Keynote address: Have we fixed the fractures in the global financial system revealed by the financial crisis

Howard Davies
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Have we fixed the hidden fractures in the financial system?

Howard Davies
Chair – RBS
Professor – Sciences Po

FSI 20th Anniversary
13 March 2019, Basel
Consensus on the policy response to the crisis remains elusive

Three songs are sung:

1. We don’t need no education...
   Hey, teachers, leave us kids alone (*Pink Floyd*)
Bank capital has risen

Global average Tier 1 capital ratios 2006-17, %

- 2006: 9.5%
- 2012: 12.1%
- 2017: 13.2%

1 Based on a sample of ~1,000 largest banks globally in terms of assets.
2 Eastern Europe, Middle East and Africa.
Source: SNL; Thomson Reuters; McKinsey Panorama

Source: McKinsey 2018 'New rules for an old game: Banks in the changing world of financial intermediation'
RBS managed a unique full house of problems

Source: Financial Times
Consensus on the policy response to the crisis remains elusive

Three songs are sung:

1. We don’t need no education...
   Hey, teachers, leave us kids alone (*Pink Floyd*)

2. Towers of gold are still too little
   Their hands could hold the world but it’ll
   Never be enough (*Loren Allred*)
Market measures of equity capital suggest limited improvement

Source: Larry Summers 2017 ‘Increased Capital and Financial Stability Some Doubts’
Banks remain weakly profitable and poorly rated by investors

Source: McKinsey 2018 ‘A decade after the global financial crisis: What has (and hasn't) changed?’
Consensus on the policy response to the crisis remains elusive

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3. Close the door, they’re coming through the window *(Strargazers)*
Other Financial Institutions are growing fast


1 Some exchange rate effects have been netted out by using a constant exchange rate (from 2017).

Sources: Jurisdictions’ 2018 submissions (national sectoral balance sheet and other data); IMF World Economic Outlook; FSB calculations.
The Eurozone and the US dominate

With investment funds of various kinds most prominent

Leveraged loans are becoming riskier

Source: Mark Carney BoE Feb 2019 – ‘The Global Outlook’
Corporates are borrowing more from the markets

Source: McKinsey 2018 ‘A decade after the global financial crisis: What has (and hasn’t) changed?’
Chinese credit growth has slowed

Source: Mark Carney BoE Feb 2019 – ‘The Global Outlook’
Overall, public debt remains high

Public debt increased rapidly after the crisis in advanced economies.

Source: McKinsey 2018 ‘A decade after the global financial crisis: What has (and hasn’t) changed?’
We can find many other risks if we wish to look

- Cyber security threats
- Fintech disruptors
- Big Tech entrants hollowing out the banking system
Indices of global economic policy uncertainty are at record highs

Standard deviations from historical average

Sources: Bloom et al (2015)² and Bank calculations

Source: Mark Carney BoE Feb 2019 – ‘The Global Outlook’
But the biggest concerns may lie in the policy arena:

- Policy uncertainty is at a record high
- The opportunity to strengthen the foundations were missed
- Policy co-ordination remains weak
- The scope for dangerous errors has grown
‘Global Banking Regulation: The Limitations of Voluntarism’
by
Howard Davies and Dr. Maria Zhivitskaya
forthcoming in April 2019
Policy errors have become more likely

- Tariff wars
- Brexit could disrupt European capital markets
- Central Bank Independence under threat in many countries
In most of Europe unemployment has remained high, and populist parties have benefited
Do you agree that it is desirable to maintain central bank independence in the future?

Source: LSE (2017) - Is the era of central bank independence drawing to a close?
Do you agree that central bank independence in the Eurozone & the UK will decline over the next 48 months?

Source: LSE (2017) - Is the era of central bank independence drawing to a close?
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