



FINANCIAL
TIMES

The future of Finance

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Financial Times

Norwegian Savings Banks Association

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The future of finance

“The ATM has been the only useful innovation in banking for the past 20 years.”

Paul Volcker, .2009

The future of finance

“We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next 10. Don’t let yourself be lulled into inaction.”

Bill Gates.

The future of finance

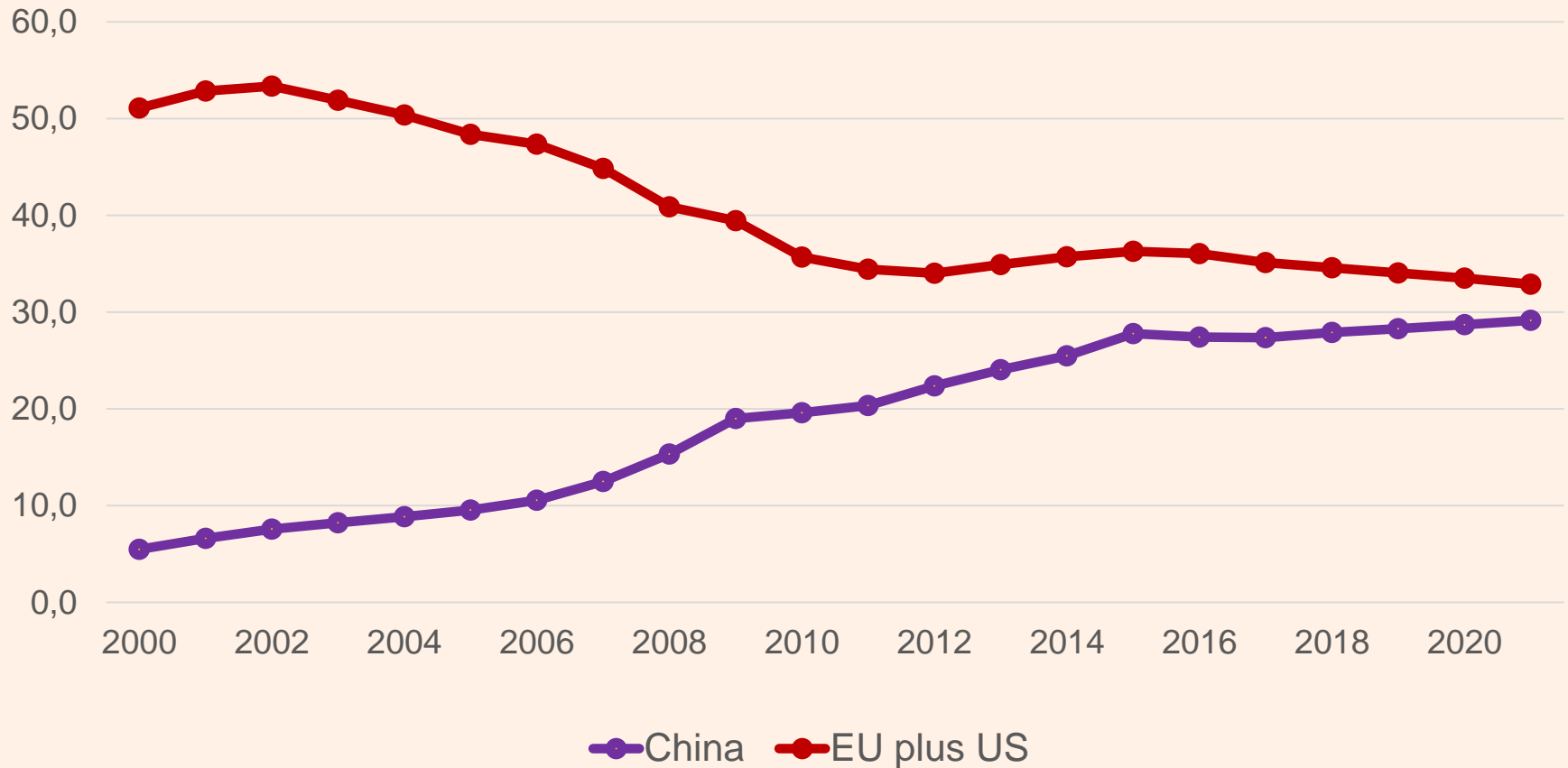
- How is the world changing?
- Is finance now safe?
- How is finance changing?
- Conclusion

1. How is the world changing?

1. China
2. Technology
3. Indebtedness
4. Crisis
5. Populism - living dangerously

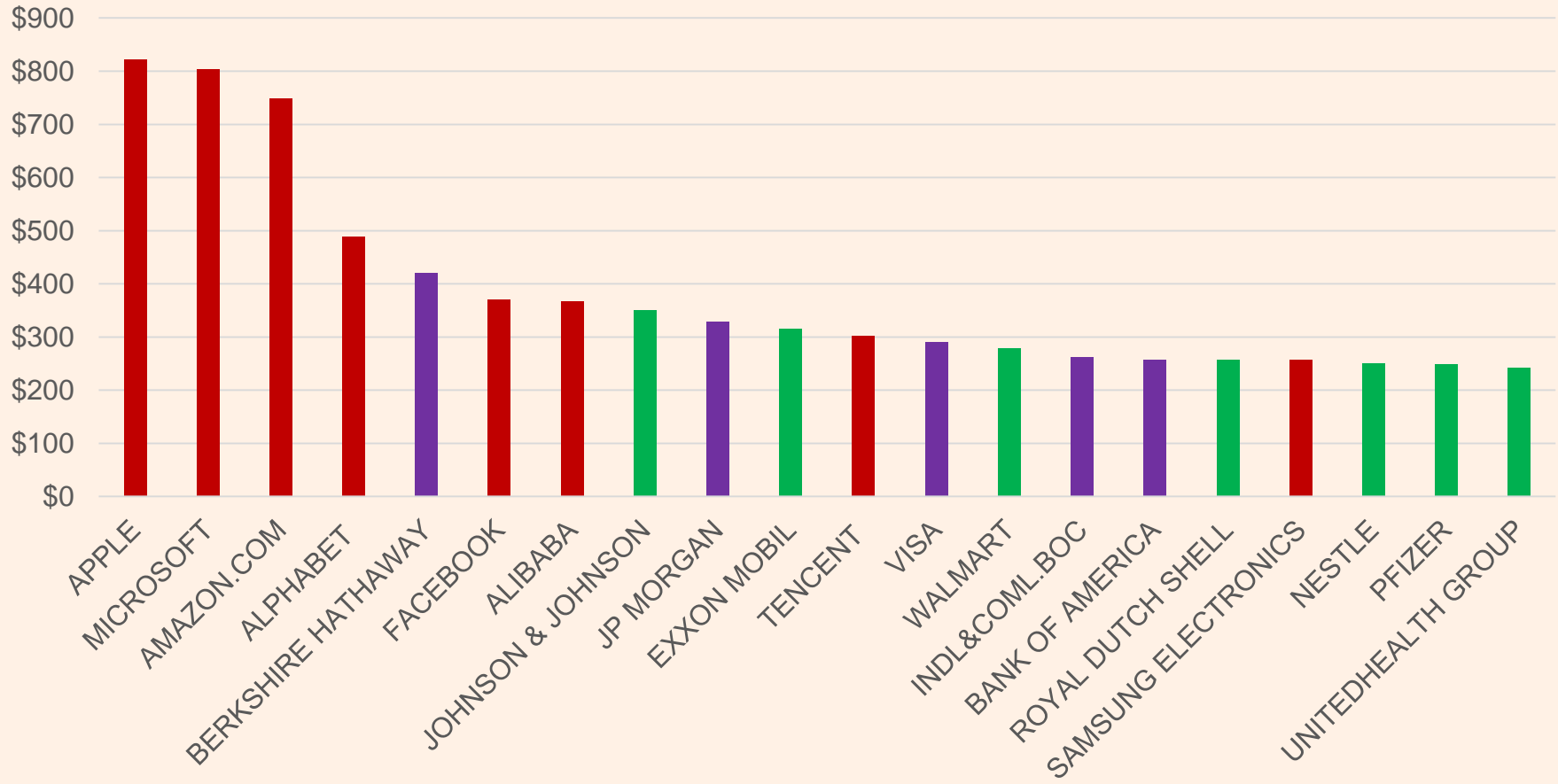
1. How is the world changing? China's savings

SHARES OF GLOBAL SAVINGS (IMF)



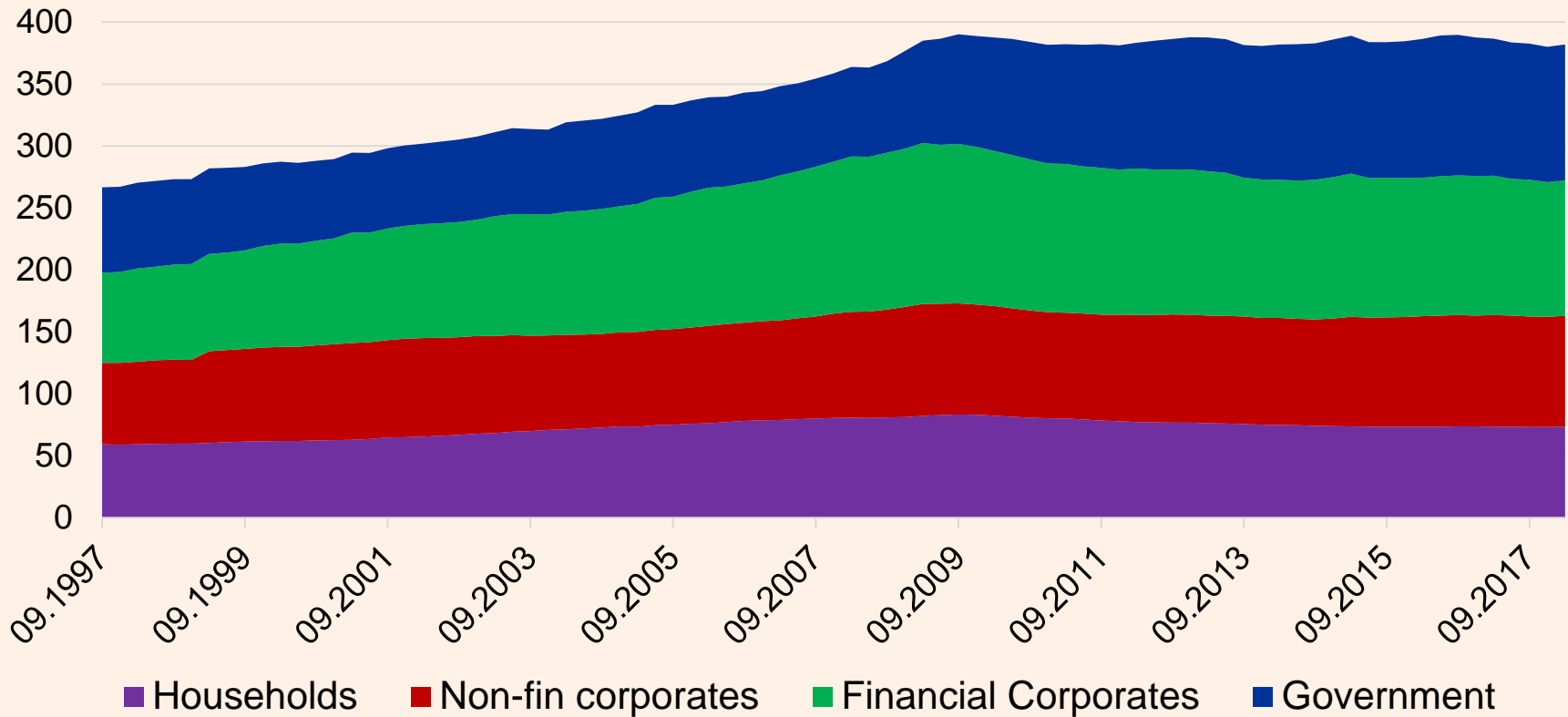
1. How is the world changing? Technology soars

MARKET VALUE (\$tn, as of 26 October 2018)



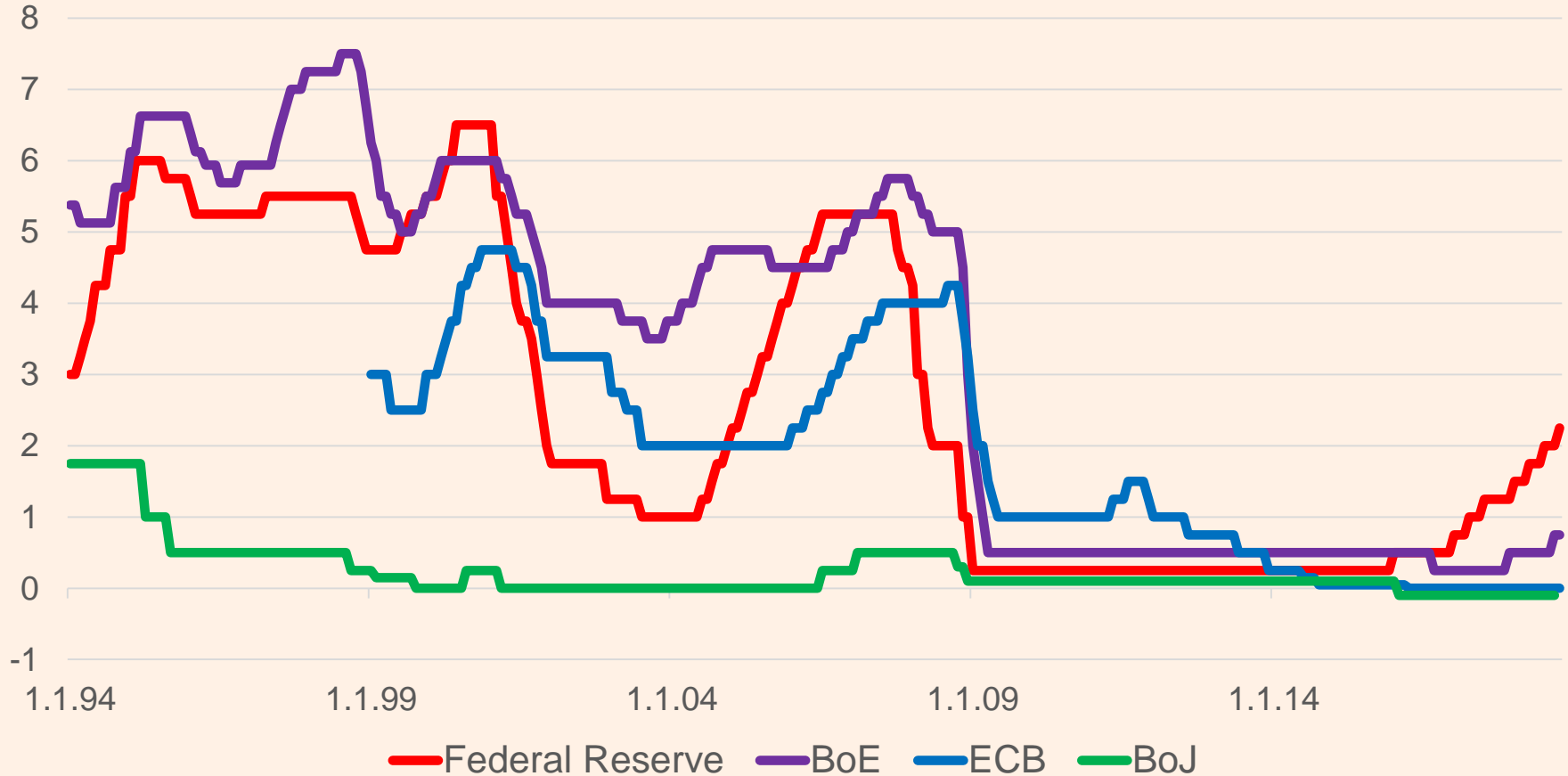
1. How is the world changing? Debt's rise

SECTORAL DEBT OVER GDP IN MATURE MARKETS
(per cent)(Source: IIF)



1. How is the world changing? Rescue

CENTRAL BANK INTERVENTION RATES



1. How is the world changing? Populism rises

GERMANY - ITALY 10-YEAR BOND SPREAD

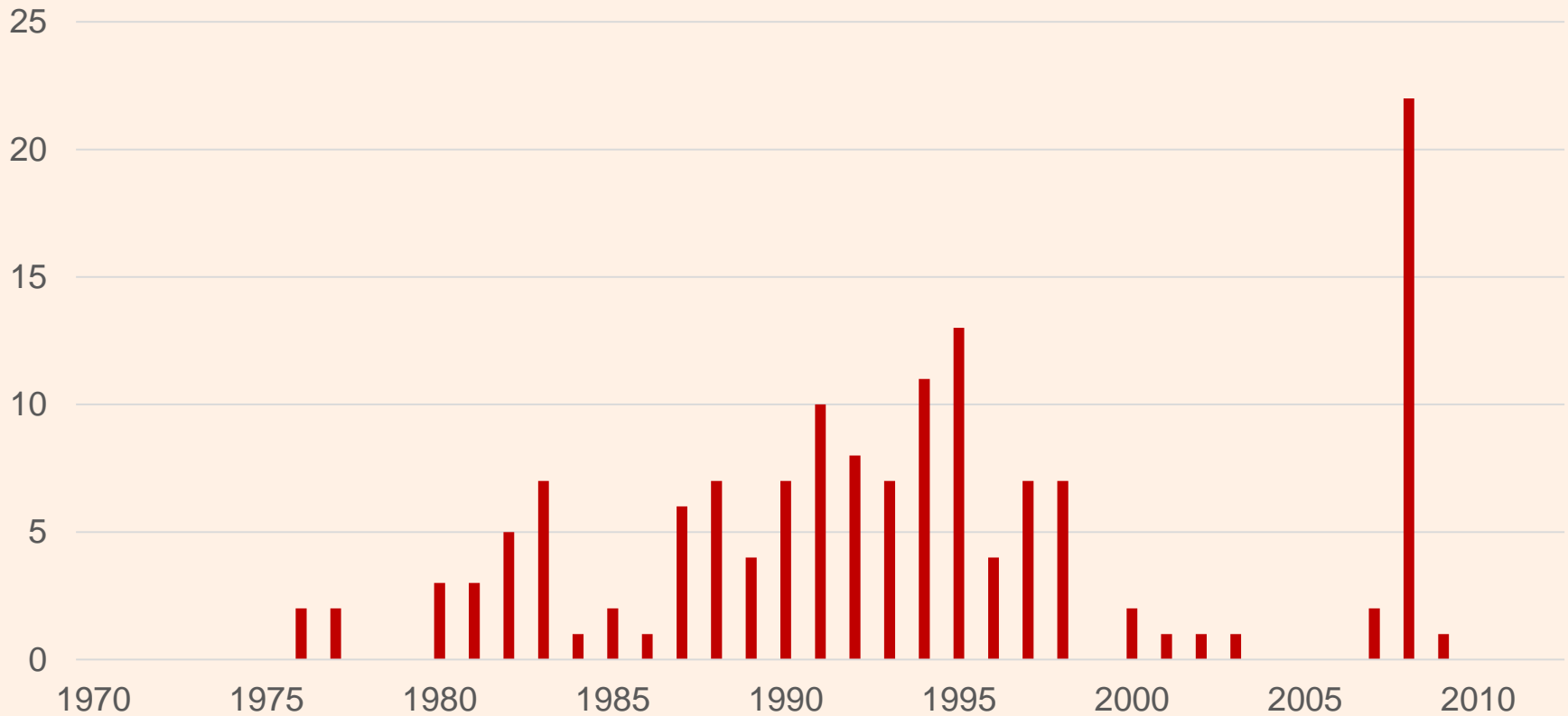


2. Is finance now safe?

- The financial crisis of 2007-09 was arguably the biggest in history. Governments put their entire balance sheets behind the financial system. This is a scandal.
- Although the biggest crisis since the Great Depression, there have been many others. While less significant, these, too, were very costly.
- So have these problems been fixed?
- The answer is that finance is safer, but it is not - and cannot be – safe
- The global financial crisis was largely due to fundamental mistakes. According to Mark Carney, governor of the Bank of England, those were:

3. Is finance now safe? Frequency of banking crises

147 BANKING CRISES
(number of countries affected)(World Bank)

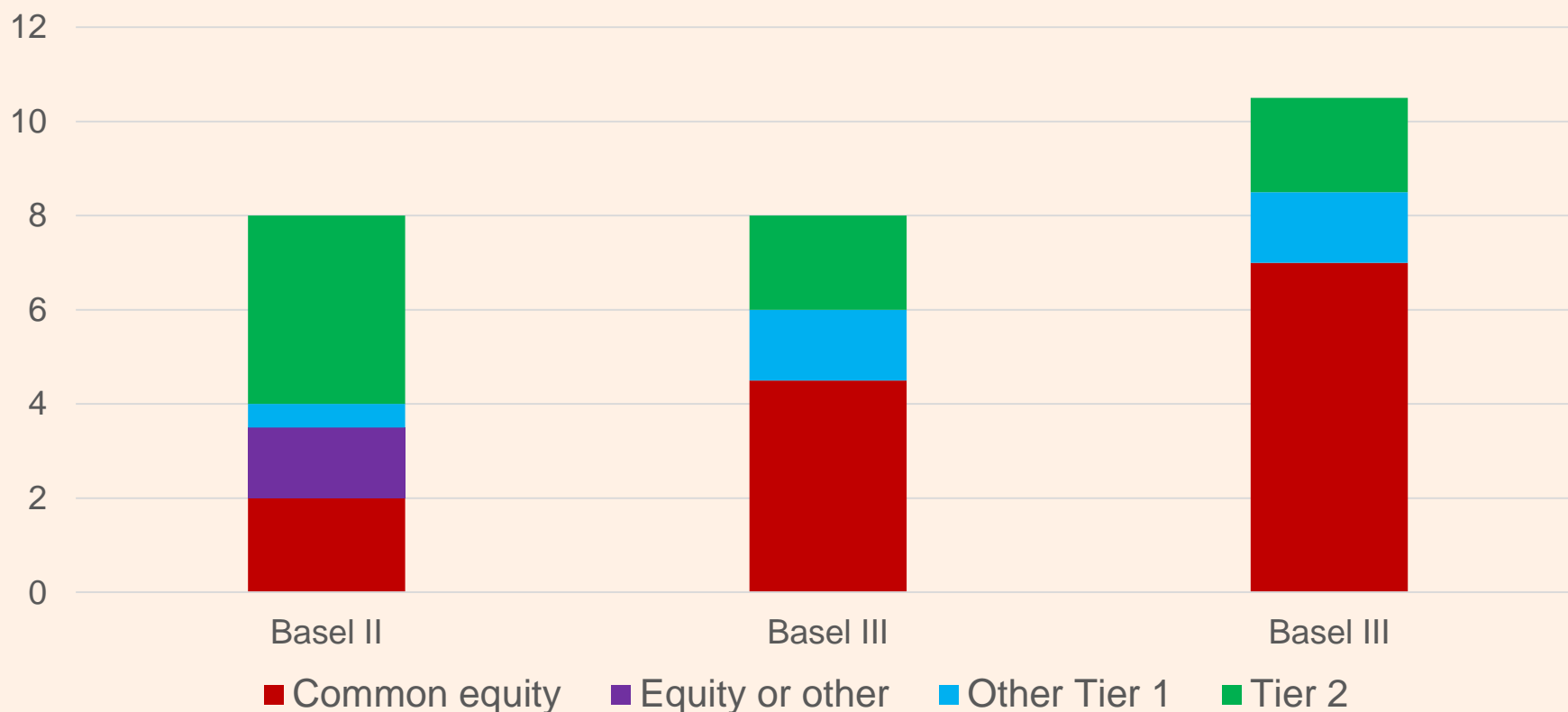


2. Is finance now safe?

1. “This time is different”
 2. “Markets always clear”
 3. “Markets are moral”
- So have these at least been fixed?
 - Certainly a great deal has changed:
 1. On market morality, there are new compensation rules, including claw-backs.
 2. On failures of markets, OTC markets are more transparent and safer, central counterparties now exist, toxic shadow banking has been curbed, and money market funds and repo markets are now regulated. But \$30tn is now held in illiquid assets of asset managers that promise daily liquidity.
 3. On “this time is different”, there are higher capital and liquidity requirements, tougher requirements for G-SIBs, resolution, stress tests and, perhaps most important, a macroprudential policy framework.

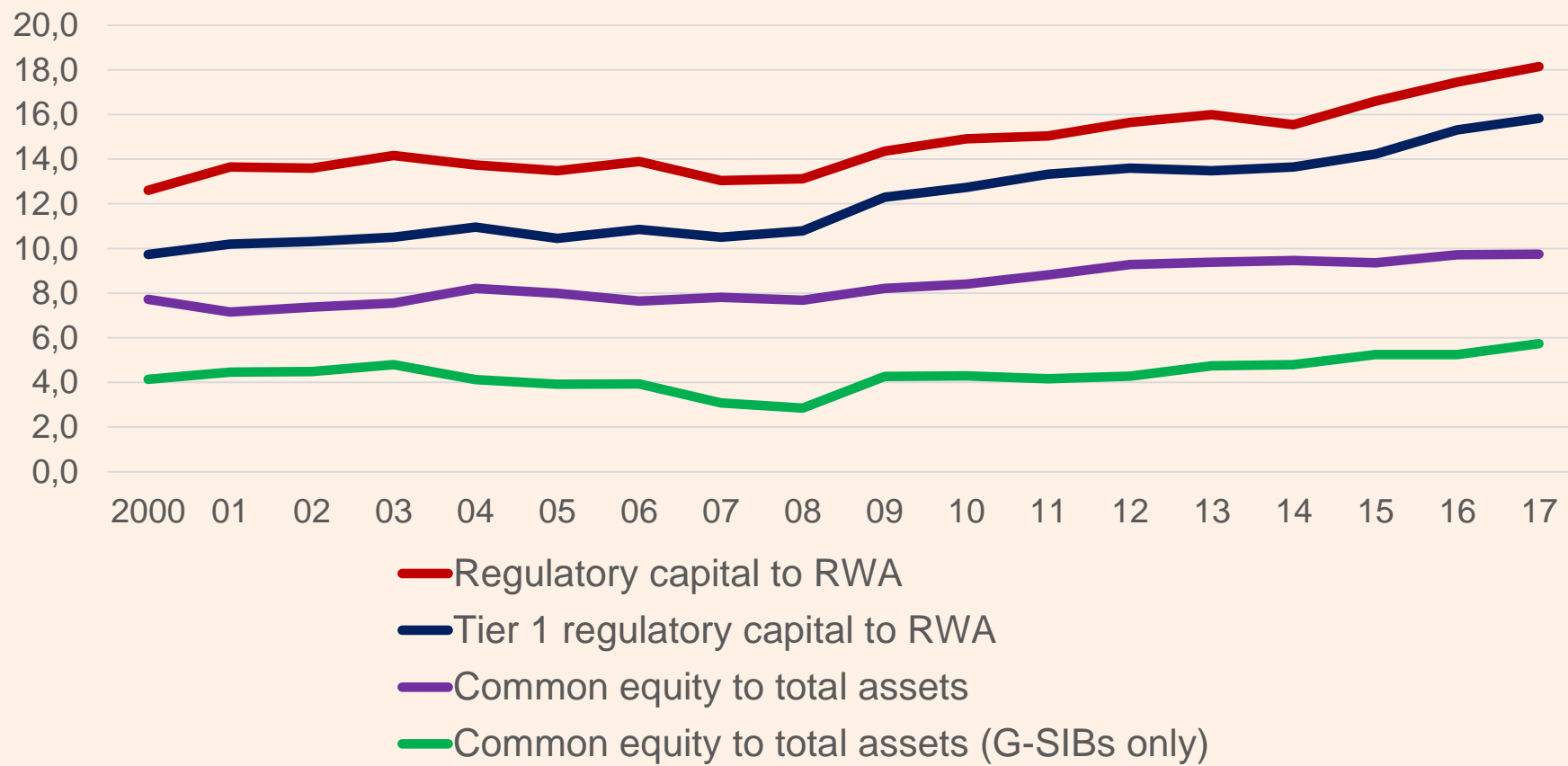
2. Is finance now safe? Modest de-leveraging

**MINIMUM CAPITAL REQUIREMENTS UNDER BASEL II AND
BASEL III (IMF)**



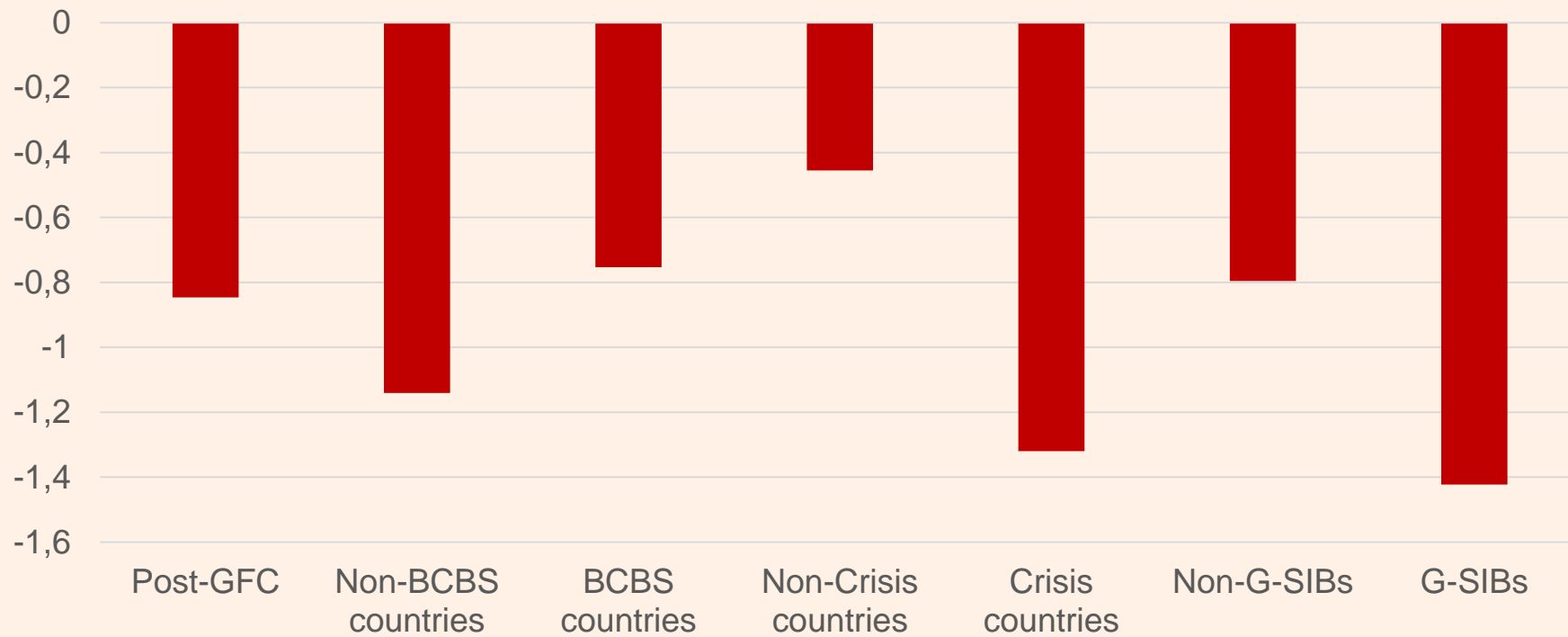
2. Is finance now safe? Modest de-leveraging

CAPITAL BUFFERS (IMF)



2. Is finance now safe? Reduced subsidies

**CHANGES IN PERCEPTION OF GOVERNMENT SUPPORT
FROM 2007 TO 2017 (NUMERICAL RATINGS SCALES)(IMF)**
(BCBS - BASEL COMMITTEE ON BANKING SUPERVISION)
(G-SIBS - GLOBAL SYSTEMICALLY IMPORTANT BANKS)



2. Is finance now safe?

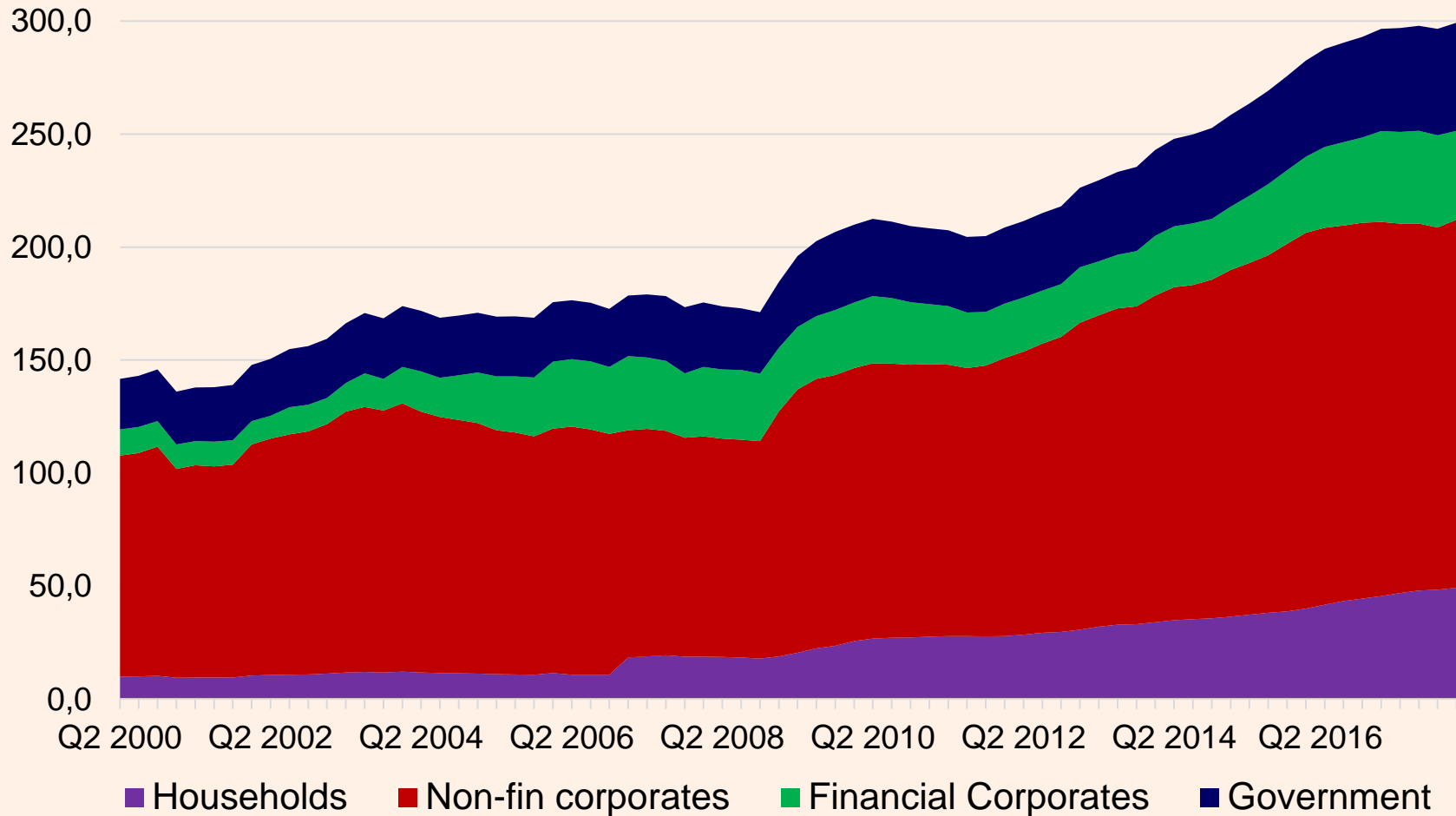
- But will all this be enough? Probably not:
 1. Sooner or later politics will create pro-cyclical de-regulation. Indeed, it is already beginning.
 2. Too much relies on the probity, competence and co-operation of regulators
 3. Fundamental asymmetries of incentives remain between the public at large and shareholders and staff, whose losses are capped at zero. While huge fines have been paid (a staggering \$321bn according to BCG), these losses are borne by shareholders, not management or staff.
 4. In addition to the incentive problems, there are also the fundamental problems of uncertainty
 5. The structural problem of intermediation remains: this is inconsistency between the promise of safe liabilities (money) and the reality of risky assets in highly-leveraged institutions benefiting from the cushion of limited liability

2. Is finance now safe?

- In addition to weaknesses in finance, there are also macro-economic difficulties:
 - Advanced economies remain highly leveraged
 - Governments are particularly leveraged
 - China is also now highly leveraged
- Interest rates might rise sharply
- So the risks of further crises are significant
- Another rescue would be far more politically and practically difficult, not least because governments are so much more indebted now.

2. Is finance safe? China's credit boom

DEBT OVER GDP IN CHINA (IIF)



3. How is finance changing?

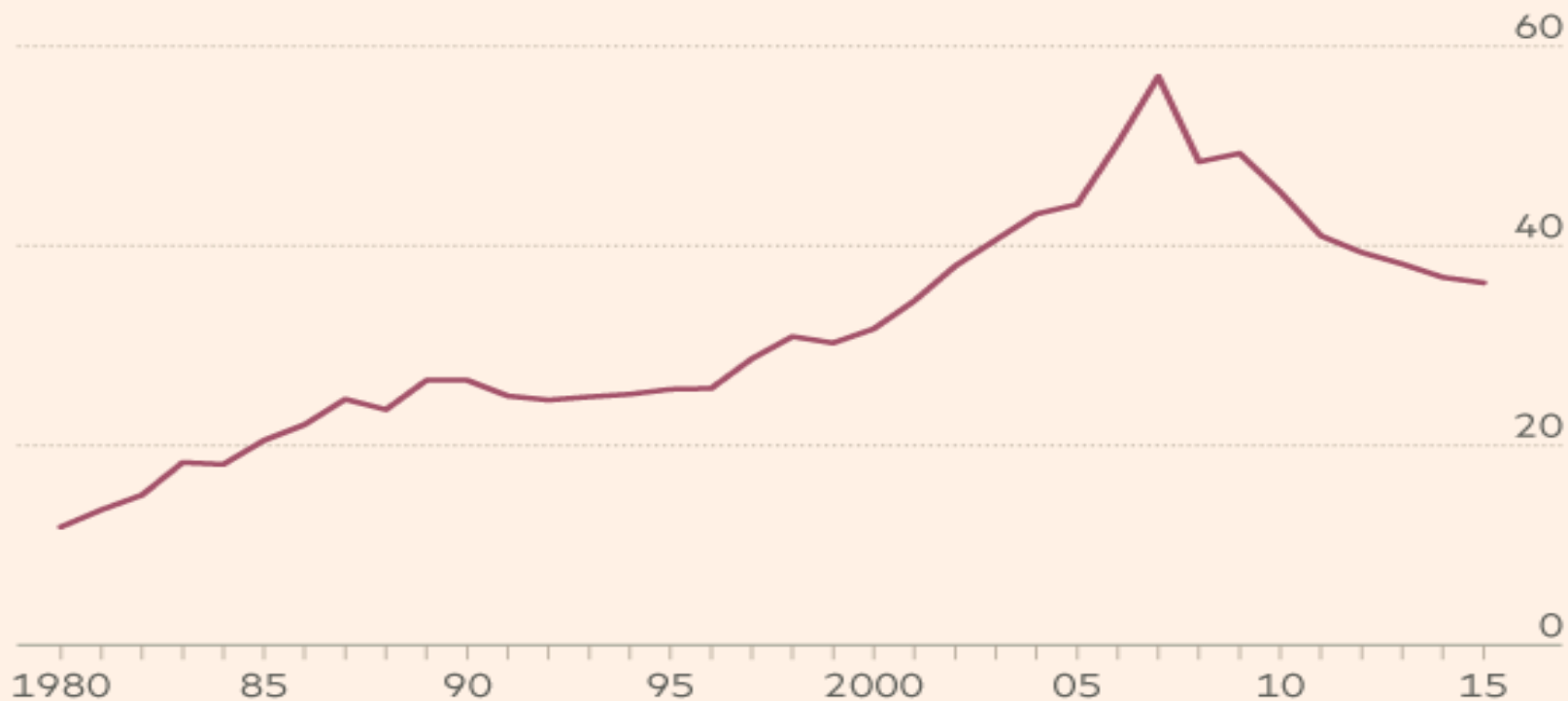
- De-globalization
- Dominance of US and Chinese banks
- High costs of intermediation
- Need for disruption
- Risks of disruption

3. How is finance changing? De-globalisation

RISE AND FALL OF CROSS-BORDER ASSETS

Assets decline

Cross-border financial assets, amount outstanding as a % of world GDP

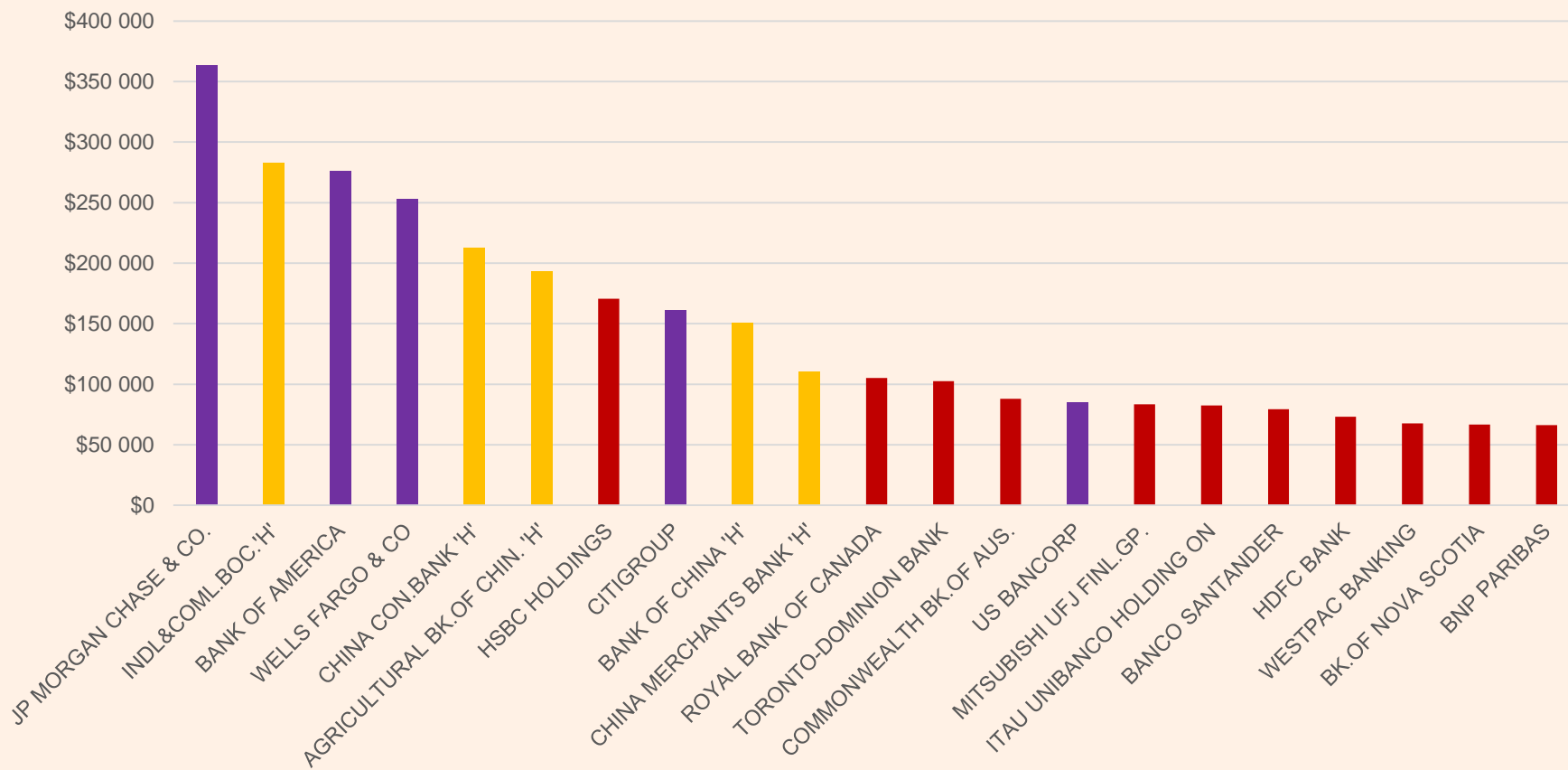


Sources: BIS; IMF

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3. How is finance changing? US & China dominate

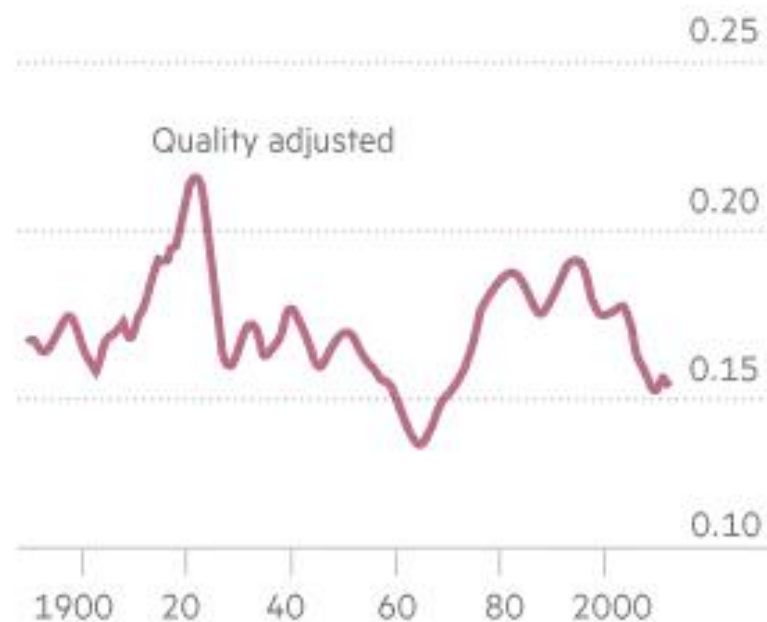
TOP 20 BANKS BY MARKET CAPITALISATION ON 03/11/2018



3. How is finance changing? Costs of banking

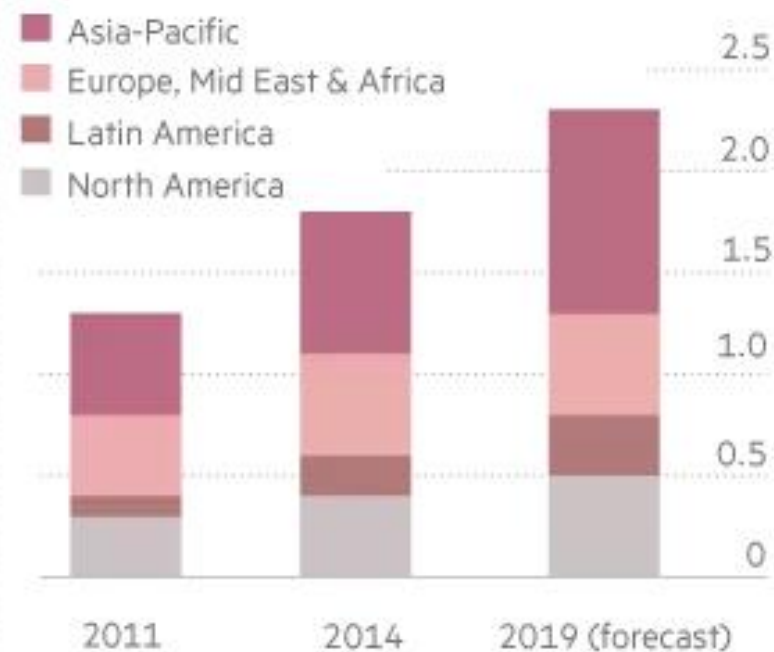
Steady intermediation

US unit cost of finance (% points)



Exorbitant costs

Payment revenues to banks (\$tn)



Sources: Andy Haldane/BoE; Philippon (2014)

'Has the U.S. Finance Industry Become Less Efficient?'; Nesta (2012-14); McKinsey

FT

3. How is finance changing?

- The existing financial system seems very inefficient
- Banks also suffered (rightly) from huge reputational damage from the crisis
- There is also evidence that its balance sheets should shrink, because, beyond a point, credit expansion does not promote growth,
- In all, then, the system is surely ripe for disruption.. Possible disruptors are:
 1. Central bank digital money
 2. New payment systems (e.g. Alipay and Apple Pay) and new competitors (Amazon? Google?)
 3. Rise of “big data” as an analytical tool
 4. New intermediaries (e.g. peer-to-peer business and consumer lending, equity crowdfunding)
 5. Real time settlement via distributed ledgers
 6. Crypto-currencies

3. How is finance changing?

- Many of these possible developments are potentially benign
- But there are also risks with all financial innovation:
 - Financial innovation always risks instability, because its risks are imperfectly understood
 - Risk arbitrage away from the regulated system to an unregulated one is always a threat
 - Regulating the new players is always difficult
 - Ill-informed customers are ripe for exploitation by new (and old) players
 - Crypto assets, in particular, are a vehicle for fraud, tax evasion and outright criminality
 - Also networking of finance creates a big security risk
- We will need to keep our guard up

4. Conclusion

- The financial system has failed in many ways
- Huge challenges and opportunities now lie ahead
- Many of these challenges and opportunities are from new technology
- But many threats are political: will authorities sustain globalization of finance in a nationalist world? Will they co-operate? How might they behave in another crisis?
- The biggest question of all is structural, not technological. It is whether we can separate money (and so the payment system and the safety of money) from credit (and so the management of investment risk in an uncertain world)
- If we cannot do so, the system must remain fragile in fundamental ways