

Ten Years After the Crash

Published on: 13 September, 2018 | Author: Investment Team

Zhou Enlai, the first Premier of the People's Republic of China was asked what he thought the significance of the French Revolution was for Western civilisation. He thought for a moment and replied: "it's too early to tell."

Ten years after the global financial crisis what are the lessons for us to learn or is it still too soon to tell?

As a team we found ourselves at Tacit Investment Management right in the middle of the turmoil as it unfolded. We heard on good authority that key figures including the US President had little or no knowledge of the global financial system.

Henry Paulson, US Treasury Secretary at the time, is reported to have gone on bended knee in the Oval Office to secure the basics of TARP and TALF. Carefully explaining the immediate need to shore up America's financial system and introduce a loan programme for investors of AAA-rated securities to thaw out frozen commercial mortgage-backed securities. In addition we discovered that there were also Chief Executives in the banking system who knew little or nothing about the assets they carried on their balance sheets.

Acronyms were liberally splashed about in an attempt at explanation. CLO's, CDS, super senior tranches, CDOs, CDO squared. Then shadow banking and 'originate and distribute' became common threads in this panicked and febrile atmosphere. Even some cash funds 'broke the buck' and became in Americanese illiquid and unrealisable. As has happened before so called financial titans were revealed to have feet of clay. A key lesson for us all to learn was to stay sceptical.

It quickly became clear that the global payments system was on the point of collapse. No bank institution had the confidence to engage in financial transactions because trust in their counterparts had all but evaporated.

At such a time credit literally and quickly dries up. Linguists tell us the root of the word credit is creditum 'to believe.' And there was no belief left. Credit is the lifeblood of a modern economy. When it fails so does the economy. It really wasn't hyperbole to say that the world economy was hours away from a new Dark Age. Key lesson two? Banking is too important to be left to the bankers.

In the intervening years some things have changed. Today banks are better capitalised and assets are ring fenced. Directors of banks are now required to know something about banking.

But perhaps the most important lesson of the multiple crises that followed the implosion of Lehman Brothers was that financial imbalances eventually revert to balance. Although sometimes with explosive reaction.

One of the key risk measures we now look out for at Tacit are signs of financial imbalances. That is excessive credit and debt, trade deficits, dependence on rolling over short term financing as well as vendor financing schemes.

Like Zhou Enlai it's still too early to know the full impact of the global financial crisis.

The imbalance today concerns wealth and income. Since the crisis, incomes have stagnated across the developed world and remain below where they should be relative to their pre-crisis trends.

If Economics is about optimising production, Politics is about distributing it. Today the economic scars of the crash have mostly healed but with the antics of President Trump, Brexit, Cinque Stelle Movimento and Alternativ fur Deutschland distributional issues are now driving events.

It means we believe that there's a real risk of old scars opening up to damage an economic recovery that's long been awaited and so far, has been extremely hard won.

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