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New Bubble Threatens Global Rebound

Although **Belief In Wizards Runs Deep** there are a few free thinkers who don't see it that way. Andy Xie is one of the
Please consider **New Bubble Threatens a V-Shaped Rebound**.

> In a normal economic cycle, an inventory-led recovery would be followed by corporate capital expenditure, leading to employment expansion. Rising employment leads to consumption growth, which expands profitability and more capex. Why won't it work this time? The reason, as I have argued before, is that a big bubble distorted the global economic structure. Re-matching supply and demand will take a long time.
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> The process is called Schumpeterian creative destruction. Keynesian thinking ignores structural imbalance and focuses only on aggregate demand. In normal situations, Keynesian thinking is fine. However, when a recession is caused by the bursting of a big bubble, Keynesian thinking no longer works.
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> The lifespan of a bubble depends on how it affects demand. The longest-lasting are property and technology bubbles. The multiplier effect of a property bubble is multifaceted, stimulating investment and consumption in the short term. The supply chain it impacts is very long. From commodity producers to real estate agents, it could stimulate more than one-fifth of an economy on the supply side. On the demand side, it stimulates credit growth and financial sector earnings, and often boosts consumption through the wealth effect. Because a property bubble is so powerful, the negative effects of a bursting are great. Excess supply created during a bubble's lifespan takes time to consume. And a bust destroys the credit system.
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> A technology bubble occurs when investors exaggerate a new technology's impact on corporate earnings. A breakthrough such as the Internet improves productivity enormously. However, consumers receive most of the benefits. Competition eventually shifts temporarily high corporate profitability toward lower consumer prices. Because the emergence of an important technology brings down consumer prices, central banks often release too much money, which flows into asset markets and creates bubbles. While an underlying technology leads to an economic boom, the bubble feels real. More capital pours into the technology. That leads to overcapacity and destruction of profitability. The bubble bursts when speculators finally realize that corporate earnings won't rise after all.
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> The cost of a technology bubble is essentially equal to the amount of over-investment involved. Because a technological breakthrough expands the economic pie, the costs of a technology bubble are easy to absorb. An economy can recover relatively quickly.
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> Some argue that, if low interest rates revive the property market, American households may be willing to borrow and spend again. This scenario is possible but not likely. The United States has not experienced serious property bubbles in the past because land is privately owned and plentiful. A supply overhang from one bubble takes a long time to digest. And American culture tends to swing to frugality after a bubble. One's outlook either for a normal recovery or a bubble-inspired boom depends on the outlook for the U.S. household savings rate. Unless the U.S. household sector is willing to borrow and spend again, emerging economies will not be able to revive the export-led growth model.

> Instead of a V-shaped recovery, we may instead get a W curve. A dip next year, although perhaps not statistically deep, could deliver a profound psychological shock. Financial markets are buoyant now because they believe in the government. The second dip would demonstrate the limits of government power. The second dip could send asset prices down -- and keep them down for a long time.

Andie Xie's conclusion (in red) is correct. He got there by focusing on the debt bubble, which is also correct.

However, Xie's statements "*In normal situations, Keynesian thinking is fine. However, when a recession is caused b the bursting of a big bubble, Keynesian thinking no longer works*" are silly.

Keynesian stimulus never works. Such stimulus may at times *appear* to work but all it does in the short run (at best) is temporarily shift demand forward.

Consider the popular "Cash For Clunkers" program, widely touted as a huge success. It was anything but a success.

For a rebuttal please see **Cash for Clunkers: Dumbest Program Ever?** on the Cato@Liberty site or my posts: **Government Bailouts and the Stock Market - The Seen and the Unseen** with a followup: **Cash For Clunkers For Housing Market Is 'No Brainer'**

When Greenspan primed the pump (as Keynesian clowns like to call it), he brought 10 years worth of housing demand forward into a few short years, pushing up prices sky high. Once that demand was exhausted, we crashed.

The moral of the story is that in the long run, Keynesian stimulus leads to perpetual bubble blowing activity with bigger and bigger debt bubbles until the whole mess blows up.

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