Euler Hermes Economic Review: 10 years on from the Global Financial Crisis

Three things the world has done well and three goals yet to be achieved

PARIS – 11 AUGUST 2017 – Euler Hermes, the world's leading trade credit insurer, has issued an assessment of the progress the world has made a decade on from the onset of the Global Financial Crisis (GFC).

"After one of the most tumultuous decades in both living memory and by any historical measure, we are seeing overall global stability and economic recovery finally beginning to gather steam," said Ludovic Subran, chief economist at Euler Hermes.

"Many lessons have been learned since August 2007 and, even during the darkest hours of the GFC, there's been much that world leaders have done well. At the same time, 10 whole years on from the onset of the crisis, there's much still to be done to ensure that the world economy continues its upward trajectory and to ensure we're fully prepared to weather any future shocks," added Subran.

Three things the world has done well

1. World leaders managed to sit together and act with unity: the G20 set a precedent for emergency coordination of monetary and fiscal responses to the crisis and this unity and common purpose was a critical building block. Starting with the London Summit in 2009, the US set the tone with a $1.1 trillion stimulus to help avert the threat of global depression. World leaders did their utmost to give a global response to a global crisis, to keep each other appraised of developments and, importantly, spoke with one unified voice. This also laid the foundations for strengthened cooperation to help prevent future crises. At the same time, international gatekeepers such as the IMF were revived and repurposed to provide an invaluable financial safety net with members increasing its emergency lending capacity while reforming its governance structures.

2. Global financial regulation was strengthened: important macro-prudential and supervisory changes were adopted during this period. Firstly, capital requirements were established ensuring that a minimum common equity Tier 1 (CET1) ratio of 4.5% must be maintained at all times by banks. Secondly, an increased leverage ratio of over 3% was ushered in. Thirdly, liquidity requirements were increased. Basel III and Solvency II, as well as the EU Single Resolution Mechanism, were inherited from this new regulation paradigm. As a result, bank activity is now much less risky and more secure for consumers. In the US, the Volcker Rule against speculative investments and the Dodd-Frank Wall Street Reform and Consumer Protection Act secured the backdrop for the financial sector to play its critical facilitating role during the recovery.

3. The world learnt to stretch its thinking: stress tests were generalized and standardized during this period and financial sector communication was more rigorously scrutinized to deliver essential transparency. Endogenous and contagion risks were also looked at in detail. This was exemplified in the 'too big to fail' reforms, which identified systematically important financial institutions (SIFIs) and imposed on them higher capital adequacy requirements, more intense supervision and better tools for resolution, including the establishment of the Financial Stability Board in Basel.

Three things the world still needs to achieve

1. The world needs to revive preventive multilateralism: it appears that world leaders only meet and truly make progress in times of crisis. The G20 has, arguably, lost some of its lustre in recent years while risks have increased. From the major debt overhang to experimental monetary policy, to political risk and protectionism, including financial protectionism, the world must address looming challenges proactively to avoid further divergence. Multilateral bodies must advance policy coordination, avoid half-baked reforms such as the generalization of resolution mechanisms that protect taxpayers, a so-called "bail-in", and continue to promote responsible use of, and access to, finance, while standing ready and prepared for the next crisis.

2. We must improve regulation, together: the recovery in the banking system has been unequal. Some banks remain undercapitalized while non-performing loans plague the balance sheets in southern Europe, for example. In addition, asset ring-fencing has increased the linkage between banks and governments. In the US, financial regulation may be overhauled at a time of unprecedented liquidity, creating new financial risks. Indeed, an asymmetric regulation nudge could create unnecessary competition, excessive speculation and moral-hazard type behaviors. Regulatory blind spots are many - for example, shadow banking, especially in emerging markets and unfunded liabilities in state pension funds - while excessive regulation has also fueled the savings glut and hindered investment growth.

3. Behaviors must change: financial stress is evident everywhere, from household debt levels to the sovereign bond markets, to bubbling asset classes. As a result, complexity and over-engineering can give a false sense of security. There will always be unknown unknowns. Simplicity, critical thinking and in part, self-regulation should complement an often late in nature regulatory change.

This last point is critical for future success, according to Ludovic Subran, who adds, “Too many rules often mask a lack of trust and purpose; yet both are paramount as finance is a good servant but a poor master.”

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