HOW THE BIGGEST BANKRUPTCY **IN THE US INFLUENCED POLITICS TODAY**

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A decade has passed since the collapse of Lehman Brothers on 15 September 2008. Lehman's bankruptcy was a catalyst to the largest financial crisis since the Great Depression. After filing for bankruptcy, money market funds and other investors were forced to write off their Lehman-related investments. Counterparty risks rose significantly. This drove large-scale redemption-driven asset sales. The subsequent sell-off affected all but the safest assets. With credit and money markets nearly frozen and equity prices falling, banks and other financial firms saw their access to funding curtailed and their capital base shrink, due to accumulating market losses. Credit spreads rose to record levels and government bond yields fell. In addition, volatilities soared across markets, indicating financial market stress. Emerging market stocks also fell as risk aversion and financial distress in developed markets spread.

THE WORLD'S MOST AUDACIOUS MONETARY EXPERIMENT

In October 2008, the US Congress authorised a US$700 billion bank rescue operation, called Troubled Asset Relief Programme (TARP), to remove distressed assets from bank balance sheets. And so began the most audacious monetary experiment in the world. Interest rates were held close to zero in the US for years, while negative rates prevailed elsewhere. The US Federal Reserve (Fed)'s balance sheet quadrupled to more than US$4 trillion. The Fed also gave the economy another boost by buying large quantities of bonds, a policy we all now know as quantitative easing.

The final quarter of 2008 saw massive impacts on the economy. Unemployment in the US rose dramatically with eight million jobs shed. Cross-border trade fell by nearly 20% from US$1.6 trillion to US$1.3 trillion, with letters of credit being difficult to obtain. By 2008, nearly 30% of all high-risk US mortgage securities were held by foreign investors. When the crisis hit, many sources of short-term bank funding dried up and European banks were left in a precarious situation… the US subprime fever had spread to Europe.

Two weeks after the US Congress approved TARP, the European Union (EU) announced its own framework for stabilising EU banks. Central bankers increasingly adopted a "whatever it takes" mode to deal with the crisis. Over the course of just three months (from September to December 2008), US Fed assets went up from US$900 billion to US$2.3 trillion and the European Central Bank (ECB) assets from €1.4 trillion to €2.1 trillion. A global banking disaster was avoided because the US Fed agreed to provide its European counterparts with practically unlimited US dollars through currency swap arrangements and due to coordinated interest rate cuts by six major central banks. The speed and scale of the collective global interventions aimed at restoring global market stability were unprecedented.

KEY TAKEOUTS

- A BANKRUPTCY THAT CHANGED THE FACE OF POLITICS
- TAXPAYERS FOOT THE "BLANK CHEQUE" BAILOUTS
- THE CONSEQUENCES: GROWING INEQUALITY AND RISING POPULISM

THE TROIKA TO THE RESCUE

The global financial crisis (GFC) also exposed fault lines within the EU. Investors had historically viewed countries like Greece, Ireland, Portugal and Spain as risky bets, and required high yields on the bonds those countries issued. After these countries adopted the euro, investors bought their bonds as if they were on par with German and French bonds. Of the nearly €300 billion worth of bonds that Greece had issued by the end of 2009, more than €200 billion were foreign owned. Investors' eagerness for this debt represented a credit bubble as dangerous as the US subprime bubble that had seen ratings agencies giving triple-A ratings on subprime debt. Although Greek bonds were denominated in the same currency as German bonds, they were backed by the Greek state. When banking problems emerged in Greece, Ireland, Portugal and Spain, and markets gyrated, the EU was gripped by paralysis.

In May 2010, the EU, together with the International Monetary Fund (IMF), agreed to lend Greece €110 billion. The money was used to settle some of the debt owned by foreign banks and investors at or near face value. This amounted to an undercover bailout – not for Greece, which merely substituted one form of debt for another – but for the foreign banks that owned Greek bonds. In return for the new loans, the European Commission, the ECB and the IMF (aka the "troika") insisted on dramatic reductions in Greek government spending. This austerity programme sent the Greek economy into an even deeper recession, further weakening the country's ability to repay its debt. The Greek bailout model then served as the template for the lending agreements that the troika subsequently made with Ireland, Portugal and Cyprus, all of which had banking crises of their own.

THE POOR PAY THE PRICE

Using taxpayers' money to bail out "greedy and incompetent bankers" was political. So was quantitative easing, a tactic that central banks adopted, following the Fed's lead. It worked primarily by boosting the price of financial assets that, relative to the middle class, were mostly owned by the wealthy. According to Credit Suisse, since the global financial crisis, global inequality has worsened, with the top 1% share of global wealth rising from 42.5% in 2008 to 50.1% in 2017. In contrast, consider how ultra-low interest rates impact the not-so-privileged, with negative after-inflation growth on savings and low rates encouraging debt. According to the St. Louis Fed, nearly 10 million homes were repossessed in the US. Since the middle class have most of their wealth tied up in their homes, they experienced the greatest proportionate losses in the economic downturn that followed the GFC. New York University economist Edward Wolff estimates that median wealth fell by 47% between 2007 and 2010. Austerity policies, especially in Europe, also added another twist to the emerging fallout. For populists, the argument that it had been necessary to save Wall Street in order to save "Main Street" was replaced with a powerful counternarrative: the entire game had been "rigged". In the 2016 US election, Donald Trump and Bernie Sanders both offered versions of this story. Resentment of Wall Street elites was one of Trump's key campaign platforms. Economic historian Adam Tooze mentions in "Crashed: How a Decade of Financial Crises Changed the World" that we are still living with the consequences of the GFC, including the political ones.

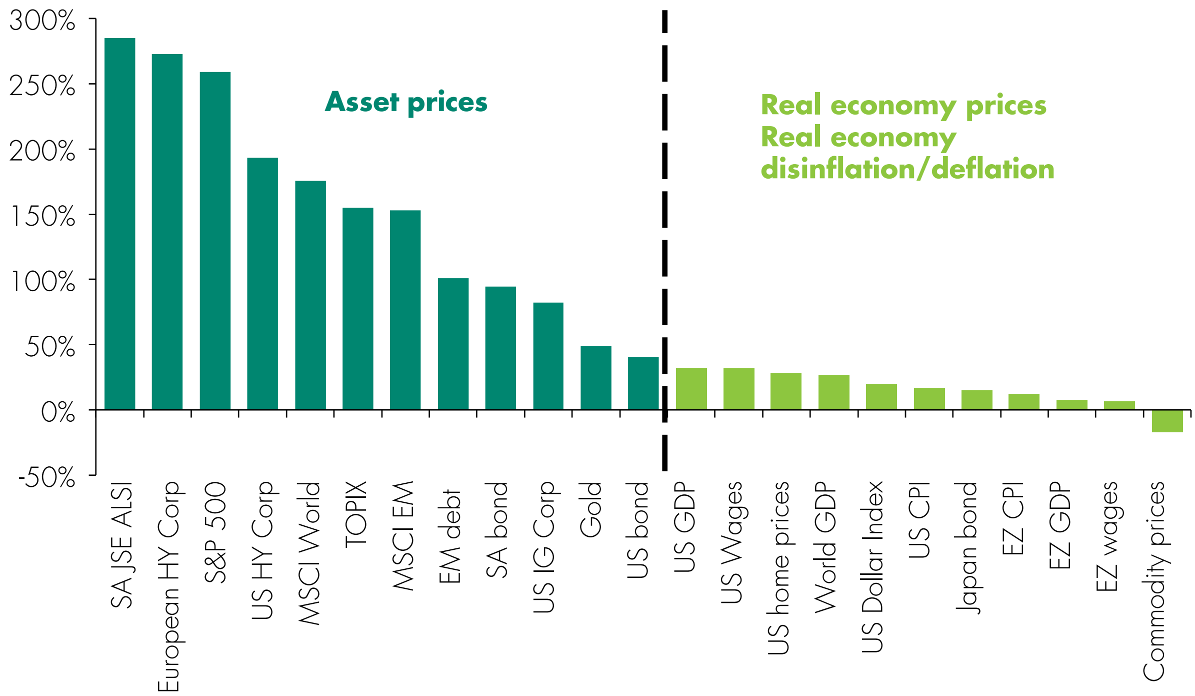
THE FINAL PRICE TAG

A decade after the collapse of Lehman Brothers, the results of the boldest central bank experiment in history are in. On the surface, it looks like a success:

- In the US, the unemployment rate is near a 48-year low, the S&P 500 Index recently reached an all-time high, consumer sentiment is good and the largest US banks have more than doubled their capital adequacy from 3.2% to 7.7%.
- In Europe, GDP growth has recovered to pre-crisis levels, while global GDP growth is 3.1%.

A closer look, however, reveals that some of the implications of this success have been rising inequality, a surge in populism, massive debt and China's rise economically. The cost of fiscal stimulus has left developed nations the most indebted since World War II, with global debt rising by 45%, from US$173 trillion in 2008 to US$250 trillion 10 years later. According to Bloomberg, an estimated US$1.4 trillion in annual economic output in the US will never be recovered — a loss that has weighed most heavily on the poor. In addition, rising populism and the growth of right-wing nationalist parties in Europe can be traced to the way the crisis undermined confidence in the politics of the status quo. Prior to the GFC, Europe was one of the most open regions in the world in terms of migration. Between 2000 and 2010, approximately 1 million people immigrated to the EU annually. Austerity policies, low economic growth, squeezing of the middle class and rising unemployment all contributed towards rising xenophobia and the "closing of borders" we have seen in recent years. Quoting the IMF Managing Director, Christine Lagarde: "The fallout from the crisis – the heavy economic costs borne by ordinary people combined with the anger at seeing banks bailed out and bankers enjoying impunity, at a time when real wages continued to stagnate – is among the key factors in explaining the backlash against globalisation, particularly in advanced economies, and the erosion of trust in government and other institutions."

CHANGES IN ASSET PRICES AND THE REAL ECONOMY SINCE THE GREAT FINANCIAL CRISIS



Sources: BBG, Nedbank CIB (total return performance in local currency)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