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The Crisis Is Morphing Again

By Mohamed El-Erian
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Dr. Laura D'Andrea Tyson's comments at the Nomura Equity Forum in Singapore were attracting considerable market attention on Wednesday, and rightly so. They come at a time when policy indications – actual, expected and perceived – have already become important drivers of relative and absolute valuations in a number of markets.

Tyson echoed Vice President Biden's weekend remark, observing that the U.S. economic situation has turned out worse than what was forecast just six months ago. Interestingly, she also went further and suggested that, with hindsight, the government's fiscal stimulus package was too small and a new one should be considered.

Tyson's comments are sure to fuel a debate that will place policymakers in an even more challenging situation, and this becomes even more intriguing if you agree with the view I expressed in an FT comment piece last Friday that "consensus" currently underestimates how high the U.S. unemployment rate will go AND how long it will persist at unusually high levels.

The Tyson remarks are a vivid illustration of the extent to which the emphasis of the policy debate is shifting from the normalization of the financial markets to countering a worse-than-expected deterioration in jobs and wages. Indeed, while 2008 was about the serial unthinkables in the financial markets, this year is all about the lagged economic, political and institutional effects.

All this should make us feel even greater sympathy for policymakers. The nature, severity and continuous morphing of the global crisis have already put them on the defensive. Inevitably, "first best" policy solutions are elusive, and even in the world of second and third best, what is economically desirable is increasingly becoming politically infeasible, and what is politically feasible may well turn out to be economically undesirable.

As an example, consider the complex tug of war that faces policymakers keen to counter the poor and deteriorating employment picture. The attractiveness of another stimulus package is tempered by the realization that the country's fiscal and debt dynamics have weakened considerably, and the possibility of maintaining loose monetary policy for a very long time (as a way to stimulate aggregate demand while, simultaneously, starting to restore fiscal sustainability) could eventually contaminate both inflationary expectations as well as the global status and value of the U.S. dollar.

The bottom line is a simple yet powerful one. The global crisis is morphing again. Having already contaminated (in a sequential and cumulative manner) housing, finance and the consumer, it is now threatening the potency and credibility of the economic policymaking apparatus. As far as I can see, there are no first best policy responses that are readily available and easy to implement. Instead, the economy will continue to struggle, navigating both the adverse implications of last year's financial crisis and the unintended consequences of the experimental policy responses. Given the inevitable socio-political dimensions, this story will play out well beyond the realm of the economy, policymaking and markets.

Mohamed A. El-Erian is chief executive and co-chief investment officer of PIMCO. His book "When Markets Collide: Investment Strategies for the Age of Global Economic Change" won the 2008 FT/Goldman Sachs Business Book of the Year.