Nasser Saidi: Economics & Governance

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The Dislocation of International Financial Markets

Posted: 27-Sep-2009

Buried in the internal pages of economic newspapers and barely discernible among the flood of newsfeeds I found two revealing pieces of news.

Standard Bank from South Africa has raised one billion dollar from a group of Chinese Banks, among which Bank of China, China Development Bank, Industrial and Commercial Bank of China (which owns a 20% stake in Standard). Only a year ago a deal of this nature and size would have been arranged in a major financial centre, most likely London. The second piece of news is that the Shanghai Stock Exchange plans to launch an international board next year that would allow foreign companies to sell shares denominated in Remimbi (the Chinese currency) for the first time, transforming Shanghai into an international financial centre. Both items herald the new, emerging international financial market, a dislocation with 150 years of financial history.

The aftermath of the financial crisis has made western financial intermediaries reluctant to lend to emerging markets and to a large extent has made them reluctant to lend to anybody! The incentive system of recent policy measures and interventions has been perverse: why would anyone want to do a real banker's job, i.e. assessing projects, analysing balance sheets, managing risk, advising clients, when central banks are bending backwards to shower banks with liquidity at (almost) zero interest rates which banks can invest in (in principle, zero risk) government bonds whose supply has skyrocketed as a result of the largest budget deficits in peacetime? Effectively, financial intermediation is taking money from one branch of government (the central bank) and lending it to another (the Treasury) pocketing the spread in interest rates, at the expense of the tax payer. To top it all, corporate governance shows no sign of improvement, and the bonus culture is alive and well, despite the admonishment of Sarkozy, and the liabilities and the capital of most western banks is guaranteed directly by the same governments that issue the bonds. This ‘achievement’ of financial creativity by the banks and their regulators will result in further ‘regulatory capture’.

In the meantime, something is moving under the surface and the opening of the Shanghai Stock Exchange to foreign companies and financing of Standard Bank is a harbinger of a wider shift. The CEO of Standard Bank candidly remarked that “There is absolutely no way we could raise this kind of money from western banks”. All the more remarkable since the maturity is five years, a rare feat in these testing times. In essence the financial crisis has severely damaged the trust and the capability of established institutions to allocate financial resources to productive uses. The old financial ‘core–periphery’ model is breaking, with linkages between ‘peripheral’ financial systems growing and strengthening. As long as once powerful players are content to limit themselves to intermediate between branches of government, at tax payer expense, there is a sea of opportunity for institutions in the emerging markets of Dubai and Shanghai to bypass London, New York, Frankfurt and deal directly with each other. Certainly this process requires a legal and regulatory framework that enjoys the trust and confidence of lenders and borrowers. And this is exactly what Dubai and other emerging financial centres are offering.

This is a golden opportunity that should not be missed by financial institutions from our region to link up with partners in China, India, Central Asia, and other areas which will be the engines of global growth in this and the coming decades. This is the right time to set sail and take advantage of the tail wind. We should thrive on the dislocation of international financial markets.