Name Date

MONDAY EXTRA

Economy May Face Prolonged Pain, History Suggests

OVERVIEW

The worst financial pain may have passed, but the U.S. economic pain could be just starting. The economic fallout from a crisis depends a lot on how much underlying economic factors are out of whack with their fundamental determinants.

REVIEW

Read the article "Economy May Face Prolonged Pain, History Suggests" and answer these questions:

1 Explain why it is common for financial markets to hit bottom long before the economy does.

2 Describe the differences between the stock market crash in 1987 and the current financial crisis.

3 Compare the current U.S. financial crisis with the 1997 financial crisis in South Korea. What lessons can U.S. policymakers learn from the South Korean experience?

DISCUSSION/RESEARCH IDEAS

■ Discuss the role of "feedback" effects on the economy. According to the article, a key risk to the economy is that the economic weakness will essentially feed on itself, by spreading beyond the correction of housing excesses and back into the financial system, which, in turn, hurts the wider economy. In your opinion, is this happening already? What evidence do you see in the stock market or in your local economy that the economic weakness is feeding on itself?

■ Fed Chairman Ben Bernanke believes feedback effects are what made the Great Depression of the 1930s great. Research the causes of the Great Depression. What historical parallels do you see between the lead-up to the Depression and the conditions that led to today's crisis? What differences are there?

■ Recessions and economic slowdowns like the current one are usually accompanied by a decline in prices, as businesses adjust to weaker consumer demand. Today, however, prices of food, fuel and other commodities are at or near record highs. How might this complicate an economic recovery?

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ANSWERS

1 Markets are forward-looking, and economic weakness is the way the underlying imbalances that produce a crisis are corrected.

2 The 1987 stock-market crash threatened the heart of the financial system. But the underlying imbalances were largely limited to the financial markets themselves—stock prices that were out of balance with corporate earnings. The current crisis reflects imbalances in other markets as well, including housing and credit.

3 The key lesson in Korea's experience, says Kihwan Kim, is that imbalances must be corrected in order for a recovery to begin. A recovery doesn't require a full resolution of those imbalances, just a convincing sign that change is taking place.