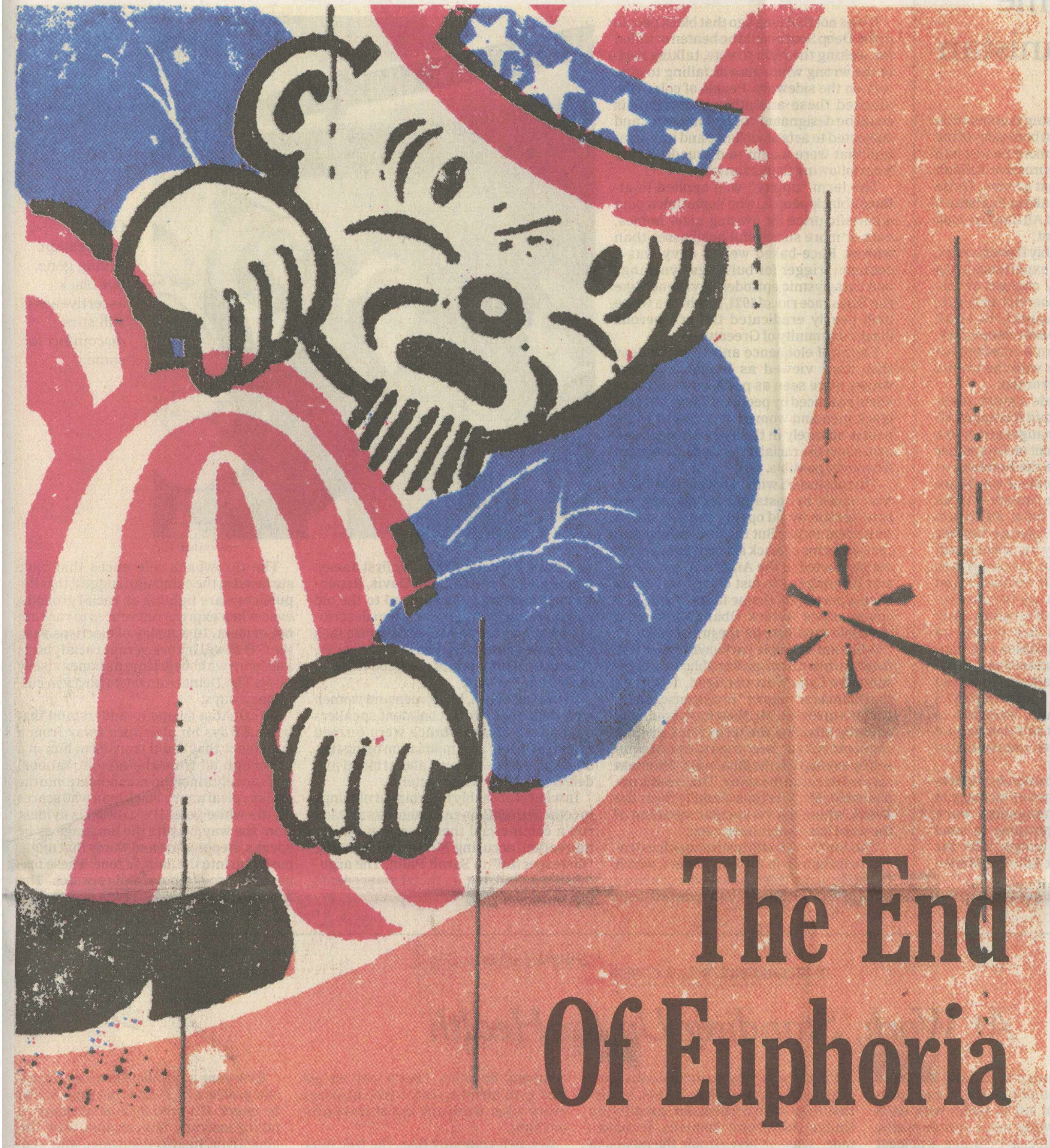
Une sélection hebdomadaire offerte par Le Monde



The End Of Euphoria

GARY TAXALI

Bill Comes Due For Excesses Of Past 15 Years

DAVID LEONHARDT

ECONOMIC ANALYSIS

ONCE AGAIN, WE are seeing the puncturing of a speculative bubble that was a result of asset prices soaring high above the underlying value of the assets. For as long as markets have existed, bubbles have formed. And whenever one of those bubbles begins to leak, it typically needs years to deflate, causing enormous economic damage as it does.

Only now, for instance, are the bubbles of the past decade and a half, first in the stock market and then in real estate, starting to go away.

But the last few weeks, by any standard, have been extraordinary for America's economy and its financial system. Merrill Lynch, which was founded during Woodrow Wilson's administration, agreed to be bought for a bargain-basement price, while Lehman Brothers, which dates back to John Tyler's presidency (1841-45), simply collapsed.

The federal government was debating a plan to buy hundreds of billions of dollars in securities that no bank wanted. It appears to be the government's biggest fiscal intervention since the Great Depression, designed to get the financial markets working again and keep a credit freeze from sending the economy into a deep recession.

Even if the economy avoids a deep recession, the next couple of years aren't likely to feel especially good. It's been a long period of excess, and the hangover could be long, as well. For the near future, the most likely outcome remains slow economic growth, scant income gains for most workers and, for investors, disappointing returns from stocks and real estate. If consumers begin to cut back on their debt-fueled spending

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WORLD TRENDS

End of Euphoria: Bill Comes Due for Excesses of the Past 15 Years

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things could get worse.

The economists at Lehman Brothers sent out their weekly roundup of the news, but it came this time with a short, italicized note, explaining that the report would be the final one to appear under the Lehman banner. That bit of understatement preceded some more: "This episode of financial crisis," Lehman's economists explained, "appears to be much deeper and more serious than we and most observers thought it likely to be. And it is by no means clear that it is over."

It's easy to think of the turmoil of the past 13 months as being unconnected to the stock bubble of the 1990s, which appeared to end with the dot-com crash of 2000 and 2001. That crash brought down the overall stock market by more than a third, its worst drop since the 1970s oil crisis. Corporate spending on new equipment then plunged and employment fell for three straight years.

But dramatic though it was, the dot-com crash did not come close to erasing the excesses of the 1990s. Indeed, by some of the most meaningful measures, Wall Street after the crash looked a lot more like it was in a bubble than a bust.

As late as 2004, financial services firms earned 28.3 percent of corporate America's total profits, according to Moody's Economy.com. That was somewhat lower than it had been over the previous few years, but still almost double the financial sector's average share of profits throughout the 1970s and '80s. By 2007, the share had fallen only marginally, to 27.4 percent.

Meanwhile, the share of wages and salaries earned by employees of financial services firms continued to climb and hit a peak last year. Of every dollar paid to the American work force in 2008, almost 10 cents went to people working at investment banks and other finance companies, up from about 6 cents or 7 cents throughout the 1970s and '80s.

How did this happen? For one thing, the population of the United States (and most of the industrialized world) was aging and had built up savings. This created greater need for financial services. In addition, the economic rise of Asia — and, in recent years, the increase in oil prices — gave overseas governments more money to invest. Many turned to Wall Street.

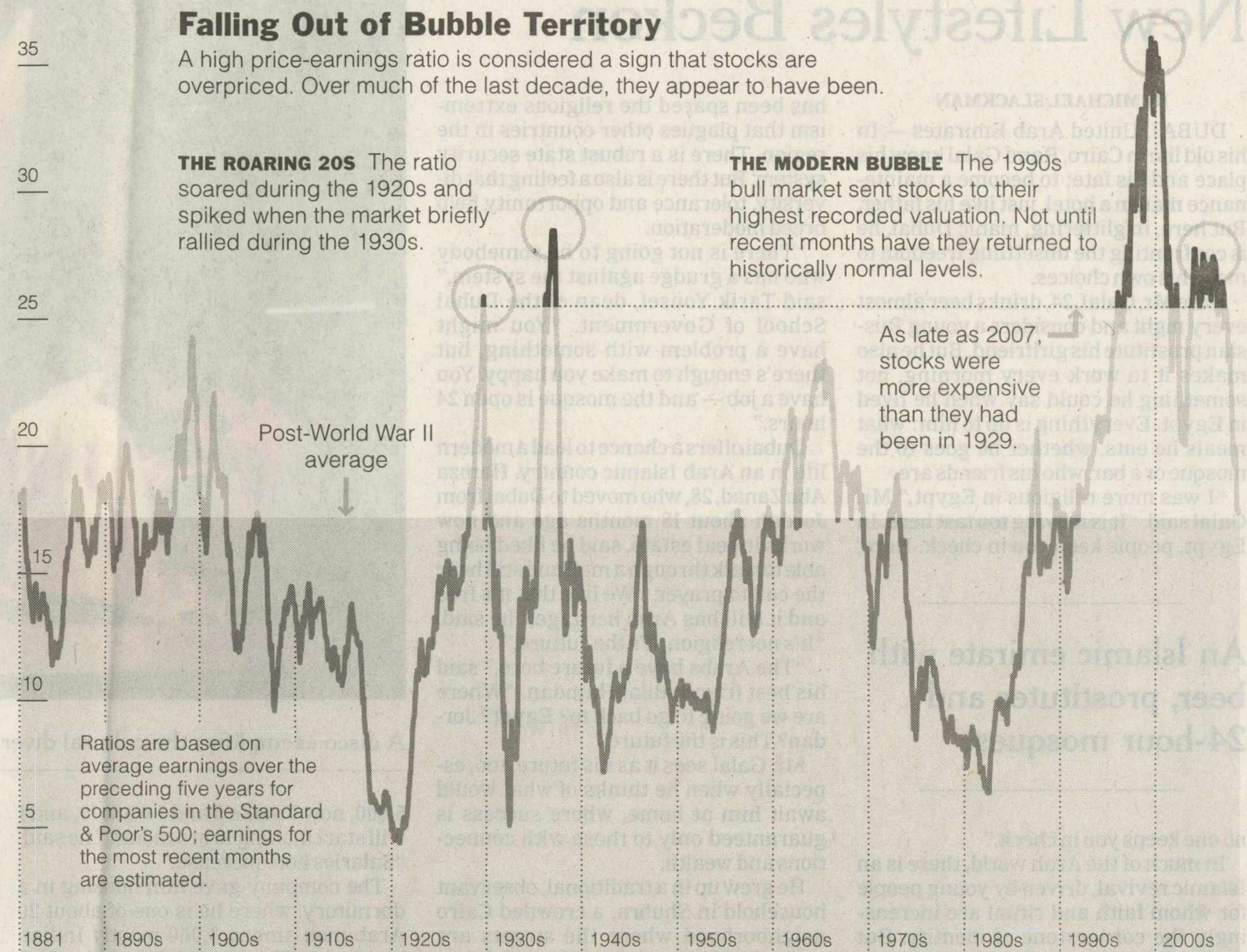
Nonetheless, a significant portion of the finance boom also seems to have been unrelated to economic performance and thus unsustainable. Benjamin M. Friedman, author of "The Moral Consequences of Economic Growth," recalled that when he worked at Morgan Stanley in the early 1970s, the firm's annual reports were filled with photographs of factories and other tangible businesses. More recently, Wall Street's annual reports tend to highlight not the businesses that firms were advising so much as finance for the sake of finance, showing upward-sloping graphs and photographs of traders.

"I have the sense that in many of these firms," Mr. Friedman said, "the activity has become further and further divorced from actual economic activity."

Which might serve as a summary of how the current crisis came to pass. Wall Street traders began to believe that the values they had assigned to all sorts of assets were rational because, well, they had assigned them.

Traders sliced mortgages into so many little pieces that they forgot what they were really trading: contracts based on increasingly shaky loans. As the crisis has spread, other loans have started going bad as well. Hyun Song Shin, an economist at Princeton University in New Jersey, estimates that banks have thus far absorbed only about one-third to one-half of the losses they will eventually be forced to take.

One of the few pieces of good news is that Wall Street finally seems to be grappling with the depth of its problems. You can see that most clearly, perhaps, in stock prices, which have at long last fallen from the stratospheric levels of



Sources: Robert J. Shiller; The New York Times THE NEW YORK TIMES

the past decade as measured by price-earnings ratio — the classic measure of whether the stock market is overvalued, obtained by dividing stock prices by annual corporate earnings.

This doesn't necessarily mean stock prices are done falling.

For one thing, corporate profits could decline, particularly if households begin pulling back on spending. The unusually rapid rise of consumer spending over the past two decades is arguably the third bubble confronting the economy. It has happened thanks in part to a huge increase in debt, which may now be coming to an end, just as Wall Street's love affair with debt appears to be ending as well.

And even if the economy does better than expected, investors may still turn pessimistic. "We tend to go through pendulum swings," said Joel Seligman, the president of the University of Rochester, a longtime Wall Street observer.

There are long periods of overexuberance, in which investors worry that they are missing the next great thing, followed by crises that make those same investors fear that the world as they know it is coming to an end.