Ten years ago today heralded the start of the 'credit crunch'. The term which was unfamiliar to most people entered dictionaries in 2008. A credit crunch refers to the sudden reduction in the availability of credit or a sudden tightening in the conditions to obtain credit. In short, the availability of credit decreased sharply and the cost of credit increased significantly. In turn, this morphed into the global financial crisis or GFC and was accompanied by a global downturn. The rest they say is history. A decade has passed and hundreds of books have been written about the credit crunch and the global financial crisis that followed.

It is worth remembering the sequence of events that followed the 9th August 2007.

Useful weblinks include:

- https://www.theguardian.com/business/2012/aug/07/credit-crunch-boom-bust-timeline
- http://news.bbc.co.uk/1/hi/business/7521250.stm

- https://www.ft.com/creditcrisis

But it is also worth considering what gave rise to the credit crunch / GFC. In many ways, the credit crunch was like an Agatha Christie ’who dunnit’? The article below, written six years ago, will act as a refresher to the many culprits who had a hand in contributing to the credit crunch and the Global Financial Crisis and recession that followed.

Credit Crunch Cluedo – a reminder of ‘who dunnit’?’

Today marks the tenth anniversary of the start of the Credit Crunch. Initially seen by many as a short-term phenomenon, it soon became clear that its effects would be deep and lasting, not least in the global recession it triggered. As a result, there has been a protracted game of ‘*who dunnit?*’, as all kinds of people have sought to apportion blame to one or other of the actors in the events leading up to its onset. In many respects this has resembled a game of Cluedo - identify the culprit, weapon and location to solve the crime.

For many it is seen as an open and shut case, with the blame in their eyes lying squarely at the door of the global banking industry. Indeed, hostility to financiers is not new and has been a recurrent theme over the centuries, particularly after financial crises. During the latest crisis, the banking and financial sector across the world has certainly not covered itself in glory, with the industry learning some harsh lessons as a result. Failures occurred at an individual, institutional and industry level globally. However, many of the explanations put forward for the economic mess we are currently in are probably overly simplistic, which is not in anyone’s interests, as we need to understand the situation fully to help avoid it happening again.

Was it the Federal Reserve (Fed) in the US with its lack of supervision and regulation, or its overly lax monetary policy during the Greenspan years? Was it the investment banks on

Wall Street with their derivatives products (some of which were termed *'financial weapons of mass destruction'*) or the mathematics geeks who invented them? Or subsequently those that bought and sold them but failed to understand the product? Or alternatively, the credit rating agencies that incorrectly applied a 'Triple A' rating to junk assets?

Was it the man in the street with the large mortgage he couldn't repay as he stretched the truth on his self-certification mortgage? Or Government policy that pushed the dream of home-ownership to the masses who simply couldn't afford it? *('We want everyone in America to own their own home' – George W. Bush October 2002)* Was it the high street banks with their under-pricing of risk or their shareholders for failing to keep them on a tighter rein? Was it the increasingly light touch regulation that was evident in the US and the UK?

Clearly, a closer analysis of the Credit Crunch and the actions of those involved reveal that apportioning blame might not be straightforward. Unlike the game of Cluedo, a single individual with one weapon in one location cannot be identified.

In my view, Deputy Governor of the Bank of England *(Charles Bean)* best summed up the scenario of the Credit Crunch and Recession. He said: *'It would be a mistake to look for a single guilty culprit…..As in Agatha Christie's Murder on the Orient express, everyone had a hand in it'.* In the credit crunch, the various characters included financial institutions, governments, borrowers, firms and regulators. Focussing on just one player ignores the role played by the others and diminishes understanding.

Prior to the credit crunch, there was an explosion of credit which was facilitated by 'innovation' and a movement towards self-regulation. Two key individuals were instrumental in relaxing regulation *(Bill Clinton & Hank Paulson)* whilst a third – Former Fed Chairman Alan Greenspan – was a strong advocate of light touch regulatory environment.

As President, one of Bill Clinton's greatest achievements was eliminating the US's massive fiscal deficit. However, in 1999 he also repealed the Glass-Steagall Act of 1933 which arguably contributed to the debt explosion which the US taxpayer has to address today. Glass-Steagall was the regulatory response to the Great Depression and separated retail banks from investment banks so as to prevent retail deposits being used for speculative activity. Meanwhile, George W. Bush's Treasury Secretary – Hank Paulson – was instrumental in preventing a second depression post-Lehman chaos. However, as CEO of Goldman Sachs, Paulson had led a delegation of banking bosses to the US Securities and Exchange Commission (SEC) in August 2004. Paulson secured a relaxation in the debt to capital ratio from which enabled US banks to more than triple the level of debt they could issue. Furthermore, the SEC employed just seven people to monitor Wall Street's $4 trillion worth of assets!

Light touch regulation and supervision was also a feature within the UK, with the first bank run *(Northern Rock)* since 1866. One of Gordon Brown's first acts as Chancellor in 1997 was to remove bank supervision powers from the Bank of England (BoE) and create the Financial Services Authority (FSA). One of its Board members, Sir John Gieve *(Deputy Governor of the BoE with responsibility for financial stability)* was accused by Treasury Select Committee Chairman John McFall of *"being asleep in the back shop while there was a mugging out front"*. Meanwhile, the emergence of a shadow banking system over the last decade facilitated the explosion of debt – namely hedge funds and Structured Investment Vehicles (SIVs). These providers of debt were 'off balance sheet' and thus fell outside of international regulatory regulations.

Essentially, light-touch regulation was a strong feature of the events leading up to the Credit Crunch, resulting in an environment in which there was the creation, consumption and accumulation of too much debt. Indeed, it has been said that US growth in the Bush era was largely debt driven. Taking out the contribution of mortgage equity withdrawal to consumption, it is estimated that growth in this period would have been something in the order of 1% per annum. For the US, like elsewhere, it was a case of 'buy economic growth now, pay later'. But we certainly can't just blame regulators and governments. As Charles Bean said, we all had a hand in it; from the banks *(investment & retail)* who under-priced debt and made it too freely available, to all of us consumers who under-saved, over-borrowed and over-spent.

The era of leverage is certainly over and we are now in a period of de-leverage for the next decade. Whether Credit Crunch 2 comes to pass or not, it is clear that dealing with household, corporate and government debt will be the order of the day for some time to come. And we all need to have a hand in dealing with that.

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