

CARI-OMFIF Forum
Lessons Learned from Financial Crises:
Implications for the Global, Asian and ASEAN
Monetary Systems

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Andrew Sheng
Chairman
Khazanah Research Institute

Paradigm failure in Disrupted world, serious blindspots, flawed diagnosis and bad prognosis

- Rise of three 1.3 billions (China, India and 1.3 billion Muslims) shifted unipolar order to multipolar system
- Neoliberal market mindset saw order as linear, self-equilibrating, mechanical and perfect, but policy is implemented in silos - national policies that do not take into consideration globalization/systemic effects; departments that implement conflicting policies, often with gaps.
- World is transiting to New Complexity that is dynamic, non-linear, interdependent and interconnected - ever evolving.
- Policy-making needs systemic (holistic) view that these are made in sub-systems operating within larger systems, with feedbacks and interactions that create non-zero sum games. Policies accentuate cyclical outcomes with cyclical swings of either pro-cyclical growth or secular stagnation/recession.

What did AFC and GFC reveal? - Four Mismatches and Bad Paradigms

- **Maturity Mismatch**
- **FX Mismatch**
- **Debt/Equity Mismatch**
- **Mismatch between theory and practice (Paradigm shifts)**
 - **Theory blindspots to Politics, Climate Change, Technology, Key role of State, Social Inequality, Capture (Greenspan Put, Rubin trade, Draghi bluff)**
 - **Bad solutions (QE) inevitable due to unwillingness to use painful fiscal/bankruptcy tools, which gave central banks the carte-blanche right to print money, moving to negative real interest rates that transfer crisis losses from borrowers to savers**

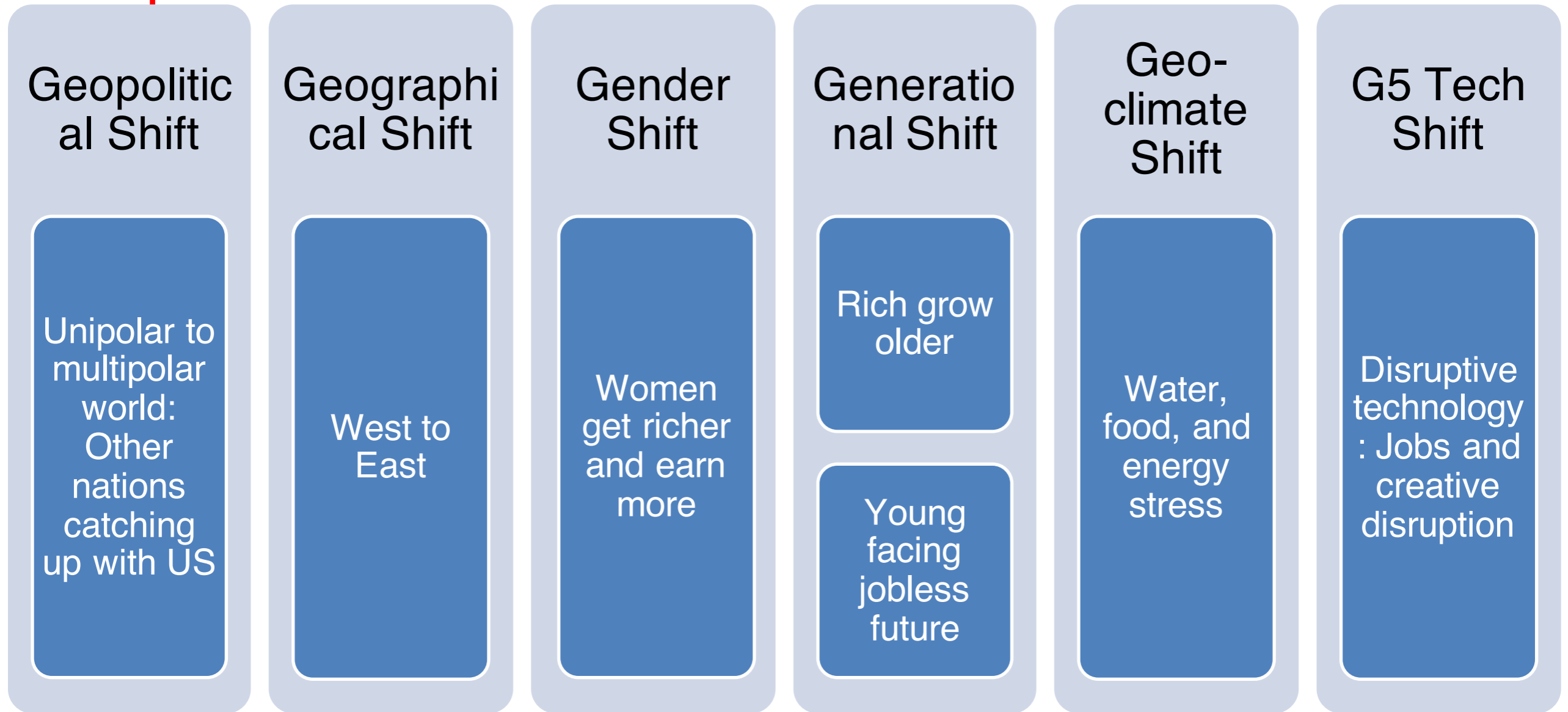
1997/98 Asian Financial Crisis

- **Maturity Mismatch** - Asian corporations borrowed short-term bank loans to finance long-term investments (real estate etc)
- **FX Mismatch** - also borrowed US Dollars to finance local currency loans - Net Financial Liabilities of Crisis nations over 50% of GDP, central banks ran out of FX reserves, massive devaluation made FX borrowers bankrupt
- **Debt/Equity Mismatch** - Asian corporations were highly geared; believed that Asian growth story would continue, despite under-developed equity and long-bond markets
- **Paradigm mistakes** - Asians believed that with US\$ zone, Fed would lend; IMF under Washington Consensus ideology/Two Gap Model worsened crisis by asking for increase in interest rates, cuts in budget and devaluation

2007/9 Global Financial Crisis (Technically North Atlantic)

- **Maturity Mismatch** - European banking systems, lending to PIGS real estate etc;
- **FX Mismatch** - PIGS central banks could not create Euro to relieve domestic banks of liquidity; needed ECB liquidity creation. European banks borrowed USD inter-bank to speculate in derivatives in US markets - when crash came, Fed had to give swaps to ECB to rescue European banks in US markets
- **Debt/Equity Mismatch** - evident in undercapitalization of banks generally, and especially for Prime Brokers (Lehmans etc).
- **Paradigm failure** - Assumed that with monetary stability, financial stability would follow; did not see massive inter-connectivity/hidden leverage of complex derivatives, hidden by off-balance sheet and offshore accounting (special vehicles, AIG etc)

Free Market Ideology did not factor in 6G mega-trend disruptors



A single factor is complex enough, but all are interacting in combination to produce very complex outcomes and Black Swans

Huge challenges to policy and business models, as America First means no more level playing field. Everyone for themselves.

Policy-making is still in silos, National instead of Global; Departmental/Local instead of National

- **Specialization and academic bias** in policy formulation creates silos - deep but partial; ignored systemic externalities and that partial systems don't add up
- **Silo effect creates gaps, overlaps and policy paralysis** - inefficiency, blindspots, insufficient attention to feedbacks, policy lags and data deficiencies.
- **Silos also subject to intellectual, political and regulatory CAPTURE**, with fragmented regulatory agencies defending their turf and industry to protect vested interests
- **Biggest partial blindspot is impact of globalization** on domestic imbalances and inequities, hence voter shift to populism

Choice of Policy Tools to Achieve Policy Objectives

1. **Monetary Policy** - affect price levels, including money
2. **Regulatory Policy** - competition, financial stability, consumer protection
3. **Fiscal Policy** - taxation and government spending
4. **Structural Reforms** - labour, infrastructure, education, R&D etc
5. **Bureaucratic effectiveness/Governance** - anti-corruption, incentives, policy capture, implementation capacity
6. **Trade/Foreign Policy** - Openness versus Protectionism, including for immigration and skills imports

Too much blamed on Uncertainty - Unknown Unknowns

- Uncertainty does not mean we cannot see future – **Gray Rhinos** (High Probability, High Impact) and **Black Swans** (low probability, high impact) events mean that we need to manage system stability in very different ways
- **Law of Unintended Consequences** is actually flaw in knowledge and Uncertainty. Over-use of Monetary Policy and Financial Regulation because these are politically more palatable. QE has huge distributional and productivity side effects.
- Protectionist mode due to populist dissatisfaction + Disruptive Technology Job loss mean that Cheap Labour Export Policy is now not viable for many EMEs.
- If trade war leads to global recession, then country with large domestic consumption, highest capacity to reform (raise productivity) and ability to remain open to trade, talent and R&D will be winner. .

Thank you

Q&A to
altsheng8@gmail.com
and
www.andrewsheng.net