World at Risk of 'Double Dip Recession'

By Stephen Long
Theme: Global Economy
Global Research, August 07, 2009
ABC News (Australia) 7 August 2009

A senior OECD official says the global financial crisis is far from over and the world faces a serious risk of another credit crunch and a double dip recession.

Adrian Blundell-Wignall is the deputy director of financial and enterprise affairs at the Organisation for Economic Cooperation and Development (OECD).

In an interview with ABC Radio's PM two years ago, Dr Blundell-Wignall warned there was a giant rolling bubble of excess liquidity moving from market to market, inflating asset prices.

He warned unless the problems causing it were addressed, it would eventually burst with devastating consequences. And it did.

Dr Blundell-Wignall – who stresses these are his personal views and do not necessarily reflect those of the OECD member states – says the lessons of history are clear.

First, guarantee bank deposits and funding. Second, remove the toxic assets from the banks. Three, recapitalise the banks. But he says the world has ignored step two.

"Did we remove the toxic assets from the balance sheet of the banking system, anywhere? No, nowhere," he said.

Instead, he says, governments and regulators have conspired in the use of a magicians' sleight of hand to hide the toxic mess.

Changing the rules

He says for example, the United States changed the accounting rules so banks no longer had to state the current market value of the toxic assets and no longer had to declare losses.

"If you can change the accounting rules and say, 'hang on, we don't have to declare any losses on this $700 billion, $800 billion, we can now declare that they're all book value'," Dr Blundell-Wignall said.

"So, it's really there and all those losses are going to be there but we don't have to declare it, and we won't have to raise any capital for it; it'll kind of be there just hidden behind the silk screen."

Dr Blundell-Wignall says the toll of bad loans is going to get worse, because claims of a US housing recovery are a false dawn.

"Every time the unemployment rate goes up when someone losses their job, they can't pay; obviously you can't; that's one of the biggest determinates of people having to default on their loans, and house prices being the other one," he said.

"It seems to me like there's still downward pressure there and we know the unemployment rate's going to lag the US by 12 to 18 months, so we know it's going to keep going up.

"So, bad loans are going to continue to happen; that's the credit crunch aspect."

Bailouts 'unsustainable'

He says Europe's banks are worse, with double the leverage of America's.

Dr Blundell-Wignall also says the efforts to rescue the world through massive fiscal stimulus and bank bailouts are unsustainable.

"When you add up the capital injections, the loans, the guarantees, the Federal Reserve actions and guarantees and so on, what you see there is the US has taken from the private balance sheet and put onto the public balance sheet, not 11 per cent of GDP, 80 per cent of GDP is what that all adds up to," he said.

Dr Blundell-Wignall says to top it off, there is a huge asset price bubble building in China and some other parts of Asia in the stock market and in property prices.

"So another one of the balls that has to be kept in the air is can China allow the bubble to keep bubbling? What we're talking about here is a race," he said.

"We've got to keep all those balls juggling in the air while the banks get rid of their underlying bad debt problems, whether they admit to them or not with the change in accounting rules."

He says there is a clear risk of a double dip recession and another credit crunch, but it is possible the world will muddle through, though not to healthy growth.

"If you can do all those things and the juggler on the stage does not drop one of the those balls, then you can see how you would muddle through," he said.