Box 5. You Don't See What You're Not Looking For

The global economic and financial crisis generated a surge in the demand for new and better data. Yet were lack of data or inadequate data key factors behind the Fund's and others' failure to foresee the crisis? The answer would seem to be "no," based on the following:

- The Fund largely ignored some core data in the key financial centers that could have helped to signal a forthcoming crisis, including such traditional mainstays as broad measures of credit growth, leverage (household, government, corporate), and the growth of high-risk financial instruments.[1]
- Despite lack of data supporting such a view, the Fund was overly enthusiastic about the soundness of U.S./U.K. financial systems and the risk-dispersing properties of financial innovation (including "exotic" mortgage products).
- The Fund believed it was sufficiently well-equipped with data to highlight the risks and vulnerabilities in emerging markets and developing countries, but did not use similar data trends to see similar risks in advanced countries.

[1]In the U.S. staff reports, the standard table on "Indicators of External and Financial Vulnerability" did not include market-sensitive and publicly available data such as an ABX index, a composite index of CDS spreads for key financial institutions, the TED spread, leverage ratios of the largest commercial and investment banks, aggregate and sectoral credit expansion, debt trends across major sectors (government, corporate, household), and pertinent information (as available) of shadow banking assets as a share of total assets, the maturity structure of shadow banking liabilities, and financial institution exposure to credit derivatives.

- The very nature of financial innovation is to stay ahead of the regulators and hence their data collection efforts as well. For this reason, the Fund would always be "behind the curve" if the Fund could only see the risks when the data are finally available.
- "You don't see what you're not looking for." Neither the U.S. nor the U.K. authorities, despite presumably having much greater access to data, saw the crisis coming. Indeed, the Fund's views on financial sector soundness were very much in line with those of country authorities. Furthermore, once the crisis was evident, the Spring 2008 *Global Financial Stability Report* was able to provide a remarkable estimate of expected financial sector losses, without any additional access to data. But now they knew what to look for!
- To quote from the *Economist* (January 15, 2010), "In the run-up to the crisis, policymakers and supervisors, like most other people, managed to rationalize bad things that were plain for all to see, such as inflated house prices and some banks' rock-bottom capital levels." As Claudio Borio of the Bank for International Settlements put it, "The main reason why crises occur is not lack of statistics but the failure to interpret them correctly and to take remedial action" (Borio, 2012).

In sum, gathering more and more data is not a substitute for the effective use of available data or for willingness to challenge mainstream thinking.

Source: This box is based on the findings in IEO (2011a).

initiatives would help their work at the Fund, half of the respondents believed that the Fund currently lacks the capacity to effectively use all the data that ideally would be gathered under these initiatives. Prioritization is thus key to ensure that the Fund has the data needed to strengthen its surveillance of an increasingly complex global economy, yet avoids placing an excessive burden on member countries and on its own ability to absorb the information.

A growing body of work helps to point the way forward.

49. Some of the recent literature has been critical of focusing primarily on ever more financial and/or market data to sound early warning of crises.[47] Several authors argue that some macroeconomic indicators are better at crisis prediction than are financial sector and market indicators, concluding that using available data in a different way may be at least as fruitful than the never-ending quest for more data (Borio and Drehmann, 2009; Eichner, Kohn, and Palumbo, 2010; Borio,

[47]For example, a number of FSIs often continue to suggest soundness even as conditions are deteriorating. Even more timely data may perform poorly as early warning indicators. For example, market indicators might fail to indicate problems on the horizon—risk and volatility indicators were at historic lows just prior to the recent global crisis. This does not imply that collecting these data serves little purpose. Some of these data may not serve well as early warning indicators, but could prove extremely useful in responding to crises.