

Comments on “The Integrated Financial Real System . . .” by Palumbo and Parker

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An Admirable and Topical Paper

- This is not just about measurement, it's about what's going on in the real economy
- In my dual role as a practitioner of measurement and of macroeconomics, I appreciate these multiple dimensions
- I'll mainly summarize the paper. Since I agree with everything in it, my contribution will be to show you several additional graphs that makes some of their points better than does the paper at present

Summary

- The paper has three parts
 - An introduction to the SNA and a convincing message about the need for integration of the national accounts and the financial accounts
 - A review of macro facts leading up to the current economic crisis/recession/depression
 - A lament that there are few if any hints in the SNA about the origins and evolution of the crisis.
 - If I were to toss out the controversial opinion that “the current recession is the first to be caused not by tight money but by easy money,” there is nothing in the SNA to support or refute that opinion.
- In this sense the authors set their standards too high – this financial and economic disaster is *sui generis*. No set of accounts could have prepared us for it nor will it ever happen again in the same form.

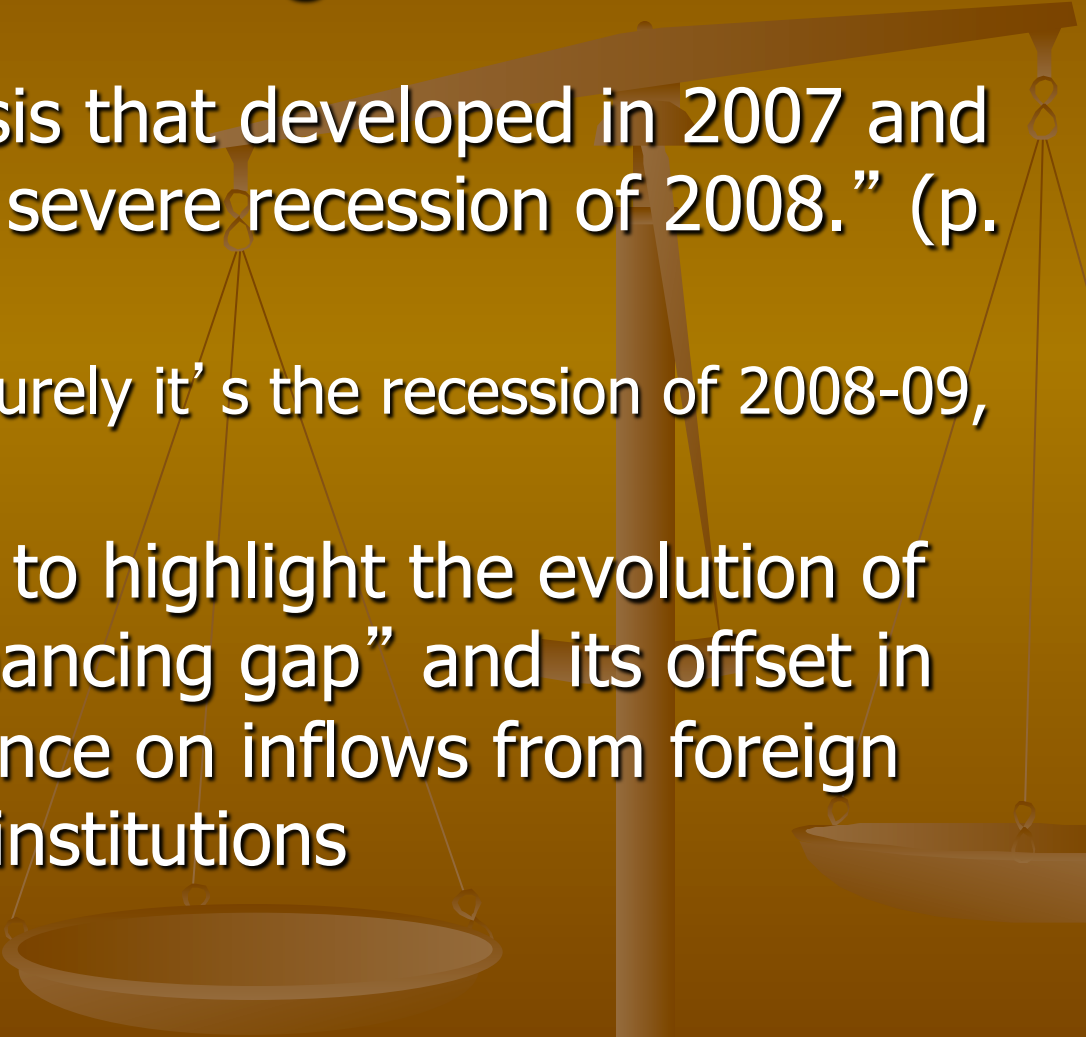
My Overall Reactions

- I'm the new kid on the block about the SNA, this is a wonderful improvement
 - I've looked at every SNA table on the BEA web site and it is an eye-opening discovery for anyone who loves double-entry bookkeeping, with revaluations brought out of the closet into explicit statements
 - My confusion about access. If you google "SNA at BEA" you get tables 101, 102 etc. only available for 2000-06. If you use the URL in footnote 5, you get tables S1, S2 etc. with much more detail and available for 1960-2007. Please explain why there are two different sets of hard-to-find tables
 - Why stop with the integration of the Flow of Funds with the BEA? What about the BLS?

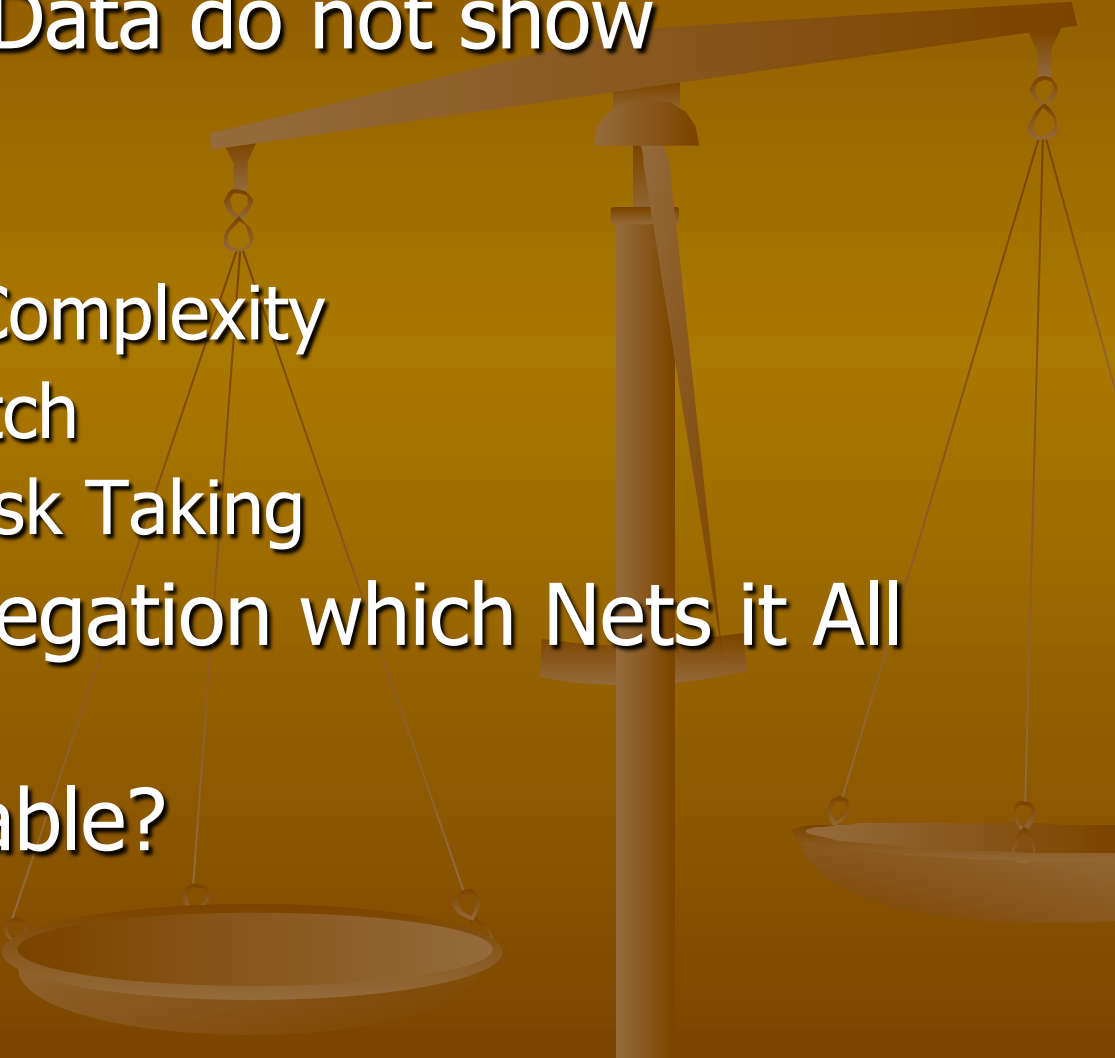
Integrate not just NIPA and FF but also BEA and BLS

- P&P lament the current lack of integration of the national accounts, the international accounts, and the flow of funds
 - Different timing, different web sites, different syntax
- As important for me is the lack of integration of the BEA and BLS web sites
 - The BEA web site is incredibly easy to use to download long time series into Excel, making further calculations easy to create (example)
 - The BLS web site is a total pain. I would support an invasion by the BEA's IT staff, advancing eastward in force and with adequate supplies, from 1441 L Street to 2 Mass Ave, ready to occupy the BLS HQ until the current mess of the BLS web site is cleaned up and converted to BEA's high standards.

Topic # 1: Developments in the Economy as Viewed through the SNA

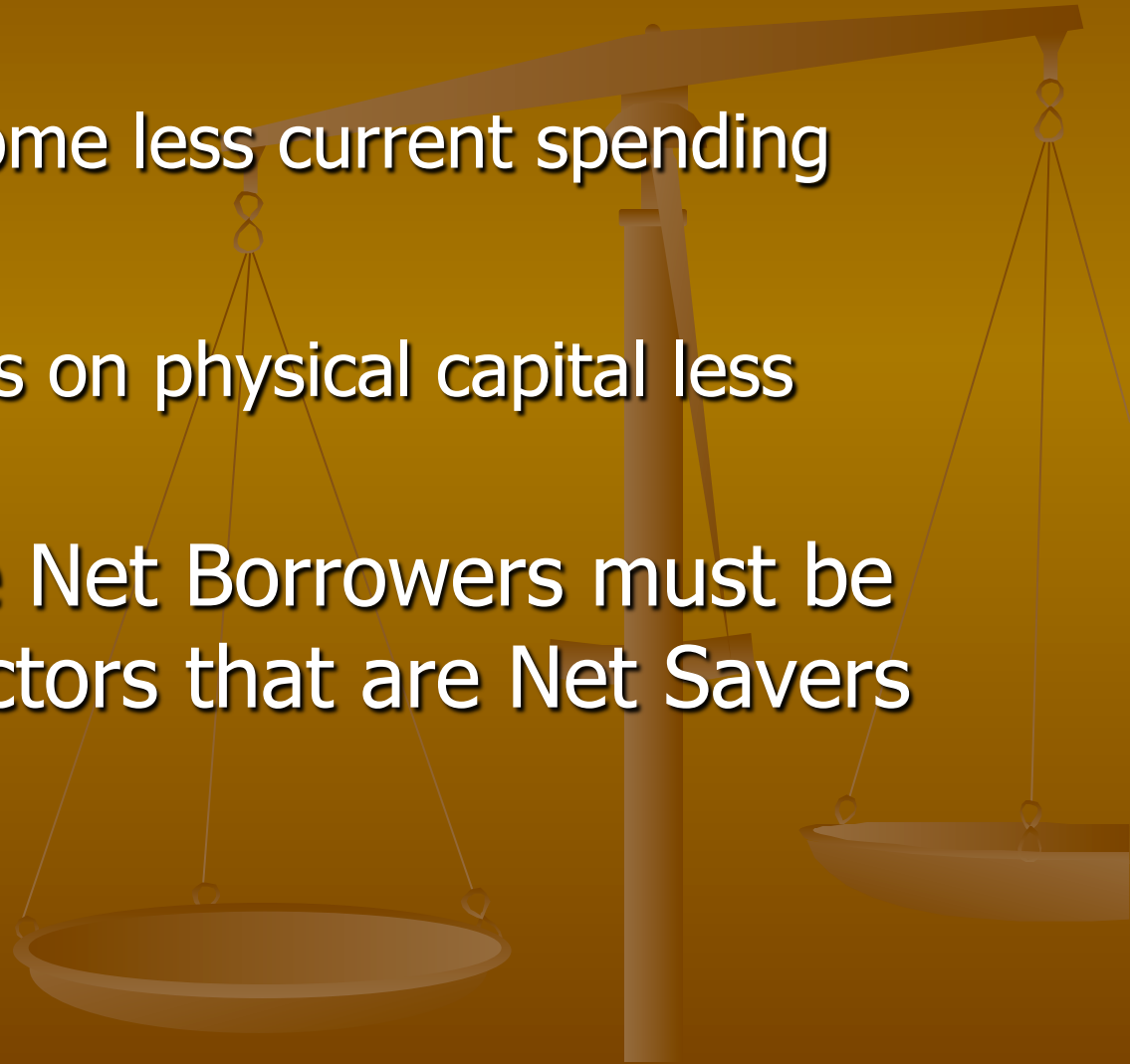
- “. . . Financial crisis that developed in 2007 and contributed to the severe recession of 2008.” (p. 3)
 - What optimists! Surely it’s the recession of 2008-09, not just 2008
 - Their first result is to highlight the evolution of the household “financing gap” and its offset in the increased reliance on inflows from foreign governments and institutions
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Topic #2: SNA Masks Trends that Led to Crisis

- Aggregate SNA Data do not show increases in:
 - Leverage
 - Balance Sheet Complexity
 - Maturity Mismatch
 - Counterparty Risk Taking
 - Masked by Aggregation which Nets it All Out
 - Isn't this inevitable?
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They Begin by Showing HH Net Saving and Investment Separately

- Net Saving
 - Disposable Income less current spending
- Net Investment
 - Gross Purchases on physical capital less depreciation
- Sectors that are Net Borrowers must be Balanced by Sectors that are Net Savers

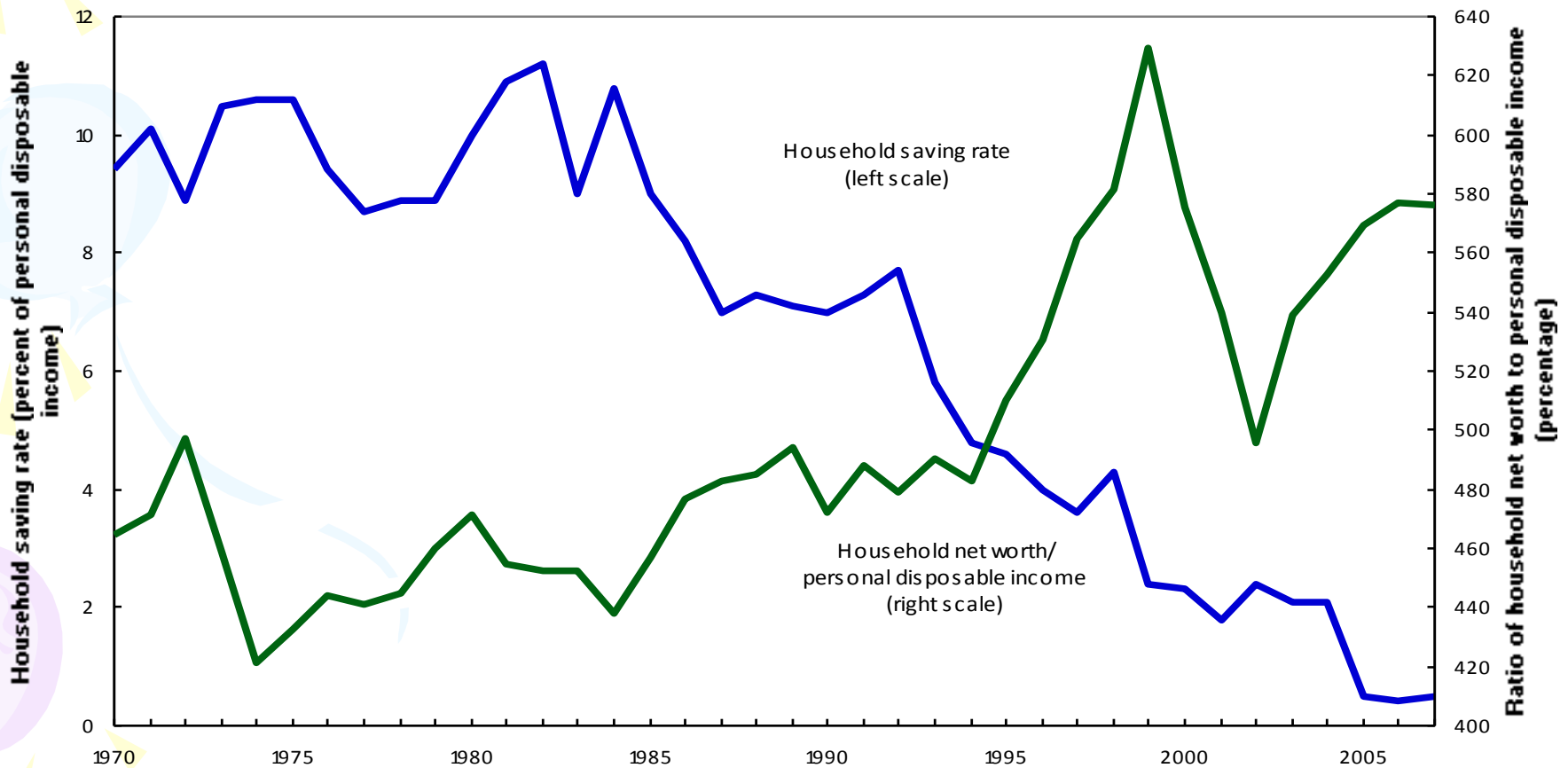


Relation to Revaluations and Debt

- HH Net Saving has declined while net investment has remained roughly stable
 - Investment peaks in 2004-06
 - Decline in net saving driven by increase in debt esp. 2003-06
 - Mortgage debt grew from 31% (1960) to 70% (2000) to 109% (2006)
- Through 2006, huge revaluations equal to 50% of disposable income in peak years
- Revaluations can be viewed as a *cause* of increased household debt
- This does not come out explicitly enough in their diagrams, so let's turn to Gordon's *Macroeconomics*, 11th edition (Addison Wesley, 2009).
 - Order your free copy from Addison-Wesley booth in exhibit hall

What is Missing: *Level of HH Net Worth* (note scale)

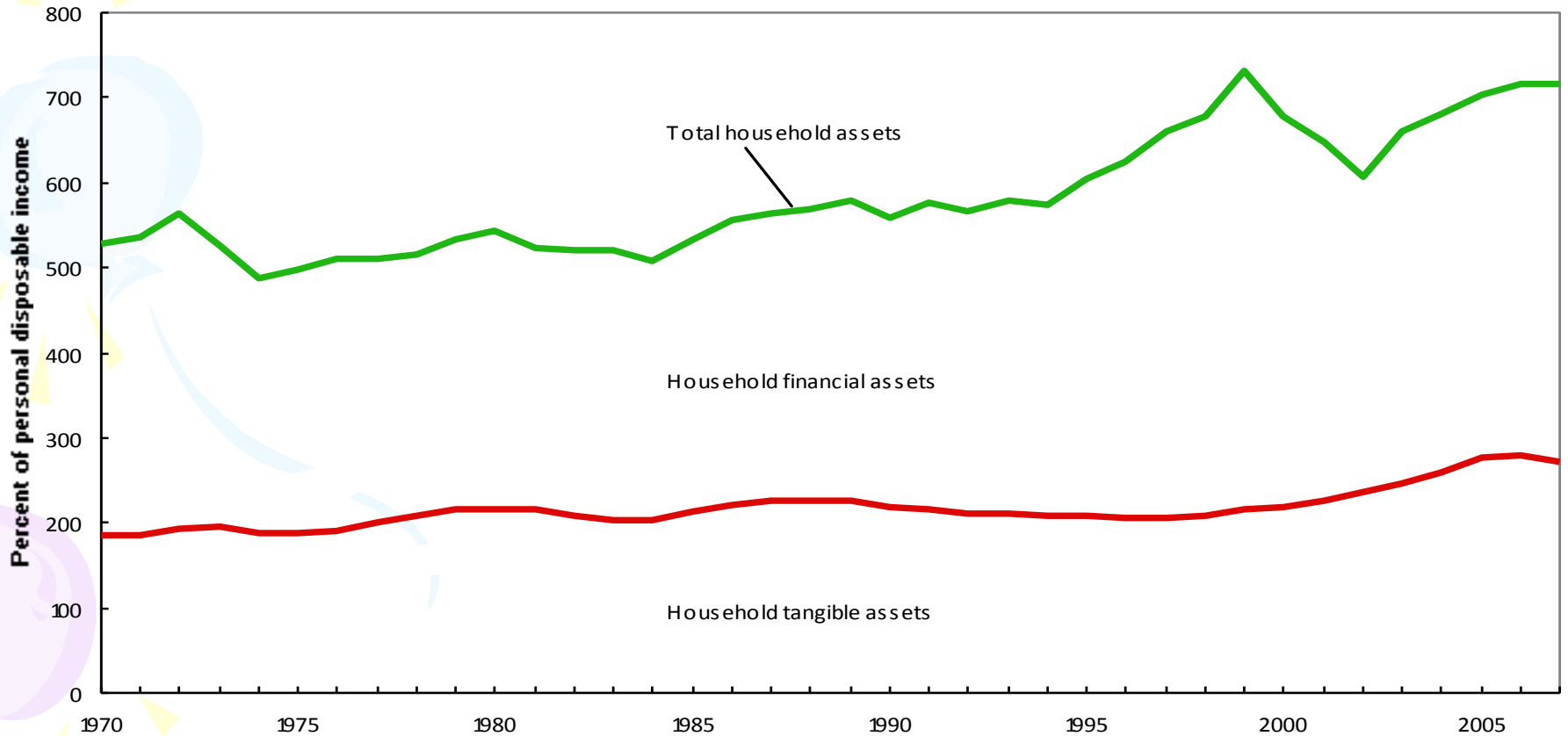
Is the Household Saving Rate a Mirror Image of Household Wealth?



Sources : Federal Reserve Board *Flow of Funds Accounts* and Bureau of Economic Analysis *NIPA Tables* . Details in Appendix C-4.

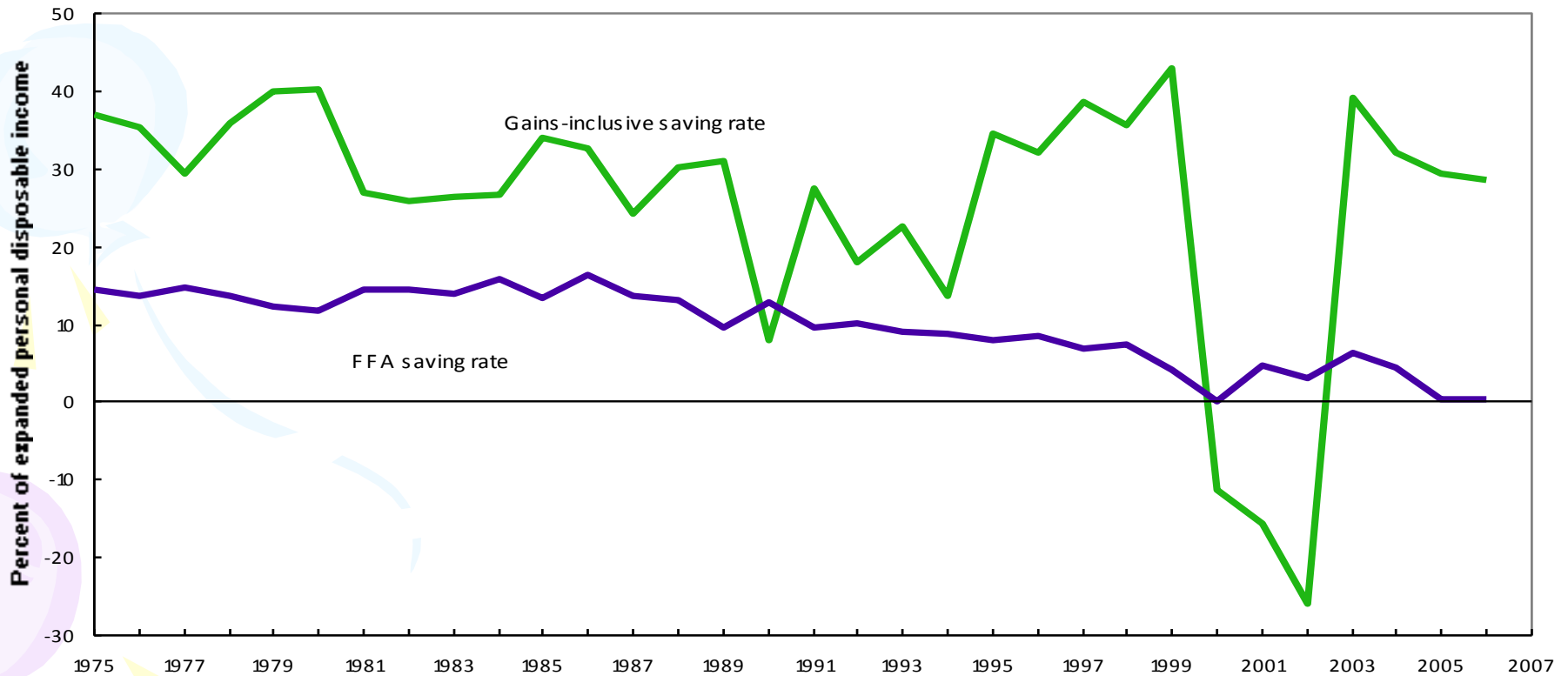
Household Net Worth: Tangible and Financial Assets

Financial Wealth Sank After 2000 but Housing Wealth Soared



Implication for Revaluation-Adjusted Household Saving

The Gains-Inclusive Saving Rate Soared in the Late 1990s but Collapsed in 2000-02

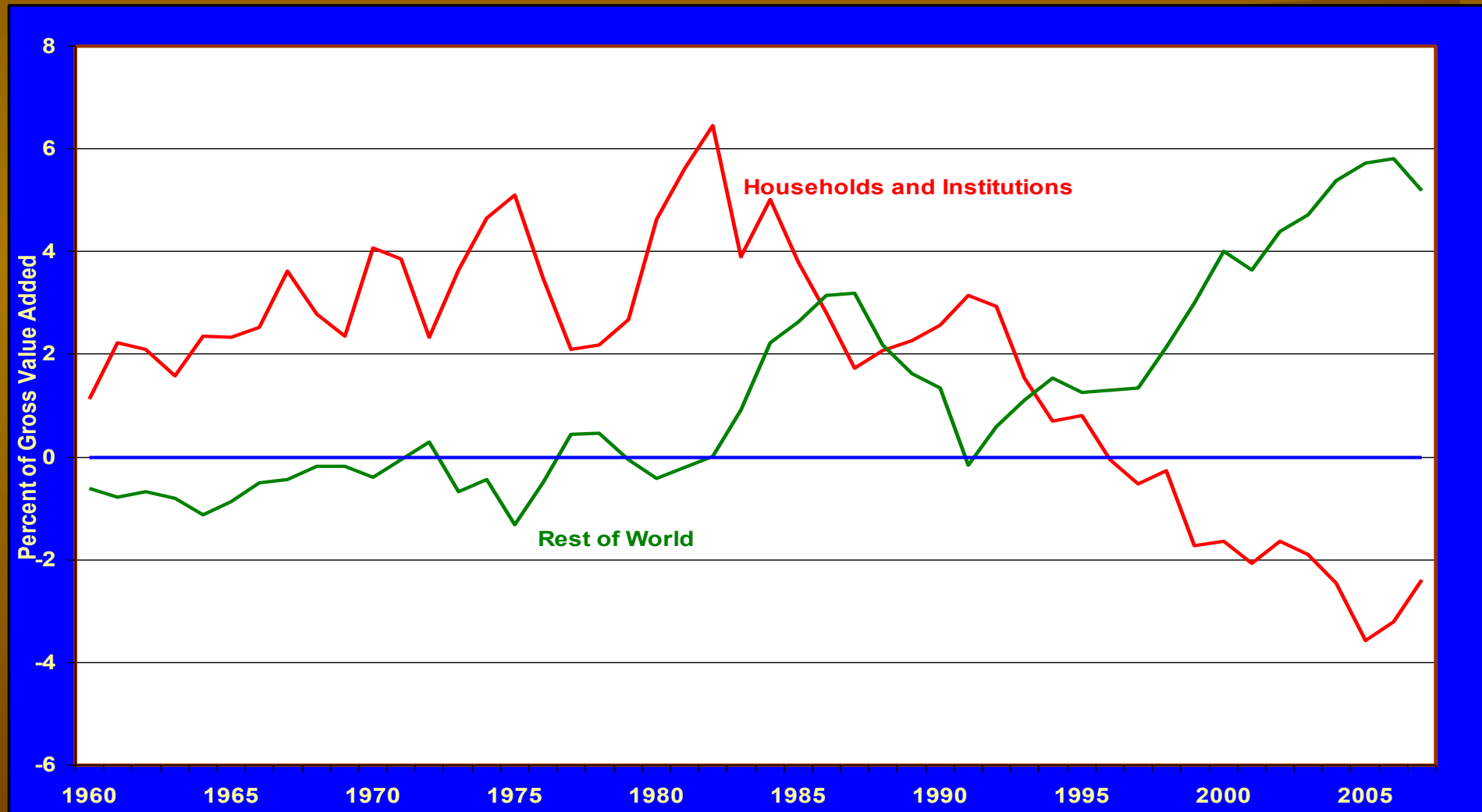


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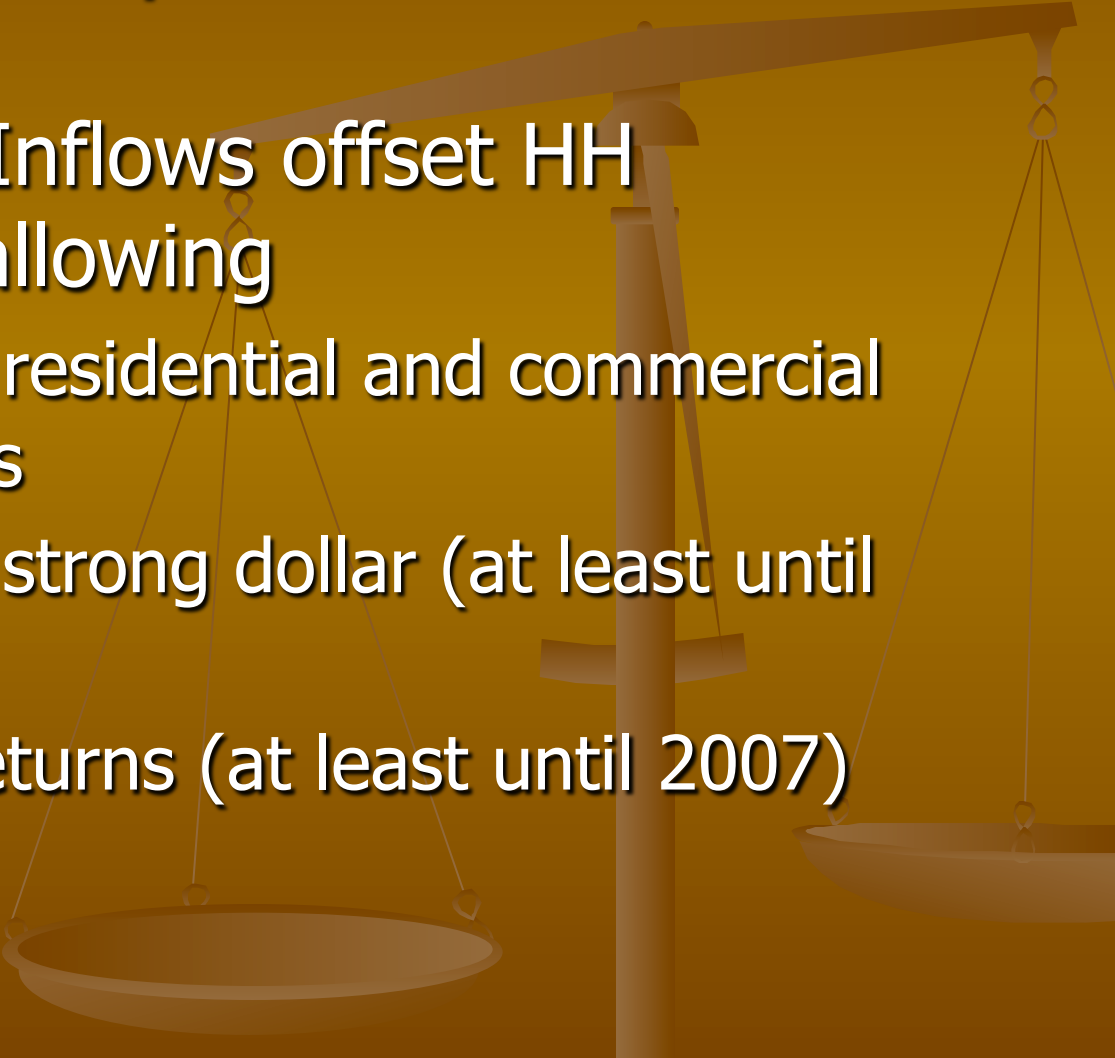
Their Table 1 Shows Financing Offset Coming from Rest of World

- Unlike their charts, Table 1 is not scaled relative to GDP or Household Income
- To See Their Relationship More Clearly, they should have drawn the following graph
- P. S. This shows how easy it is to download from BEA web site and create graphs in San Francisco hotel rooms

Illustrating Their Main Point #1: Net Financing, HH vs. Rest of World



Agree with their Main Conclusion from this Section but timing needs to be qualified

- Foreign Capital Inflows offset HH Financing gap, allowing
 - Maintenance of residential and commercial investment rates
 - Maintenance of strong dollar (at least until 2002)
 - Strong equity returns (at least until 2007)
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What SNA Didn't Reveal

- Financial Sector Crisis
- Their list of components starts with exposure to mortgage credit
- Then they add
 - High leverage
 - Complexity of assets
 - Maturity Mismatch
 - Reliance on Counterparty Risk



Reasons the SNA Didn't Reveal Problems

- SNA doesn't distinguish different types of corporate bonds or commercial paper
- Doesn't show process by which mortgages show up in bonds as they are securitized
- Leverage is difficult to observe because risk is difficult to observe
- No indication in SNA of exotic mortgages, land mine of mortgage resets, low or no down payments, or NINJA loans

Qualification/Question

- Authors say that SNA didn't reveal rise in "short-term funding" and refer to a Figure 3, but they must mean Figure 5.
 - Figure 5 on p. 17 does *not* show a build-up of short-term debt, with 2007 = 2000, and with 2003-04 = average of the 1980s
 - Agree with their final set of recommendations for separating asset holdings of households from those of the financial sector.
 - Overall, they're expecting the SNA to do too much. No set of accounts could have provided advance warning of something so unprecedented and complex
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