A year after financial crisis, a new world order emerges

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WASHINGTON — One year after the near collapse of the global financial system, this much is clear: The financial world as we knew it is over, and something new is rising from its ashes.

Historians will look to September 2008 as a watershed for the U.S. economy.

On Sept. 7 , the government seized mortgage titans Fannie Mae and Freddie Mac . Eight days later, investment bank Lehman Brothers filed for bankruptcy, sparking a global financial panic that threatened to topple blue-chip financial institutions around the world. In the several months that followed, governments from Washington to Beijing responded with unprecedented intervention into financial markets and across their economies, seeking to stop the wreckage and stem the damage.

One year later, the easy-money system that financed the boom era from the 1980s until a year ago is smashed. Once-ravenous U.S. consumers are saving money and paying down debt. Banks are building reserves and hoarding cash. And governments are fashioning a new global financial order.

Congress and the Obama administration have lost faith in self-regulated markets. Together, they're writing the most sweeping new regulations over finance since the Great Depression. And in this ever-more-connected global economy, Washington is working with its partners through the G-20 group of nations to develop worldwide rules to govern finance.

"Our objective is to design an economic framework where we're going to have a more balanced pattern of growth globally, less reliant on a buildup of unsustainable borrowing . . . and not just here, but around the world," said Treasury Secretary Timothy Geithner .

The first faint signs that the U.S. economy may be clawing its way back from the worst recession since the Great Depression are only now starting to appear, a year after the panic began. Similar indications are sprouting in Europe , China and Japan .

Still, economists concur that a quarter-century of economic growth fueled by cheap credit is over. Many analysts also think that an extended period of slow job growth and suppressed wage growth will keep consumers — and the businesses that sell to them — in the dumps for years.

"Those things are likely to be subpar for a long period of time," said Martin Regalia, the chief economist for the U.S. Chamber of Commerce . "I think it means that we probably see potential rates of growth that are in the 2-2.5 (percent) range, or maybe . . . 1.8-1.9 (percent)." A growth rate of 3 percent to 3.5 percent is considered average.

The unemployment rate rose to 9.7 percent in August and is expected to peak above 10 percent in the months ahead. It's already there in at least 15 states. Regalia thinks that it could be five years before the U.S. economy generates enough jobs to overcome those lost and to employ the new workers entering the labor force.

All this is likely to keep consumers on the sidelines.

"I think this financial panic and Great Recession is an inflection point for the financial system and the economy," said Mark Zandi , the chief economist for forecaster Moody's Economy.com. "It means much less risk-taking, at least for a number of years to come — a decade or two. That will be evident in less credit and more costly credit. If you are a household or a business, it will cost you more, and it will be more difficult to get that credit."

The numbers bear him out. The Fed's most recent release of credit data showed that consumer credit decreased at an annual rate of 5.2 percent from April to June, after falling by a 3.6 percent annual rate from January to March. Revolving lines of credit, which include credit cards, fell by an annualized 8.9 percent in the first quarter, followed by an 8.2 percent drop in the second quarter.

That's a sea change. For much of the past two decades, strong U.S. growth has come largely through expanding credit. The global economy fed off this trend.

China became a manufacturing hub by selling attractively priced exports to U.S. consumers who were living beyond their means. China's Asian neighbors sent it components for final assembly; Africa and Latin America sold China their raw materials. All fed off U.S. consumers' bottomless appetite for more, bought on credit.

"That's over. Consumers can do their part — spend at a rate consistent with their income growth, but not much beyond that," Zandi said.

If U.S. consumers no longer drive the global economy, then consumers in big emerging economies such as China and Brazil will have to take up some of the slack. Trade among nations will take on greater importance.

In the emerging "new normal," U.S. companies will have to be more competitive. They must sell into big developing markets; yet as the recent Cash for Clunkers effort underscored, the competitive hurdles are high: Foreign-owned automakers, led by Toyota , reaped the most benefit from the U.S. tax breaks for new car purchases, not GM and Chrysler .

Need a loan? Tough luck: Many U.S. banks are in no condition to lend. Around 416 banks are now on a "problem list" and at risk of insolvency. Regulators already have shuttered 81 banks and thrifts this year.

The Federal Deposit Insurance Corp. reported on Aug. 27 that rising loan losses are depleting bank capital. The ratio of bank reserves to bad loans was 63.5 percent from April to June, the lowest it's been since the savings-and-loan crisis in 1991.

For all that, the U.S. economy does seem to be rising off its sickbed. The latest manufacturing data for

August point to a return to growth, and home sales are rising. Indeed, there are many encouraging signs emerging in the global economy.

It's all growth from a low starting point, however, and many economists think that there'll be a lower baseline for U.S. and global growth if the new financial order means less risk-taking by lenders and less indebtedness by companies and consumers.

That seems evident now in the U.S. personal savings rate. It fell steadily from 9.59 percent in the 1970s to 2.68 percent in the easy-money era from 2000 to 2008; from 2005 to 2007, it averaged 1.83 percent.

Today, that trend is in reverse. From April to June, Americans' personal savings rate was 5 percent, and it could go higher if the unemployment rate keeps rising. Almost 15 million Americans are unemployed — and countless others are underemployed or uncertain about their job security, so they're spending less and saving more.

A few years ago, banks fell all over themselves to offer cheap home equity loans and lines of consumer credit. No more. Even billions in government bailout dollars to spur lending haven't changed that.

"The strategy that was stated at the beginning of the year — which is that you would sustain the banking system in order that it would resume lending — hasn't worked, and it isn't going to work," said James K. Galbraith , an economist at the University of Texas at Austin .

Over the course of 2008, the nation's five largest banks reduced their consumer loans by 79 percent, real estate loans by 66 percent and commercial loans by 19 percent, according to FDIC data. A wide range of credit measures, including recent FDIC data, show that lending remains depressed.

Why? The foundation of U.S. credit expansion for the past 20 years is in ruin. Since the 1980s, banks haven't kept loans on their balance sheets; instead, they sold them into a secondary market, where they were pooled for sale to investors as securities. The process, called securitization, fueled a rapid expansion of credit to consumers and businesses. By passing their loans on to investors, banks were freed to lend more.

Today, securitization is all but dead. Investors have little appetite for risky securities. Few buyers want a security based on pools of mortgages, car loans, student loans and the like.

"The basis of revival of the system along the line of what previously existed doesn't exist. The foundation that was supposed to be there for the revival (of the economy) . . . got washed away," Galbraith said.

Unless and until securitization rebounds, it will be hard for banks to resume robust lending because they're stuck with loans on their books.

"We've just been scared," said Robert C. Pozen , the chairman of Boston -based MFS Investment Management . He thinks that the freeze in securitization reflects a lack of trust in Wall Street and its products and remains a huge obstacle to the resumption of lending that's vital to an economic recovery.

Enter the Federal Reserve. It now props up the secondary market for pooled loans that are vital to the functioning of the U.S. financial system. The Fed is lending money to investors who're willing to buy the safest pools of loans, called asset-backed securities.

Through Sept. 3 , the Fed had funded purchases of $817.6 billion in mortgage-backed securities. These securities were pooled mostly by mortgage finance giants Fannie Mae , Freddie Mac and Ginnie Mae . In recent months, the Fed also has moved aggressively to lend for purchase of pools of other consumer-based loans.

Today, there's little private-sector demand for new loan-based securities; government is virtually the only game in town. That's why on Aug. 17 , the Fed announced that it would extend its program to finance the purchase of pools of loans until mid-2010. That suggests there's still a long way to go before a functioning securitization market — the backbone of consumer lending — returns to a semblance of normalcy.

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