THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Ten Years after the Global Financial Crisis: what have we learned and what did we forget?

#LSEfinance

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Professor Catherine R. Schenk

University of Oxford

What did we learn?

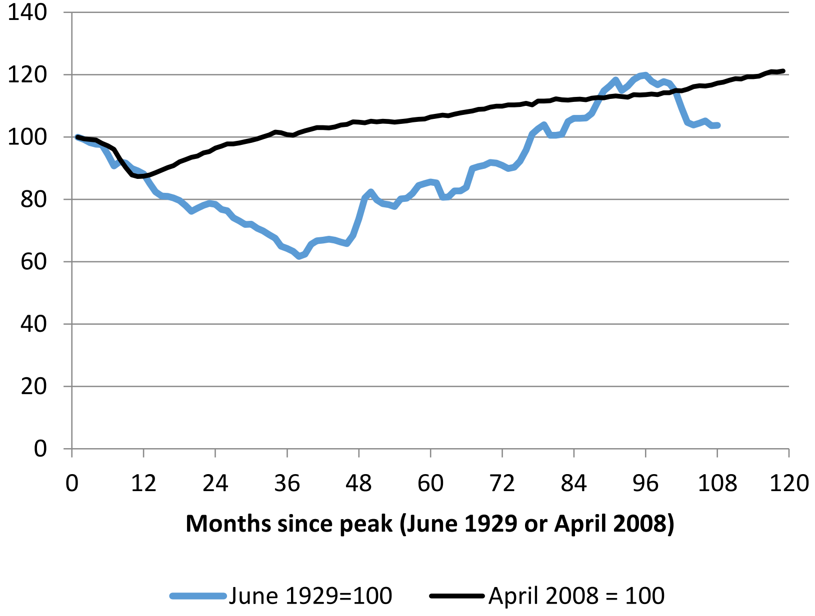
- Many recent reviews of events 10 years ago
  - Hindsight – why were governments so complacent, regulators so blind, bankers so greedy, home-buyers so irresponsible?

⇨ Reinvigorated focus on (macro)-prudential supervision: but pro-cyclical policies
Reinvigorated focus on micro-prudential supervision: less tractable

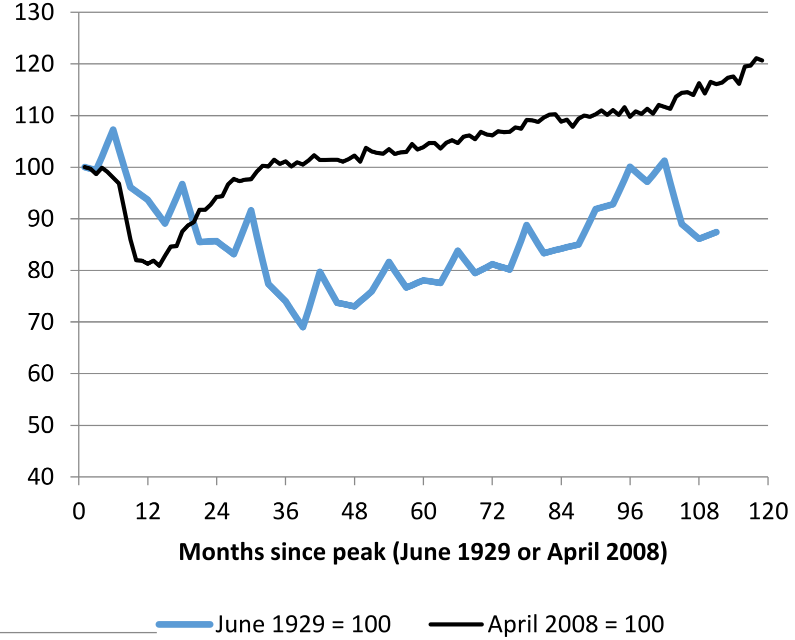
- Key uses of the past based on 1930s (Bernanke, Kindleberger, Eichengreen et al)
  - 1930s Sovereign Debt/War Debt, Asset Market shock, Financial Crisis, Agricultural Slump
  - Lack of US leadership
  - European Financial Crisis: Ten years after = World War II

- Fiscal expansion (short-lived and risky)
- Monetary expansion (QE – now 10 years old)
- Regulation: Basel III and Dodd Frank
- International Cooperation

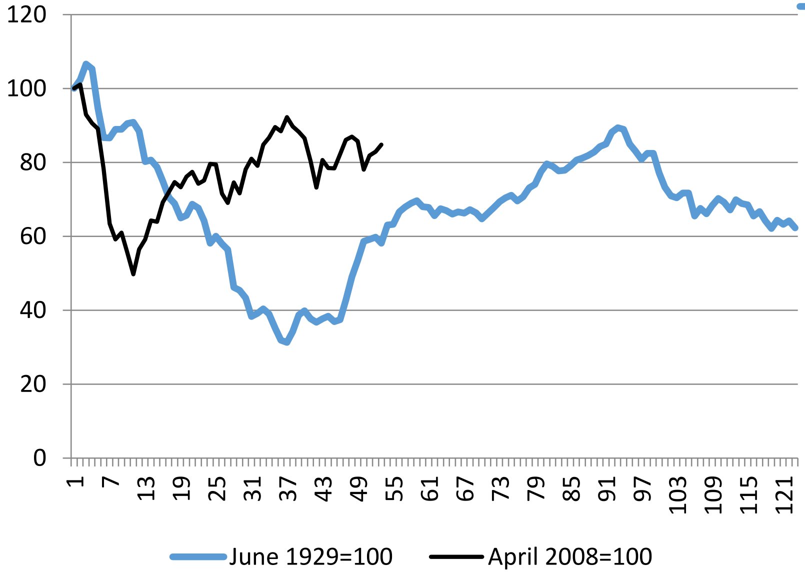
World Industrial Production



World Trade



Source: Eichengreen and O'Rourke
VoxEU (2010)
'A Tale of Two Depressions'
[O'Rourke: updated June 2018]



Equity Markets

Neglected Uses of the Past

- 'Currency wars' of 1930s: competitive devaluation (**currency manipulation**)

- Governance of the Global Economy: 1930s crisis inspired the **Bretton Woods System** and the International Monetary Fund/World Bank
  - Capital controls, pegged exchange rates, global source of liquidity for ST deviations from equilibrium
  - Global Financial Safety Net: 1970s vs 2010s

- 1930s trade shock/turn to **protectionism** not fulfilled (yet)
  - The 'Great Reversal' of globalization (Rajan and Zingales 2000-2004)

Currency Wars today?

1930s: part of economic nationalism, leads to retaliatory trade barriers, dangers of floating exchange rates and short term capital flows

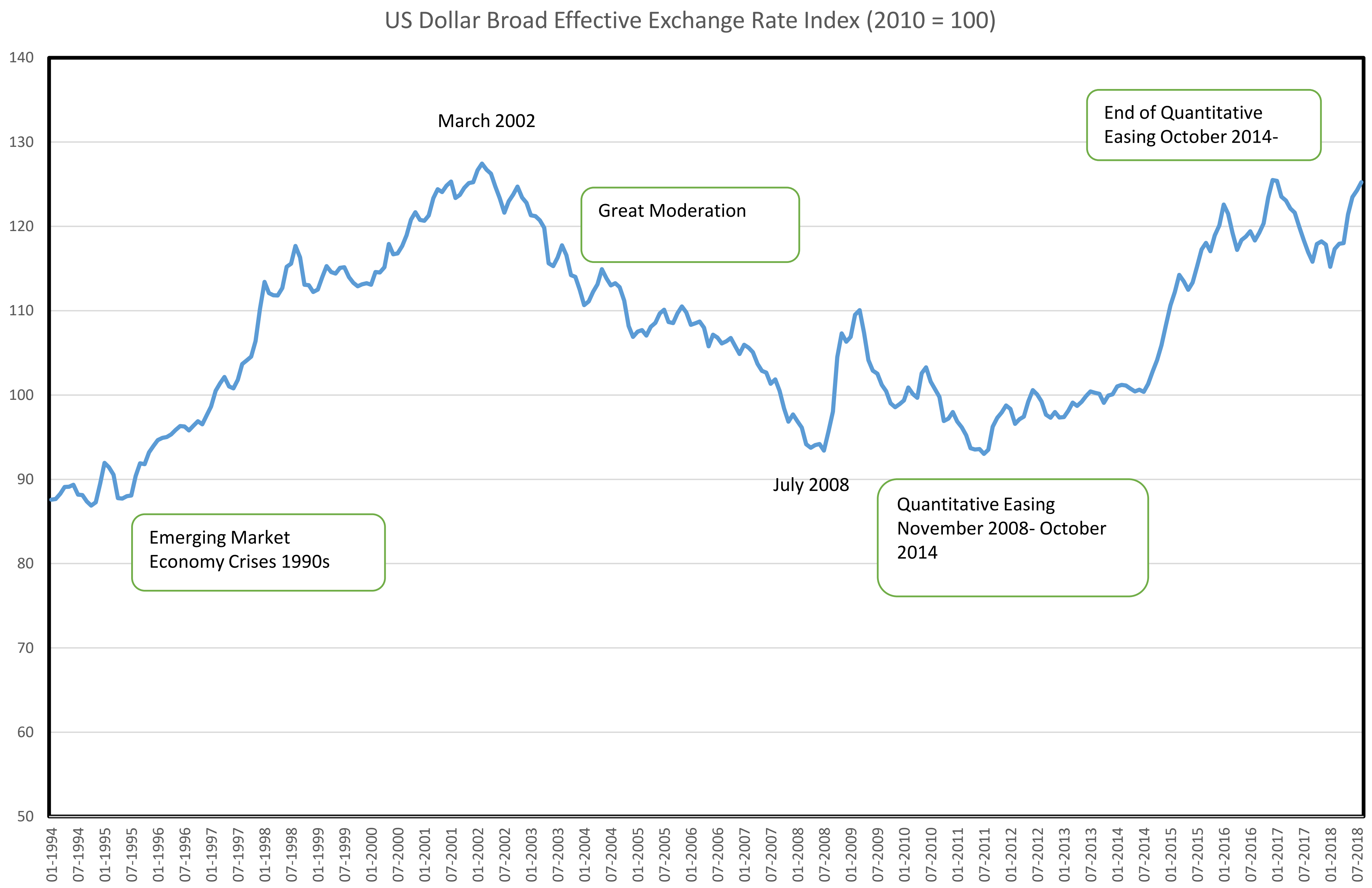
- 2010s not the same as 1930s, **BUT**
- Spillover effects from Unconventional Monetary Policy
- Impact on Emerging Market Economies:
  - Capital inflow in 2009-12
  - Taper tantrum 2013
  - Capital outflow 2014-

- Impact exacerbated by Dollar indebtedness
- EMEs v USA; USA v China

- Retreat from Floating Exchange rates
- IMF Institutional View on Capital Flow Management (2012)

Jay Powell – May 2018

- ‘Monetary stimulus by the Fed and other advanced-economy central banks played a relatively limited role in the surge of capital flows to EMEs in recent years. There is good reason to think that the normalization of monetary policies in advanced economies should continue to prove manageable for EMEs’ (Powell 2018).


US Dollar Broad Effective Exchange Rate Index (2010 = 100)
140
130
120
110
100
90
80
70
60
50
March 2002
Great Moderation
End of Quantitative Easing October 2014-
July 2008
Quantitative Easing November 2008- October 2014
Emerging Market Economy Crises 1990s
01-1994
07-1994
01-1995
07-1995
01-1996
07-1996
01-1997
07-1997
01-1998
07-1998
01-1999
07-1999
01-2000
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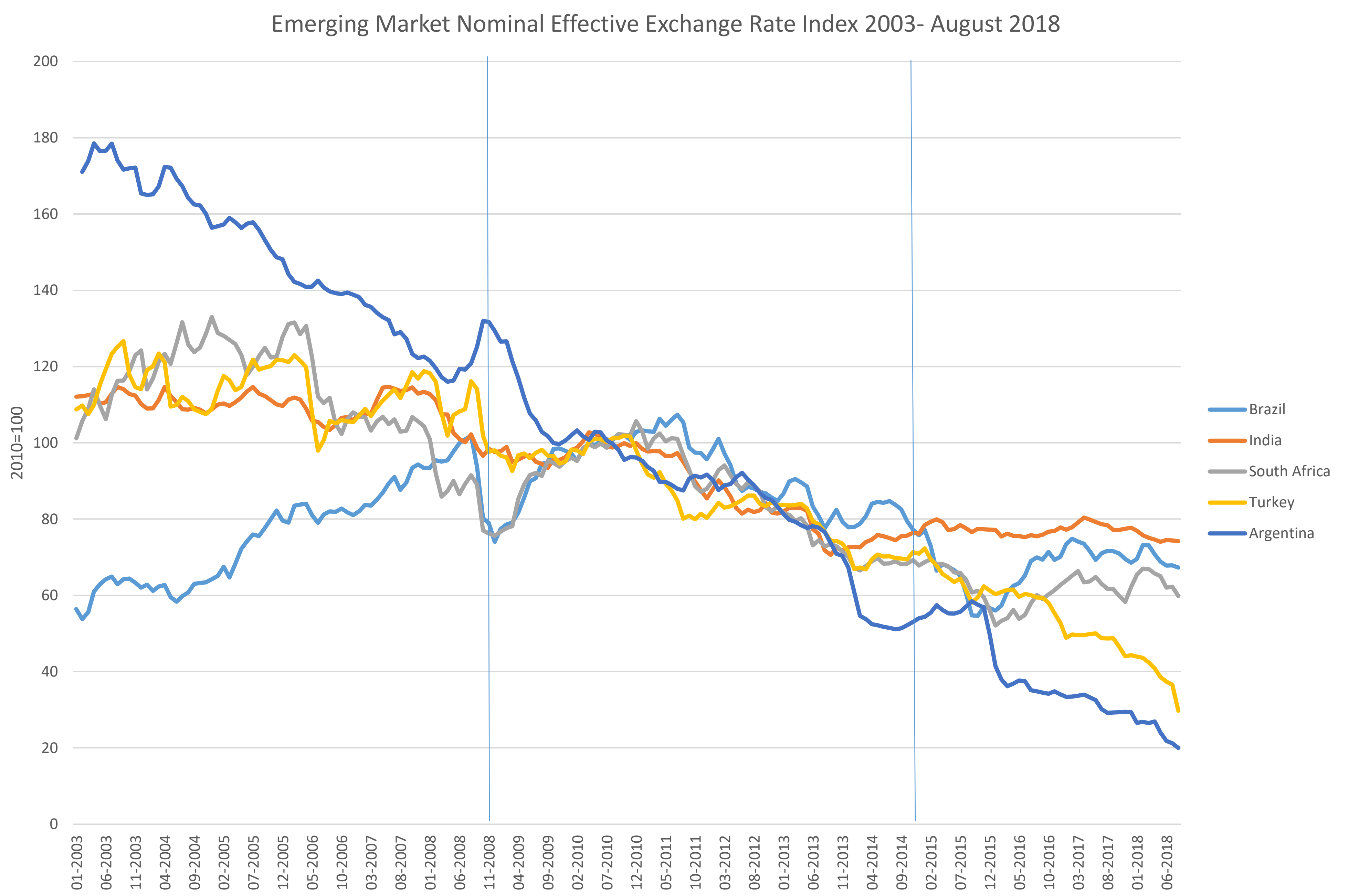
01-2018
07-2018

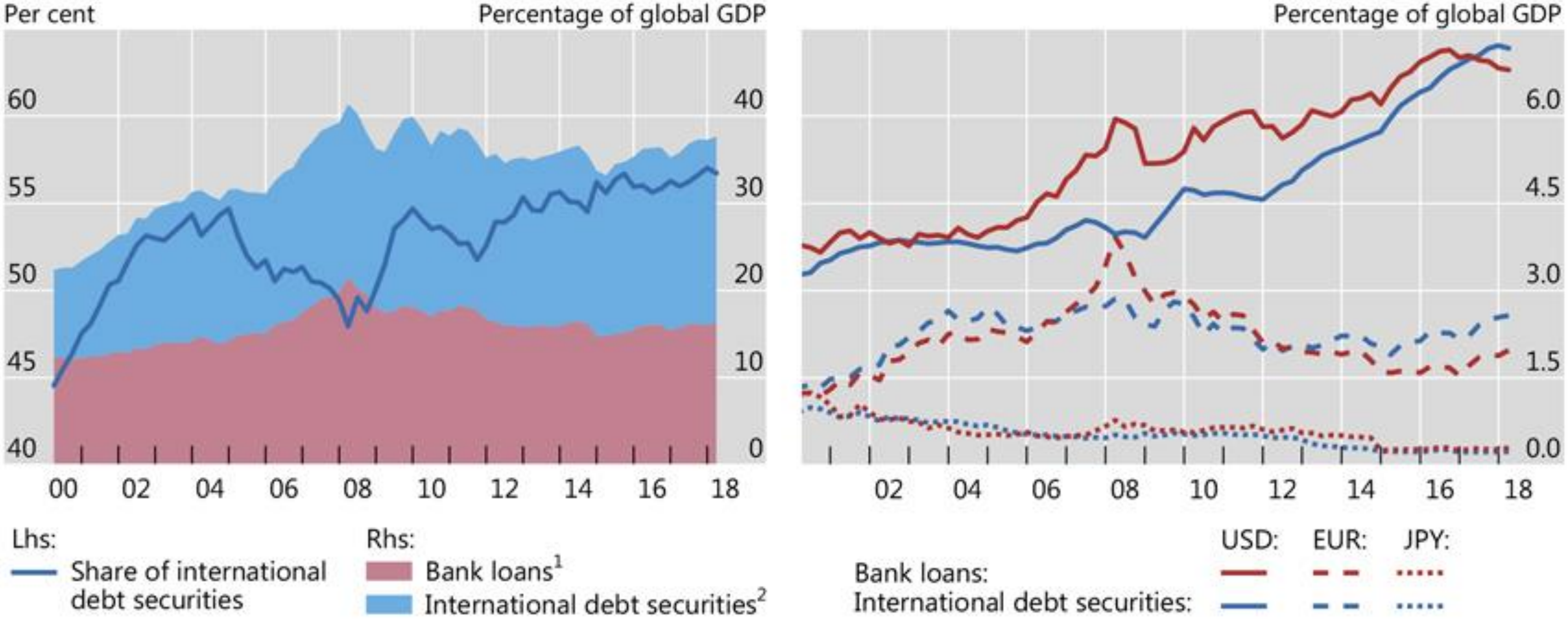


Emerging Market Nominal Effective Exchange Rate Index 2003- August 2018
2010=100
200
180
160
140
120
100
80
60
40
20
0
01-2003
06-2003
11-2003
04-2004
09-2004
02-2005
07-2005
12-2005
05-2006
10-2006
03-2007
08-2007
01-2008
06-2008
11-2008
04-2009
09-2009
02-2010
07-2010
12-2010
05-2011
10-2011
03-2012
08-2012
01-2013
06-2013
11-2013
04-2014
09-2014
02-2015
07-2015
12-2015
05-2016
10-2016
03-2017
08-2017
01-2018
06-2018
Brazil
India
South Africa
Turkey
Argentina

The share of debt securities and the US dollar in international credit has risen

International credit to the non-bank sector, amounts outstanding — Graph 1

International credit to non-banks by instrument | International credit to non-residents by instruments and currency



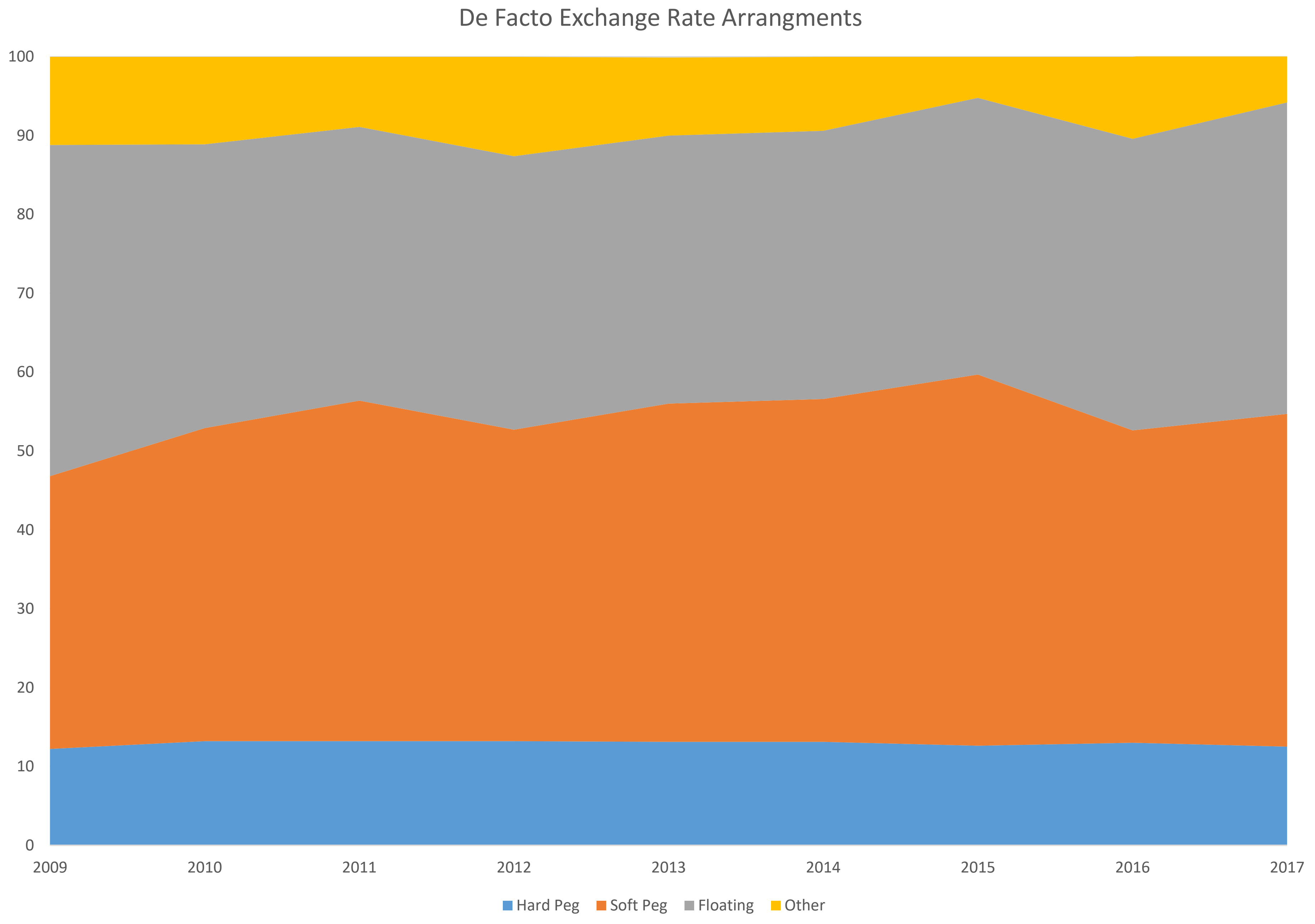
Further information on the BIS global liquidity indicators is available at www.bis.org/statistics/about_gli_stats.htm.

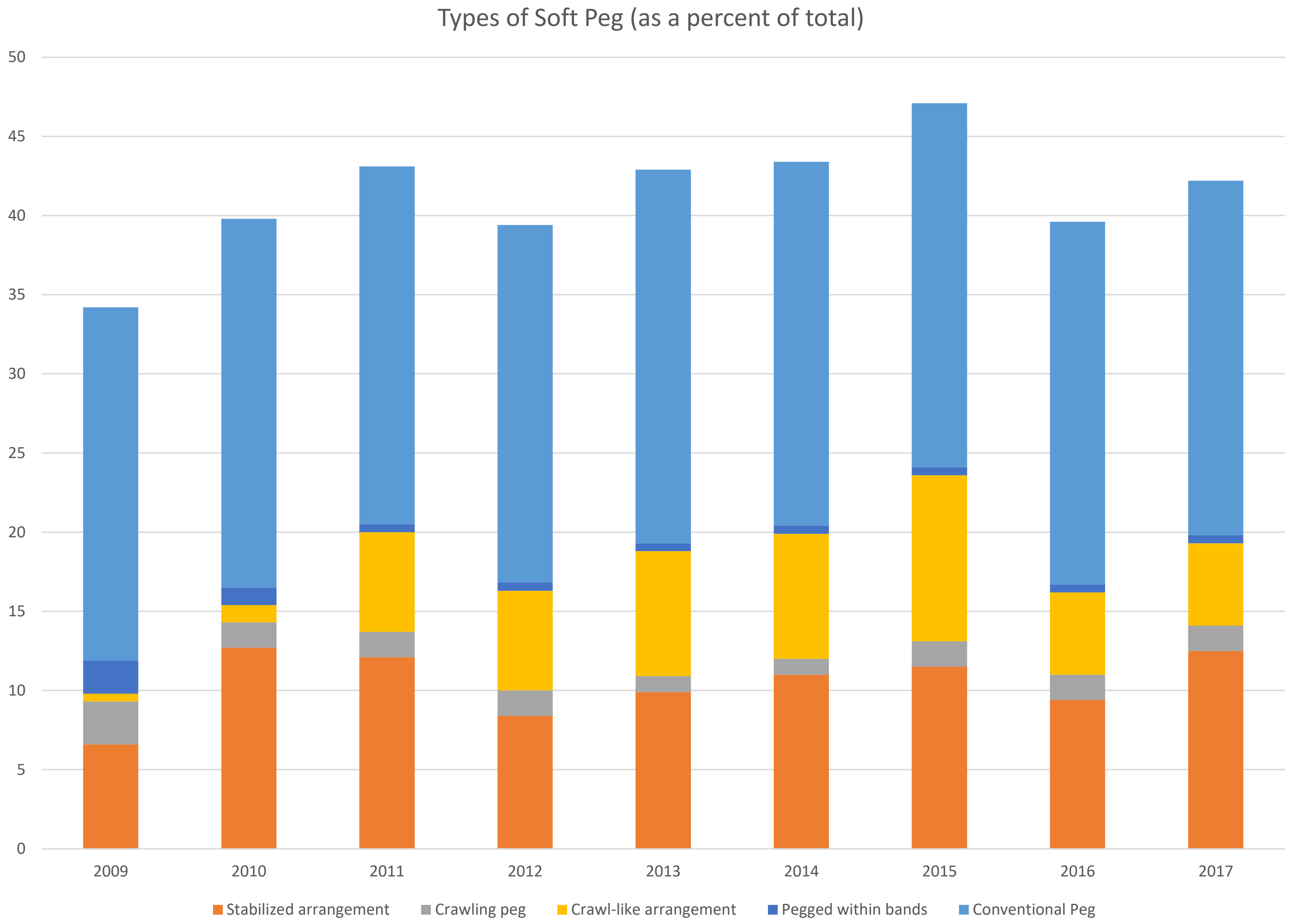
[1] Cross-border loans and local loans in foreign currency to non-bank borrowers. [2] By residence and immediate sector of issuer; all instruments; all maturities; non-bank issuers. International debt securities are debt securities issued by non-banks in a market other than the local market of the country where the borrower resides.

Sources: Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; BIS locational banking statistics and global liquidity indicators; BIS calculations; authors' calculations.

Exchange Rate Regimes and Capital Flow Management

- EMEs that have harder inflation targets tended to suffer less from spillover effects (IMF 2018)
- There has been no increase in the proportion of countries that float their exchange rates and a slight drift toward de facto soft pegs


De Facto Exchange Rate Arrangments
100
90
80
70
60
50
40
30
20
10
0
2009
2010
2011
2012
2013
2014
2015
2016
2017
Hard Peg
Soft Peg
Floating
Other


Types of Soft Peg (as a percent of total)
50
45
40
35
30
25
20
15
10
5
0
2009
2010
2011
2012
2013
2014
2015
2016
2017
Stabilized arrangement
Crawling peg
Crawl-like arrangement
Pegged within bands
Conventional Peg

Governance of the Global Economy

- Reinvigorated: G20 and FSB
- Governance reform: International Monetary Fund, Bank for International Settlements (esp. China)
- Side-lined? World Trade Organisation, World Bank
  - Regional Trade Agreements, Chinese OBOR/BRI

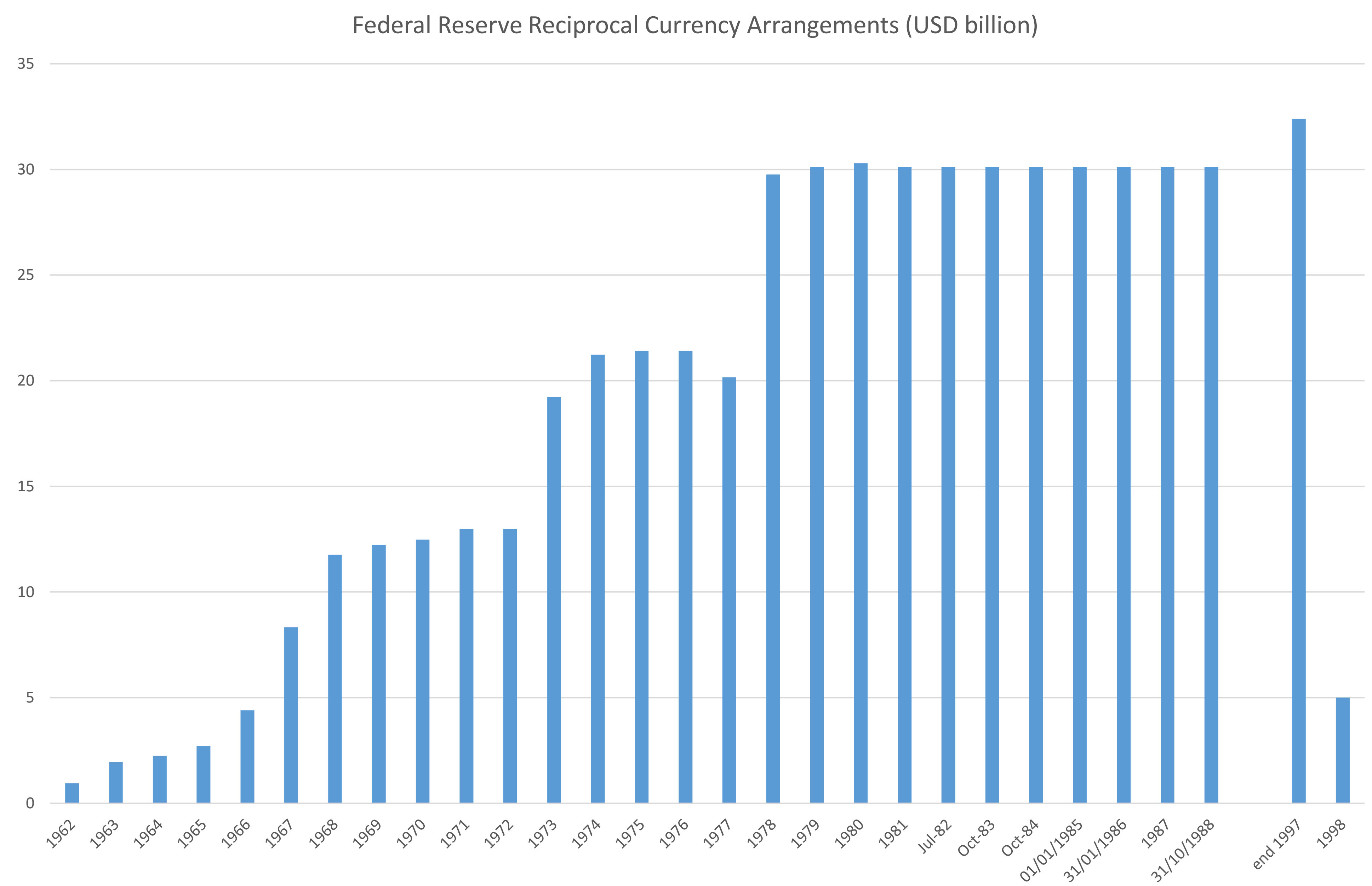
Learning from 1970s

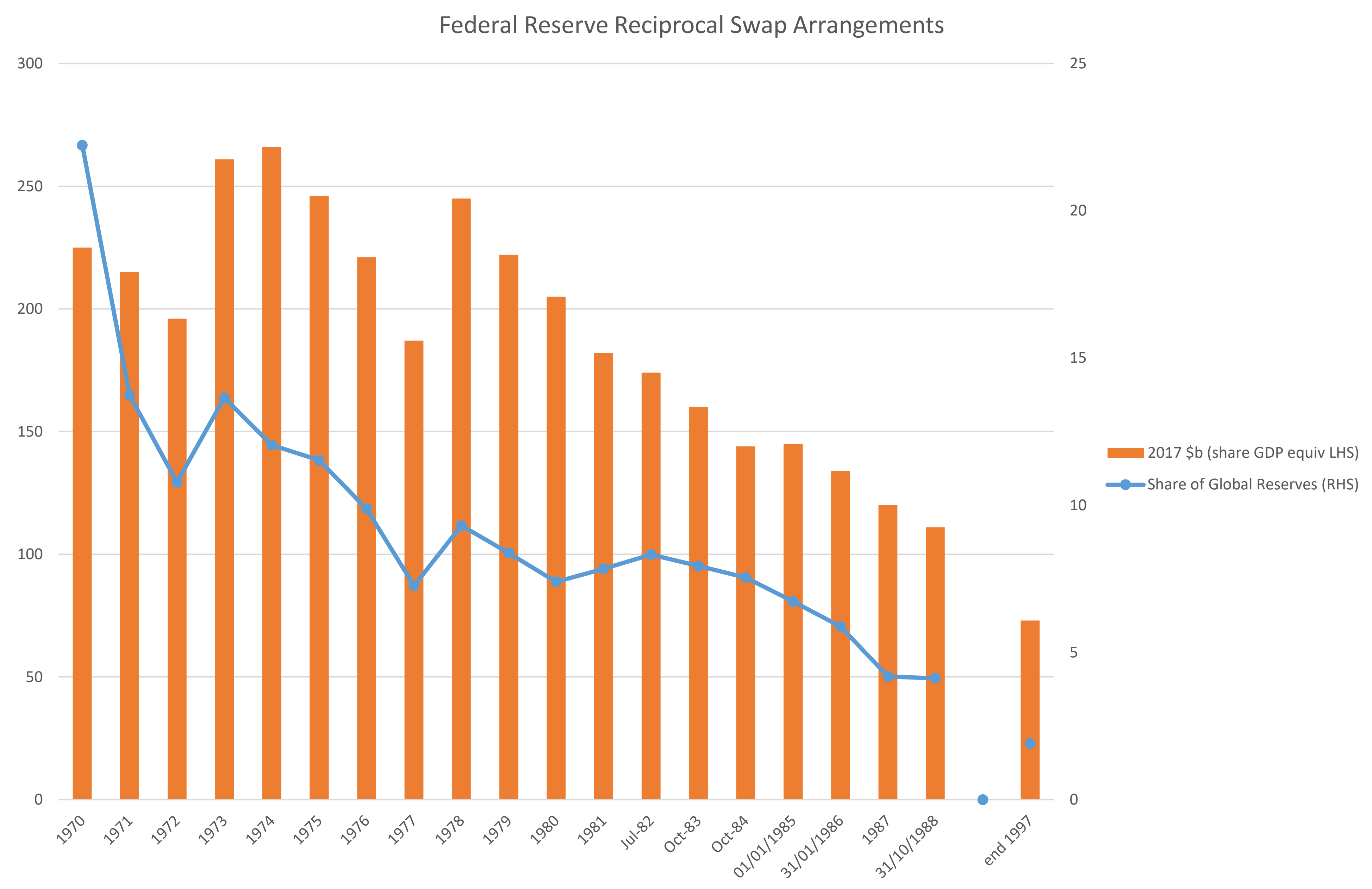
- Coordination problems, is 20 too big to maintain momentum?
  - 1970s: CXX ineffective
- Basel Process: long delays, backward looking, negotiated with banks, implemented just in time for the next crisis
- Basel III finalized December 2017, implementation expected in 2022-2027
- Reforming the SDR

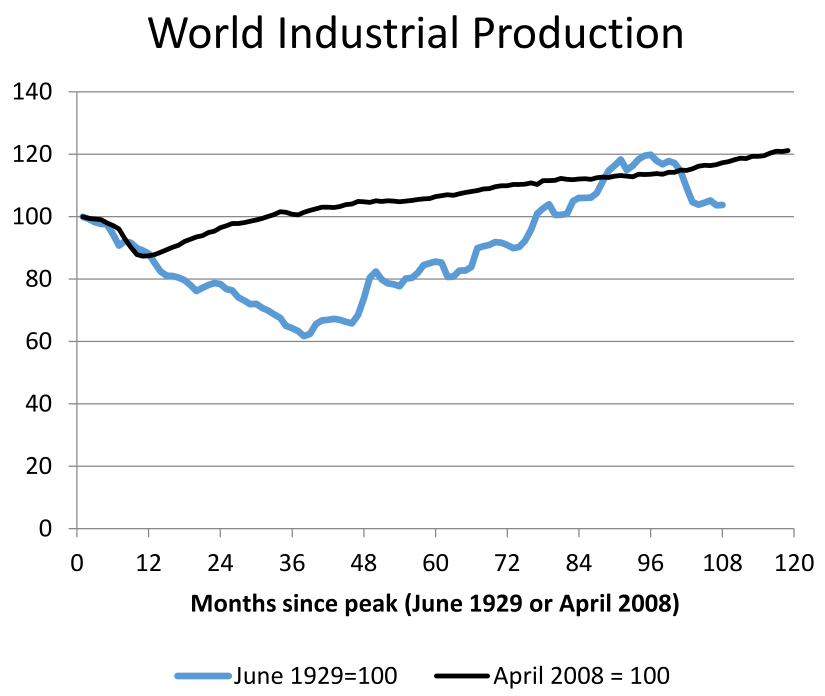
Global Financial Safety Net

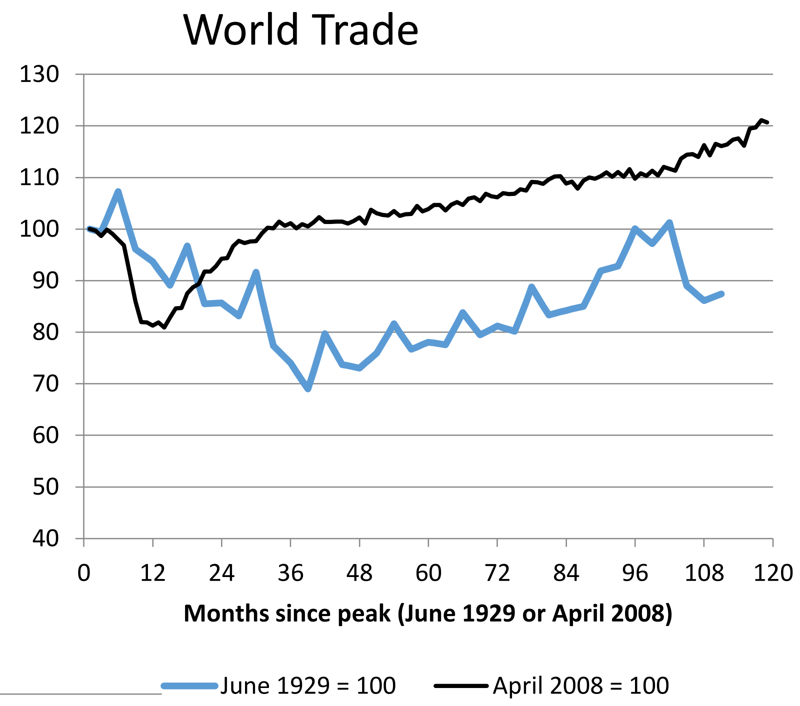
- International Monetary Fund (core outcome of 1930s):
  - stigma and uncertainty about conditionality (new non-conditional schemes expensive but not attractive)
  - bilateral focus of surveillance, advice
- National Foreign Exchange Reserves – global imbalances

- Regional Financial Arrangements: restricted, IMF Backstop
- Central Bank Swaps: restricted (Fed Swaps v PBoC Swaps)
  - Compare to 1970s: Multilateral swaps negotiated through BIS, Bilateral Fed Swaps


Federal Reserve Reciprocal Currency Arrangements (USD billion)
35
30
25
20
15
10
5
0
1962
1963
1964
1965
1966
1967
1968
1969
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
Jul-82
Oct-83
Oct-84
01/01/1985
31/01/1986
1987
31/10/1988
end 1997
1998


Federal Reserve Reciprocal Swap Arrangements
300
250
200
150
100
50
0
25
20
15
10
5
0
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
Jul-82
Oct-83
Oct-84
01/01/1985
31/01/1986
1987
31/10/1988
end 1997
2017 $b (share GDP equiv LHS)
Share of Global Reserves (RHS)





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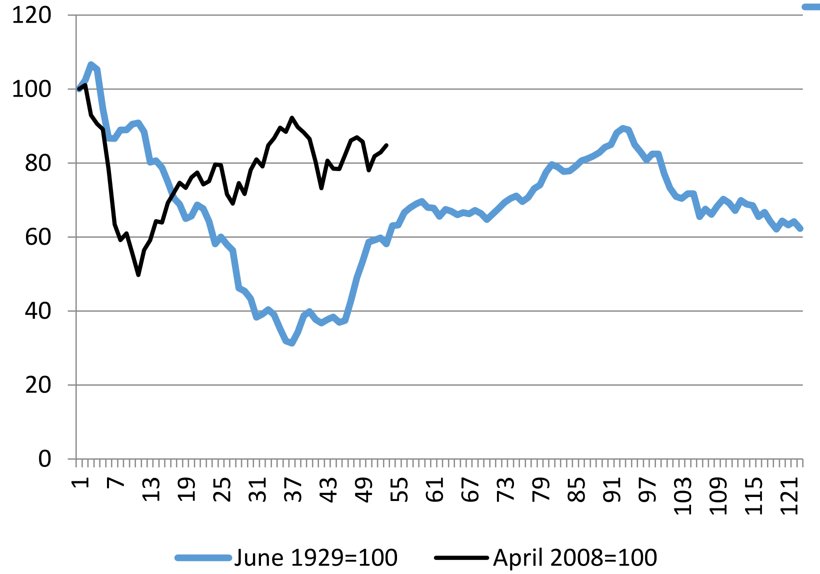

Global Equity Markets

Conclusions

- Important lessons were learned
  - Sustain global liquidity
  - Confident leadership and cooperation
  - Maintaining open markets for goods and capital
- Initial Success seemed to demonstrate distinctive nature of GFC2008 vs 1930s:
  - no currency wars or trade protectionism
  - success of G20
  - broader and more intense international financial architecture
- Ten Years After: time to reassess?
  - Economic nationalism, trade wars, currency wars, global financial safety net

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