Paulson says crisis sown by imbalance

By Krishna Guha in Washington

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Global economic imbalances helped to foster the credit crisis by pushing down global interest rates and driving investors towards riskier assets, outgoing US Treasury Secretary Hank Paulson told the Financial Times.

In a valedictory interview, Mr Paulson cast the crisis as partly the result of a collective failure to come to terms with the way the rise of emerging markets was reshaping the global financial system. These imbalances – arising from differences in the inclinations of different nations to save and invest – are reflected in large current account deficits and surpluses around the world.

The US Treasury Secretary said that in the years leading up to the crisis, super-abundant savings from fast-growing emerging nations such as China and oil exporters – at a time of low inflation and booming trade and capital flows – put downward pressure on yields and risk spreads everywhere.

This, he said, laid the seeds of a global credit bubble that extended far beyond the US sub-prime mortgage market and has now burst with devastating consequences worldwide.

“Excesses…built up for a long time, [with] investors looking for yield, mis-pricing risk,” he said. “It could take different forms. For some of the European banks it was eastern Europe. Spain and the UK were much more like the US with housing being the biggest bubble. With Japan it may be banks continuing to invest in equities.”

This argument – already advanced by a number of economists and largely endorsed by Federal Reserve chairman Ben Bernanke – suggests that the roots of the crisis do not simply lie in failures within the financial system.

It also implies that avoiding crises in future will require global macroeconomic co-operation as well as better financial regulation and risk-management.