

# The Big Picture

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"News to use & amuse"

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## The fight

It appears that in fighting global warming, we cannot close or damage any of the industries that are creating most of the emissions. We must change by keeping everything the same.

David Bartlett, after recently [proposing](#) that the view from Cradle Mountain superceded the effects of a pulp mill on 80,000 Tamar valley residents, now is stating the closure of any of the big smelters in Tasmania (ie. the big power users) would be perverse.

"It would be a perverse outcome if a state like Tasmania, which supplies the majority of the nation's renewable energy, has a huge forest resource and emits about 40 per cent less per capita than the Australian average, suffers in any way economically from the introduction of a Carbon Pollution Reduction Scheme that is designed to help the rest of the country catch up to us," he said yesterday. [Merc](#)

Thanks to a dearth of ideas and competence, Labor seems entirely unable to take any action that might upset industry.

We need to be asking how we can get Zinc or whatever with the minimum emissions and then doing that. Instead Labor appears stuck...unable to offer or develop alternatives.

Is it just Tasmanian Labor that's so weak?

According to The Australian, the States are building opposition to the federal emissions scheme. Mainly, it seems, because it requires actual change on the part of many industries.

Check federal Labor's [gift](#) of \$6.2 bn to the automobile industry. Instead of exploring alternative means of transportation, or local supply and delivery to reduce dependence on automobiles, we're throwing money at the industry. Cargo cult stuff again.

The notion that General Motors is somehow an Australian industry is entirely risible. Of course, that industry does create lots of jobs but can we not create those jobs in other industries that don't burn up so much fossil fuel.

A very practical colleague pointed out that if \$2 billion were offered as a prize for developing a low carbon emitting alternative to fossil fuels, we might just get results...but just handing the money over to industry is a common Labor mistake. It will likely find its way to help pay of US losses and help GM/Ford profit from the fuel gobblers made in Australia.

Our politicians do not know what to do. They follow party policy which is devised by larger groups of people who also do not know what to do.

## Rules for consensus

Some simple rules for consensus decision making include;

- consensus must represent all people affected by the decision equally (avoid conflicts of interest)
- in expert areas, consensus must be obtained from those

with the expertise, or familiar with all of the implications (e.g. health)

In the political domain of Australia, these simple requirements are usually ignored with progressively alarming results.

Consensus decision is a poor choice when expertise is required. Imagine a surgeon asking for a vote on where to make incisions! Or a pilot getting passenger votes on control movements! Yet governments don't respect these requirements, instead exposing us all to severe problems by their methods.

## Some actions

If we can't trust the governments to come up with useful ideas then we are forced to trust ourselves. We need to figure out what might happen then take steps to protect ourselves from the worst of it.

Given the highly fluid state of the global situation and the stark contrasts presented by the various viewpoints, here's a few ideas that might save a bit of money or deliver some advantage. Your contributions are welcome.

- Manage your own affairs, don't rely on paid 'advisors'
- Check your super funds – explore Ethical Investments
- Consider managing your own super fund as a cash account
- Get out of debt
- Consider cyclone fencing your veggie garden
- Form reliable local supply networks that operate in cash
- Purchase needed imported products before coming price rises

Overall, it's a good idea to act to control any risk that could do serious harm, for example if your house is near the sea, check whether sea level rises might affect you and how.

If you're buying a house, it may pay to wait for predicted market collapses. If you're selling...do it now while prices are high.

## In this issue

The fight .....	1
Rules for consensus.....	1
Some actions.....	1
In case you missed it.....	3
Liquidity Trap.....	3
Into the Trap.....	3
Economic Models.....	4
Rudd's car plan is Labor at its worst.....	4
Travelling second-class.....	5
The worst is not behind us.....	6

## In case you missed it

### Financial mess

New reins needed on old horse [TheAge](#)

Deep in foreign debt [TheAge](#)

Soft landing a big challenge [TheAustralian](#)

### Governance, fear, economy

Crown land rent increases hit clubs [Telegraph](#)

\$6.2 bn for auto industry [SMH](#)

Sick state's stunted growth [TheAustralian](#)

Report hides \$8 bn loss [TheAge](#)

NSW State of dysfunction [TheAustralian](#)

640 spin doctors in Qld [CourierMail](#)

Paying for others' inefficiencies [TheAustralian](#)

NSW State budget 'robbery' [Telegraph](#)

Triple whammy on taxes [SMH](#)

### Forestry/farming/fishing

Wrong spot says Lennon [Mercury](#)

Contractors raise price fixing concerns [ABC](#)

Minister aware of forest contract woes [ABC](#)

Farmer fury at snail breach [Mercury](#)

### Food/water

Top quality water worth conserving [TheAustralian](#)

Water rations hit home [HeraldSun](#)

Food crisis a warning we must heed [TheAustralian](#)

Recycle sewerage is last resort [TheAustralian](#)

### Climate

Recycling fear on emissions trading [Age](#)

Smelter carbon cloud [Mercury](#)

States revolt over Rudd's carbon plan [TheAustralian](#)

### Health & education revolution

Hospitals need \$3 bn now [TheAge](#)

Teaching crisis looms [SMH](#)

### Communications/transport/energy

Wait for trains as Labor blows \$40 m on spin [Telegraph](#)

Govt uploads hypocrisy with net censorship [TheAge](#)

Car giants laugh at Aussie 'suckers' [TheAustralian](#)

Workers disdainful of 'airy fairy' corporate welfare [TheAge](#)

### World

Time to declare an end to the war on terror [TheAge](#)

## Liquidity Trap

*By Colin Twiggs November 8, 5:00 a.m. ET (8:00 p.m. AET)*

Most of us have heard these re-assuring words from at least one economist in recent weeks: "Don't worry. This is not another Great Depression. We have learned a lot since then." What have we learned? In 1929 investors had a currency backed by gold; nowadays our dollars are backed by an IOU from the world's biggest debtor. In 1929 the financial system was far less sophisticated: accounts were tallied with pen and paper. Today we have sophisticated financial models which we trust implicitly — until they fail to predict the impending collapse. In 1929 communication was largely by mail. Today we are all interconnected, with communications around the globe measured in milliseconds. In 1929 the relatively new Fed was still cautiously finding their way and regularly making mistakes. Today we have a Fed confidently patrolling the financial markets with a huge can of gasoline, ready to douse any new flare-ups. And promising to use as much gas as it takes to restore stability.

In 1929 voters distrusted government and any big spending programs were likely to be met by howls of outrage. Roosevelt won election in 1932 by criticizing Hoover's huge deficits, advocating "immediate and drastic reductions of all public expenditures," "abolishing useless commissions and offices, consolidating bureaus and eliminating extravagances reductions in bureaucracy," and for a "sound currency to be maintained at all hazards." His New Deal program then went on to do exactly the opposite, far surpassing any previous excesses. Today we have House majority leaders who subscribe to the same New Deal philosophy of big government spending in order to "rescue" the economy.

Why am I not confident that we are in good hands? The mistakes being made threaten to dwarf those of 1929. Leaders seem to be ignorant that negative real interest rates and budget deficits are the same gasoline that caused the fire in the first place. If they continue along their present path, the inevitable conflagration will make the Great Depression seem like a backyard barbecue by comparison.

### Into the Trap

The Fed rapidly lowered interest rates in an attempt to stimulate borrowing, but has so far achieved little response. The banking and business sectors are focused on deleveraging: selling assets in order to reduce debt on their balance sheets. The effective fed funds rate, meanwhile, has fallen below 0.50 percent, warning us to expect further cuts.

The economy is headed for a liquidity trap, where interest rates offered on bank deposits are too low to attract investors. An outflow of funds from banks would force them to liquidate assets, unless the Fed prints more money to shore up their balance sheets.

If banks are forced to liquidate assets, calling in loans would set off a downward spiral similar to the 1930s. Borrowers are forced to liquidate investments, forcing prices lower and placing banks under even greater threat, with collateral value of stocks and real estate no longer covering the nominal value of loans.

Continual debasement of the currency, on the other hand, leads to another trap where investors lose faith in the currency. Provoking a flight to gold and other portable stores of value — in effect an alternative currency. In 1933 Roosevelt had to ban

private individuals from holding gold in order to prevent this. Legislation that was only revoked in 1974.

## Economic Models

Economics has attracted many brilliant mathematicians over the years, including John Maynard Keynes. Their mathematical models of the macro-economy are truly impressive. Unfortunately they are two-dimensional and have not stood up to the test of a multi-dimensional reality. Similar to the risk management models employed until recently by major banks, broker-dealers, and mortgage insurers. The models generally assume that if you pull on one end of a piece of string, the other end will move. Unfortunately the economy is not like that. It is more like a rubber band where you can pull on one end and the other may or may not move, depending on the restraints. This creates the impression that the two are disconnected. But it has created a tension that the market will move to release as soon as the restraint is removed. And, like a rubber band when you release it, the market will not only revert to equilibrium but will overshoot in the other direction. And that, ladies and gentlemen, is a recession.

The study of the economy needs to draw more from the study of herd behavior in evolutionary biology and the field of fluid mechanics in engineering: the study of how liquids and gases move and the forces upon them.

### Rudd's car plan is Labor at its worst

Bernard Keane writes: © Crikey Canberra

Forget the greenwash, the key statement in today's car package is this one from the Prime Minister.

Only 15 or so countries in the world can design, engineer and build a car from scratch and we are determined to maintain that capacity.

There it sits in the press release, unadorned with any supporting evidence or justification of any kind. We're just gonna have a car industry.

The other prize example of question-begging is to be found in the [Executive Summary](#) of the policy launched this morning:

While the Government has recognised the scale of the transformation required by extending support to 2020, our ultimate goal is that industry should be self-sufficient.

As St Augustine famously said about Hippo's troubled chariot industry, Lord, make us self-sufficient, but not yet. What would most Australian businesses give to be told they had 12 years to become commercially viable, but that taxpayers and consumers would pick up the tab until then, thanks.

Kevin Rudd this morning was emphasising the green aspects of the automotive package. You got the impression we were going to drive our way to a low-carbon future in an Australian-made green machine. And true, the second biggest item in the package is an additional \$130m in 2009-10 to kick off the bigger, longer, faster, greener Green Car contestable grants program, which wasn't scheduled to start until 2010. Now it will go for 10 years, at \$130m a year, rather than five years at \$50m pa. The Government didn't specify the conditions for receiving grants under the program, but judging by the Toyota hybrid car announcement earlier this year, pretty much anything with the

words "low emissions" in it will get a few million.

By the end of the 10 years of the Green Car program, the industry will be nearing the end of the extended assistance program that is the big budget ticket in the package: an extra \$100m a year from 2011-15 on top of the \$200m it was scheduled to get, and a further \$200m a year from 2016-20, when it wasn't getting anything.

Anyone who thinks 2020 will be the end of the taxpayer largesse to these multinationals and their tame unions is mad. This nonsense will keep going for decades unless someone with some guts calls time on the handouts.

There are some small additional measures. LPG conversions get an immediate boost that will take a further \$10.5m off this year's surplus. There'll be just over \$6m a year to further encourage exports (quite why multinationals need help to export stuff is a complete mystery). The only faintly responsible part of the package is a \$116.3m adjustment package intended to help the less viable parts of the components industry and its workers "adjust"-- i.e. close. That's another nearly \$60m off this year's surplus -- if one is left.

In total, we're talking \$2.4b and change in extra funding between now and 2020.

The other element of the Government's spin was its claim that this was somehow leveraged investment by taxpayers. "The governments expects this assistance to stimulate industry investment of at least \$16b ... It is about mutual obligation all round -- a genuine partnership."

Doubtless the number crunchers in Detroit, currently working out what sort of three-into-two merger will save the US auto industry, will be breathing a little easier knowing that they'll continue to get assistance in Australia from 2016.

And the lack of actual announcements about new investments -- strangely enough, given the turmoil besetting the world car industry -- gives the game away. There's no commitment to additional investment from the big car makers beyond what they've already announced. The Government has leveraged precisely nothing in its package. It's not even clear Ford and General Motors will still be around in their current forms next year.

This is ALP tradition at its very worst. Because of the financial generosity and strength of the manufacturing unions, because of John Button's legacy, and because, almost certainly, of an absurd left-wing conviction that only the manufacture of physical objects is somehow a real economic activity, Australian consumers and taxpayers are condemned to continue paying too much for imported cars and subsidising 60,000 jobs. Other industries should be furious that this rort, this scam, this extended exercise in economic and fiscal vandalism, is being continued and exacerbated by a supposedly free market government.

What's the bet, though, that they'll stay silent in the hope of attracting some assistance of their own? When it comes to rent-seeking, *everyone* is a strategic industry.

The Government's package is an exercise in keeping a brain-dead body ticking over. It's brain-dead because it has failed to meet the changing needs of Australian consumers over the past decade and relied on assistance as its primary commercial strategy. And even with assistance, parts of the body have routinely died. It's time to cut off the life support and let the car industry operate like the majority of Australian businesses.

## Travelling second-class

© Paul Mees [TheAge](#) November 12, 2008

LAST week, it was the Oaks day train debacle; this week, it's the chaos surrounding the new timetables. Melbourne's rail system has once again failed the city, leaving hapless travellers stranded on trains and at stations. Melburnians could be forgiven for wondering if the city's rails are cursed. If European cities, and even Perth, can have first-rate trains, why can't we?

We used to have just that. By coincidence, the first film made in Australia was shot at the 1896 Melbourne Cup. It opens at Flemington Racecourse station, with a steam train pulling into the platform. While the passengers disembark, a locomotive leaves its siding and backs into position at the rear of the train. As soon as the train has emptied, it is towed away from the platform to make room for the next arrival.

In the late 19th century, trains transported more passengers to and from the races than they do today. Crowds were almost as great and everyone went by train, as there were no cars, buses or electric trams. The Racecourse station only had a single platform, but steam trains arrived and departed at two-minute intervals. The fiascos we saw on Oaks day this year and Derby day two years ago would have been unthinkable.

By the 1920s, the system had been electrified and expanded. More trains left Flinders Street Station in peak hour than do today, with a service every three minutes on the Sandringham line. Reliability was high and cancellations rare. Europeans envied Melbourne for the excellence of our rail system. So why can't we transport people reliably to and from the races now?

The Department of Transport says the reason is that we don't have enough tracks, even though we have many more than in the 1920s. Sir Rod Eddington agrees, and has proposed a multibillion-dollar tunnel from Footscray to Caulfield that will take decades to build and has a price tag we can't afford. But the Eddington tunnel would not have prevented the stuff-ups on Oaks day; nor it will fix the problems created by running the Epping and Hurstbridge lines the wrong way through the city loop.

The main cause of Melbourne's rail woes is a tremendous deterioration in management and planning. Levels of efficiency that could be achieved in the 1920s, or even in the 19th century, are now claimed to be impossible in the 21st century. Things are so tangled that the public doesn't even know who to blame for the collapse of service: is it Connex, or the private company that maintains tracks and signals, or Transport Minister Lynne Kosky, or one of the many divisions of the Department of Transport?

The truth is that under the current system of "public-private partnerships", nobody can be held accountable for anything that matters. Huge subsidies are paid under Byzantine franchise agreements requiring time-consuming monitoring and reporting of trivia. Any energy left over is devoted to increasingly desperate efforts to spin away mounting public discontent. Since nobody is responsible for tackling the real problems, they are not being fixed.

Not everyone sees things this way, however. Last year, Kosky asked her department for a report on how the system was travelling. The Department of Transport reported in August that everything was wonderful. The system works just fine, and "the performance of the incumbent operators has been sound".

The minister responded by promoting Jim Betts, the principal author of the report, from director of public transport to secretary of the entire department. He is now overseeing the secret negotiations to extend the present arrangements with new contracts lasting up to 15 years. The word is that the department may sacrifice Connex to appease public anger, replacing it with another private operator while keeping Yarra Trams in place. This will be more spin to disguise the lack of attention to the real problems.

The "franchising" system is a shambles and a farce, and nothing will change as long as it persists. No successful urban rail system in the world operates on the model we use in Melbourne: even Margaret Thatcher balked at applying it to London.

We have ample evidence of the kind of management structures that produce well-run public transport: lean, dynamic, accountable regional authorities that are publicly owned but kept at arm's length from the ministerial spin cycle.

An excellent example is the Zurich Transport Network, which controls all public transport in the state (canton) of Zurich. The ZVV, which many observers regard as the best transit agency in the world, administers a public transport network as big as Melbourne's with 34 staff (the equivalent organisation in Melbourne employs more than 10 times that), of whom only six are responsible for timetables and service planning.

The Zurich staff and their jobs are set out, in German and English, on the authority's website ([zvv.ch](http://zvv.ch)). Everyone knows where the buck stops in Zurich's public transport system.

A century ago, it was Melbourne, not Zurich that was the world leader in urban rail provision. We could become so again, but only if our public transport system is run for the benefit of its passengers, rather than its operators and administrators.

Dr Paul Mees is senior lecturer in transport planning at RMIT.

# The worst is not behind us

By Nouriel Roubini November 14, 2008 © "Forbes"

It is useful, at this juncture, to stand back and survey the economic landscape--both as it is now, and as it has been in recent months. So here is a summary of many of the points that I have made for the last few months on the outlook for the U.S. and global economy, as well as for financial markets:

--[The U.S. will experience its most severe recession since World War II, much worse and longer and deeper than even the 1974-1975 and 1980-1982 recessions.](#) The recession will continue until at least the end of 2009 for a cumulative gross domestic product drop of over 4%; the unemployment rate will likely reach 9%. The U.S. consumer is shopped-out, saving less and debt-burdened: This will be the worst consumer recession in decades.

--The prospect of a short and shallow six- to eight-month V-shaped recession is out of the window; a U-shaped 18- to 24-month recession is now a certainty, and the probability of a worse, multi-year L-shaped recession (as in Japan in the 1990s) is still small but rising. Even if the economy were to exit a recession by the end of 2009, the recovery could be so weak because of the impairment of the financial system and the credit mechanism that it may feel like a recession even if the economy is technically out of the recession.

--[Obama will inherit an economic and financial mess worse than anything the U.S. has faced in decades:](#) the most severe recession in 50 years; the worst financial and banking crisis since the Great Depression; a ballooning fiscal deficit that may be as high as a trillion dollars in 2009 and 2010; a huge current account deficit; a financial system that is in a severe crisis and where deleveraging is still occurring at a very rapid pace, thus causing a worsening of the [credit crunch](#); a household sector where millions of households are insolvent, into negative equity territory and on the verge of losing their homes; a serious risk of deflation as the slack in goods, labor and commodity markets becomes deeper; the risk that we will end in a deflationary liquidity trap as the Fed is fast approaching the zero-bound constraint for the Fed funds rate; the risk of a severe debt deflation as the real value of nominal liabilities will rise, given price deflation, while the value of financial assets is still plunging.

--[The world economy will experience a severe recession:](#) Output will sharply contract in the Eurozone, the U.K. and the rest of Europe, as well as in Canada, Japan and Australia/New Zealand. There is also a risk of a [hard landing in emerging market economies](#). Expect global growth--at market prices--to be close to zero in Q3 and negative by Q4. Leaving aside the effects of the fiscal stimulus, [China could face a hard landing growth rate of 6% in 2009.](#) The global recession will continue through most of 2009.

--The advanced economies will face [stag-deflation \(stagnation/recession and deflation\)](#) rather than stagflation, as the slack in goods, labor and commodity markets will lead advanced economies' inflation rates to become below 1% by 2009.

--Expect a few advanced economies (certainly the U.S. and Japan and possibly others) to reach the zero-bound constraint for policy rates by early 2009. With deflation on the horizon, zero-bound on interest rates implies the risk of a liquidity trap where money and bonds become perfectly substitutable, where real

interest rates become high and rising, thus further pushing down aggregate demand, and where [money market fund](#) returns cannot even cover their management costs.

Deflation also implies a debt deflation where the real value of nominal debts is rising, thus increasing the real burden of such debts. Monetary policy easing will become more aggressive in other advanced economies even if the [European Central Bank](#) cuts too little too late. But monetary policy easing will be scarcely effective, as it will be pushing on a string, given the glut of global aggregate supply relative to demand--and given a very severe credit crunch.

--For 2009, the consensus estimates for earnings are delusional: Current consensus estimates are that S&P 500 earnings per share (EPS) will be \$90 in 2009, up 15% from 2008. Such estimates are outright silly. If EPS falls--as is most likely--to a level of \$60, then with a price-to-earnings (P/E) ratio of 12, the S&P 500 index could fall to 720 (i.e. about 20% below current levels).

If the P/E falls to 10--as is possible in a severe recession--the S&P could be down to 600, or 35% below current levels.

And in a very severe recession, one cannot exclude that EPS could fall as low as \$50 in 2009, dragging the S&P 500 index to as low as 500. So, even based on fundamentals and valuations, there are significant downside risks to U.S. equities (20% to 40%).

Similar arguments can be made for global equities: A severe global recession implies further downside risks to global equities in the order of 20% to 30%. Thus, the recent rally in U.S. and global equities was only a bear-market sucker's rally that is already fizzling out--buried under a mountain of worse-than-expected macro, earnings and financial news.

--Credit losses will be well above \$1 trillion and closer to \$2 trillion, as such losses will spread from subprime to near-prime and prime mortgages and home equity loans (and the related securitized products); to commercial real estate, to credit cards, auto loans and student loans; to leveraged loans and LBOs, to muni bonds, corporate bonds, industrial and commercial loans and credit default swaps. These credit losses will lead to a severe credit crunch, absent a rapid and aggressive recapitalization of financial institutions.

--Almost all of the \$700 billion in the TARP program will be used to recapitalize U.S. financial institutions (banks, broker dealers, insurance companies, finance companies) as rising credit losses (close to \$2 trillion) will imply that the initial \$250 billion allocated to recap these institutions will not be enough. Sooner rather than later, a TARP-2 will become necessary, as the recapitalization needs of U.S. financial institutions will likely be well above \$1 trillion.

--Current spreads on speculative-grade bonds may widen further as a tsunami of defaults will hit the corporate sector; investment-grade bond spreads have widened excessively relative to financial fundamentals, but further spread-widening is possible, driven by market dynamics, deleveraging and the fact that many AAA-rated firms (say, GE) are not really AAA, and should be downgraded by the rating agencies.

--Expect a U.S. fiscal deficit of almost \$1 trillion in 2009 and 2010. The outlook for the U.S. current account deficit is mixed: The recession, a rise in private savings and a fall in investment, and a further fall in commodity prices will tend to shrink it, but a stronger dollar, global demand weakness and a larger U.S. fiscal deficit will tend to worsen it. On net, we will observe still-large

U.S. twin fiscal and current account deficits--and less willingness and ability in the rest of the world to finance it unless the interest rate on such debt rises.

--In this economic and financial environment, it is wise to stay away from most risky assets for the next 12 months: There are downside risks to U.S. and global equities; credit spreads--especially for the speculative grade--may widen further; commodity prices will fall another 20% from current levels; gold will also fall as deflation sets in; the U.S. dollar may weaken further in the next six to 12 months as the factors behind the recent rally weather off, while medium-term bearish fundamentals for the dollar set in again; government bond yields in the U.S. and advanced economies may fall further as recession and deflation emerge but, over time, the surge in fiscal deficits in the U.S. and globally will reduce the supply of global savings and lead to higher long-term interest rates unless the fall in global real investment outpaces the fall in global savings.

Expect further downside risks to emerging-markets assets (in particular, equities and local and foreign currency debt), especially in economies with significant macro, policy and financial vulnerabilities. Cash and cash-like instruments (short-term dated [government bonds](#) and inflation-indexed bonds that do well both in inflation and deflation times) will dominate most risky assets.

So, serious risks and vulnerabilities remain, and the downside risks to financial markets (worse than expected macro news, earnings news and developments in systemically important parts of the global financial system) will, over the next few months, overshadow the positive news (G-7 policies to avoid a systemic meltdown, and other policies that--in due time--may reduce interbank spreads and credit spreads).

Beware, therefore, of those who tell you that we have reached a bottom for risky financial assets. The same optimists told you that we reached a bottom and the worst was behind us after the rescue of the creditors of Bear Stearns in March; after the announcement of the possible bailout of Fannie and Freddie in July; after the actual bailout of Fannie and Freddie in September; after the bailout of [AIG](#) (nyse: [AIG](#) - [news](#) - [people](#).) in mid-September; after the TARP legislation was presented; and after the latest G-7 and E.U. action.

In each case, the optimists argued that the latest crisis and rescue policy response was the cathartic event that signaled the bottom of the crisis and the recovery of markets. They were wrong literally at least six times in a row as the crisis--as I have consistently predicted over the last year--became worse and worse. So enough of the excessive optimism that has been proved wrong at least six times in the last eight months alone.

A reality check is needed to assess risks--and to take appropriate action. And reality tells us that we barely avoided, only a week ago, a total systemic financial meltdown; that the policy actions are now finally more aggressive and systematic, and more appropriate; that it will take a long while for interbank and credit markets to mend; that further important policy actions are needed to avoid the meltdown and an even more severe recession; that central banks, instead of being the lenders of last resort, will be, for now, the lenders of first and only resort; that even if we avoid a meltdown, we will experience [a severe U.S., advanced economy and, most likely, global recession](#), the worst in decades; that we are in the middle of a severe global financial and banking crisis, the worst since the Great Depression; and that the flow of macro, earnings and financial news will significantly surprise (as during the last few weeks) on the

downside with significant further risks to financial markets.

I'll stop now.

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