

Report to G20 summit glosses over problems in global financial system

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Sometimes it is hard to know whether statements issued by financial authorities are aimed at fooling themselves, the organisations to which they are being delivered or whether, they consider it best not to say too much in public documents lest this “frightens the horses.”

This is the case regarding the letter issued by the Financial Stability Board (FSB), the world’s major financial watchdog, under the name of its chair Klaas Knot, to the summit meeting of G20 leaders that begins in New Delhi at the weekend.

Knot began with a warning that global economic recovery is “losing momentum” and the rise in interest rates in major economies is being increasingly felt, but that so far the banking system had remained resilient overall. This, he claimed, was due not least to the “strong bank capital buffers introduced by the post-crisis G20 reforms.”

The March banking sector turmoil saw three of the four largest bank failures in US history, as well as the collapse and takeover of Credit Suisse. It was a “test” for the financial reforms put in place after the global financial crisis (GFC) of 2008 and one that they passed, at least according to Knot.

Individual cases of banking sector stress, he wrote, were a stark reminder of the “speed with which vulnerabilities can be exposed in the current environment.” However, he concluded it was encouraging and a testament to the G20 reforms “that the strains faced by individual banks did not cascade into a full-blown crisis.”

In fact, any objective assessment reveals that the G20 reforms completely failed the test.

In the case of the US, depositors, including wealthy individuals and corporations with the three failed US banks—Silicon Valley Bank, Signature and First

Republic—had to have their money guaranteed by US authorities. Not to have done so could have sparked a “systemic crisis.”

With the demise of Credit Suisse, the failure of the international resolution framework, the so-called reforms, was even more apparent.

In a deal arranged by the Swiss National Bank and the Swiss government, Credit Suisse was taken over by UBS in a deal which contravened all the regulations and agreements, designated as “resolution,” made after the GFC.

This was openly admitted at the time. Swiss National Bank chairman Thomas Jordan said “resolution” would have risked a systemic crisis.

“Resolution in theory is possible under normal circumstances, but we were in a fragile environment with enormous nervousness in financial markets in general. Resolution on these circumstances would have triggered a bigger financial crisis, not just in Switzerland but globally,” he said.

In other words, resolution would work when it was not needed but not in a situation with which it was supposed to deal.

The same point was made by Swiss finance minister Karin Keller-Sutter. She said that acting according to the emergency protocols drawn up for the failure of major banks “would have triggered an international financial crisis.”

She had concluded that a major globally important bank could not be wound up according to the G20 protocols.

Ignoring the experiences of March, Knot said he remained “convinced that the international resolution framework developed by the FSB in the aftermath of the 2008 GFC is fit for purpose.”

However, he noted that “further strains in financial

markets cannot be ruled out in the months ahead as higher debt servicing costs continue to permeate the economy.”

At the same time, the financial system is “in the midst of deep structural change, including the need to respond to accelerating digitalisation and to climate change risks.”

One of the “key trends” in recent years has been the increased importance of non-bank finance intermediation (NBFI), sometimes known as the “shadow banking” system, which has diversified sources of borrowing, but also has led to a build-up of debt.

“If not properly managed, leverage can amplify stress in the event of a shock and lead to systemic disruption, as demonstrated by recent strains in commodities and bond markets.”

But management requires accurate information and data otherwise the would-be regulators are working in the dark. The IMF has admitted that there are major areas of NBFI about which it knows next to nothing.

Knot made his reference to this problem as mild as possible.

“NBFI leverage can take different forms and is often difficult to identify or measure, which complicates the assessment of associated vulnerabilities,” he said.

The best he could come up with was a report to the Summit on trends in this area identifying “possible actions” to fill key data gaps and that would “address associated vulnerabilities.”

The only conclusion to be drawn from these remarks is that at present the FSB and every other financial authority is flying blind.

The key area of digitalisation is the emergence of crypto assets. Knot wrote that a number of incidents over the past year had “highlighted the vulnerabilities in the crypto-asset eco system, which warrant close monitoring given the growing linkages with the traditional financial system.”

He explained that the “interconnectedness of the global financial system makes it possible that a cyber incident at one financial institution, or an incident at one of its third-party providers, could have spill-over effects across borders and broad sectors.”

Climate change also posed risks to the financial system because “recent weather events have shown the potential for non-linear effects,” that is, economic

consequences which far outweigh expectations and thereby feed into the financial system.

In conclusion, Knot warned there were certain to be challenges and shocks for the global financial system in the months and years to come, and it was “possible” that action by authorities could absorb rather than amplify it. In words, in the event of more shock, authorities may be able to contain it but that is no certainty.

Overall, the picture presented by this report, from what the *Financial Times* described as “the world’s most powerful financial watch dog,” is one in which the agencies of the capitalist ruling class know their financial system is riddled with potential sources of crises. But they have no real idea from where the next one might strike much less what to do about preventing it.



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