No.76

Eyes of IIMA Institute for International Monetary Affairs

2016.12.12

Be Watchful for The Year Ending with Number 7
Is it by an Accident or of a Necessity
that an International Financial Crisis Occurs in Every Decade?

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A well-known Japanese proverb says that what occurs twice will occur thrice and this refers to a repeatability of things. The author has long recognized it was an Oriental saying derived from a Buddhism concept of metempsychosis, but I found the same expression in English and noticed that the concept seems to be common to all countries.

This saying can also be applied to the current world of international finance and economy. For instance, while some people theoretically explain the cyclical factors for business cycles like Kitchin Wave (short-term phenomenon that focuses on inventory changes), Juglar Wave (mid-term cycle that focuses on the capital investment) and Kondratieff Wave (long-term cycle that focuses on technical innovation), there are phenomena that happen at regular intervals with no identifiable causes. I would like to cite as a latter case the phenomena that an international financial crisis has occurred in the years ending with the number 7.

Year	Popular (reference) name of crisis	Major Developments	Causes and Backgrounds
1987	Black Monday	・NY Dow 30 Average drops by 22.6% d/d ・Global Stock Selloff (Nikkei 225 drops 14.9% d/d)	① Bigger US Trade deficit than expected. ② Widespread forecast of US rate hike to address the lower dollar FX rates after the Plaza Accord. ③ Change of Fed Chairman from P. Volcker to Alan Greenspan two months before the Black Monday
1997	Asian Currency Crisis (1998 Russian Ruble Crisis)	Financial and economic crises triggered by selloff of Asian currencies by institutional investors headed by Hedge Funds	① Ballooning current account deficits financed through short-term borrowing under the dollar-peg system ② Delayed improvement of financial system in the affected countries
2007	Sub-prime Loan Problems (2008 Lehman Bankruptcy)	・Housing loan assets to low/middle income class went bad after the bubble burst of the US housing market. ・Bankruptcy of financial institutions that held such assets and related structured assets	① Characteristics of sub-prime loans as a derivative ② Incorrect ratings on the borrowers ③ Spread of the risks to nationwide and overseas through securitization of the assets

As the Table above shows, this phenomenon started in 1987 and following it we had a historic crisis in 1997 and 2007, namely, once in every decade.

Needless to say, the international financial institutions and government authorities in individual countries have not stayed without doing anything. They carefully analyzed and examined the causes of the crisis and introduced various regulations and new standards while strengthening their individual efforts on supervising the financial institutions so that the similar crises would not be repeated.

Especially, when the subprime loan problems happened in 2007, regulations were reinforced and expanded at an unprecedented scale to address the emergence of financial crises that were accompanied by rapid global credit contraction, reflecting on the “Too Big to Fail” problem where moral hazard could be rather created on the financial management because of the presumption that even large global financial institutions would be saved by the government when they faced with a crisis of bankruptcy.

Year	Popular Name (reference) of crisis	Major Countermeasures Taken
1987	Black Monday	・July 1988: Adoption of Basel I Accords ① Unification of setting method of banks’ capital adequacy ratio. ② Adoption of minimum level of requirement (8%)
1997	Asian Currency Crisis (1998 Russian Ruble Crisis)	・October, 1998: New Miyazawa Initiatives announced. Japan’s Contribution of $30 billion to support Asian countries affected by the crisis ・May 2000: Establishment of Chaing Mai Initiative (CMI) Comprehensive cooperative arrangement that includes a network of bilateral swap arrangements (BSA) ・August 2003: Agreement of Asian Bond Market Initiative (ABMI)
2007	Sub-prime Loan Problems (2008 Lehman Bankruptcy)	・September 2009: Declaration of G20 Pittsburg Summit and others ① Reform of OTC Derivatives Markets Introduction of obligation for derivatives contracts to be cleared through central depository parties and application of higher margin requirements for non-centrally cleared contracts ・July 2010: Enactment in the US of Dodd-Frank Wall Street Reform and Consumer Protection Act (Comprehensive financial regulation reform act) ① New establishment of Financial Stability Oversight Council (FSOC) ② Introduction of Volcker Rule (rules that in principle prohibit banks from making high risk trading and investment in funds) ③ Regulation on Foreign Banking Organizations (FBO) (Strengthened oversight and regulation on the major banks operating in the US and overseas) ・September 2010: Adoption of Basel III (to be fully implemented by 2019) ① Reinforcement both in quality and quantity of the numerator (equity capital) in the capital adequacy ratio ② Review of calculation method for the denominator (risk assets) in the capital adequacy ratio ③ Introduction of Liquidity Coverage Ratio (LCR) ④ Introduction of Net Stable Funding Ratio (NSFR) ⑤ Strengthened regulation over large exposures ・October 2011: Financial Stability Board (FSB)

		① Publishes Recommendations of the FSB on "Shadow Banking: Strengthening Oversight and Regulation" ・November 2011: FSB ① Specification of "Global Systemically Important Financial Institutions (G-SIFIs)" ② Requites G-SIFIs to make additional increase of capital requirement and improve the framework for failure resolution to keep the disturbances to the minimum. ・November 2015: FSB ① Announces a concrete level of "Total Loss Absorbing Capacity (TLAC)

Have these regulations, then, reduced to zero the possibility of future recurrence of financial crises? Unfortunately, the answer is "No."

In addition to the progress of globalization, in an environment where the amount of money in circulation has grown more rapidly than the real economy has needed, over-regulation of the financial institutions and financial systems could rather bring a higher volatility in the foreign exchange and interest rate markets through lower market liquidity.

Furthermore, human beings are originally greedy. Even with these regulations, there will inevitably emerge someone who tries to make profits by finding some means to avoid or transcend the regulations

The financial innovation that makes full use of modern IT technology and financial engineering, could also have a sufficient chance to become one of the factors that create a new financial disturbance, as it was the case with the pre-Lehman crisis days, by producing new financial instruments that hollow out the existing regulations and supervision, or otherwise by creating a shadow banking.

Finally, I would like to introduce our statistics of IIMA-GMVI[1] (IIMA-Global Market Volatility Index) that this institute compiles and publishes daily. This is a volatility index that integrates the indexed volatilities of major foreign exchange, bond and stock markets in the world. Experience tells that the volatility Index rises rapidly within two years after the Index goes below the value of 2. In the recent past, despite the Trump Shock, the Index remained at a low level of 2.41 as of December 9th after it fell below the 2 value line in early October.

Of course the author considers it desirable to have a continued stability in the international financial architecture and system. However, the past experience and timing of financial crises warns us that we had better to prepare for any recurrence of a financial crisis in 2017.

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1 http://www.iima.or.jp/Docs/ppp/index/kaisetsu.pdf (in Japanese)