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Managing financial crises

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The views expressed are my own and do not necessarily represent the position of the Bank of Finland.





I. Introduction

- **Financial crises** arise when some financial institutions or assets suddenly lose a large part of their value.
- Different types of crises:
 - **Banking crises** (runs or related difficulties)
 - **Speculative bubbles** and crashes (stock markets, real estate)
 - **Currency crises**; isolated crises and contagion
- **Systemic crises**: a large number of institutions or assets behave in a non-sustainable way.
- The frequency of financial crisis doubled in the period since 1973 in comparison to 1945-71.
 - Excluding the current global crisis, six out of ten biggest bubbles have occurred since 1970s (Table).



The big ten financial bubbles

(from Kindleberger and Aliber 2005)

1. The Dutch Tulip Bulb Bubble 1636
2. The South Sea Bubble 1720
3. The Mississippi Bubble 1720
4. The late 1920s stock price bubble 1927–29
5. The surge in bank loans to Mexico and other developing countries in the 1970s
6. The bubble in real estate and stocks in Japan 1985–89
7. The 1985–89 bubble in real estate and stocks in Finland, Norway and Sweden
8. The bubble in real estate and stocks in Thailand, Malaysia, Indonesia and several other Asian countries 1992–97
9. The surge in foreign investment in Mexico 1990–93
10. The bubble in over-the counter stocks in the United States 1995–2000

Source: C.P. Kindleberger and R. Z. Aliber: Manias, Panics and Crashes, A History of Financial Crises, 2005



II. Empirical Overview

II.1 The Current Crisis

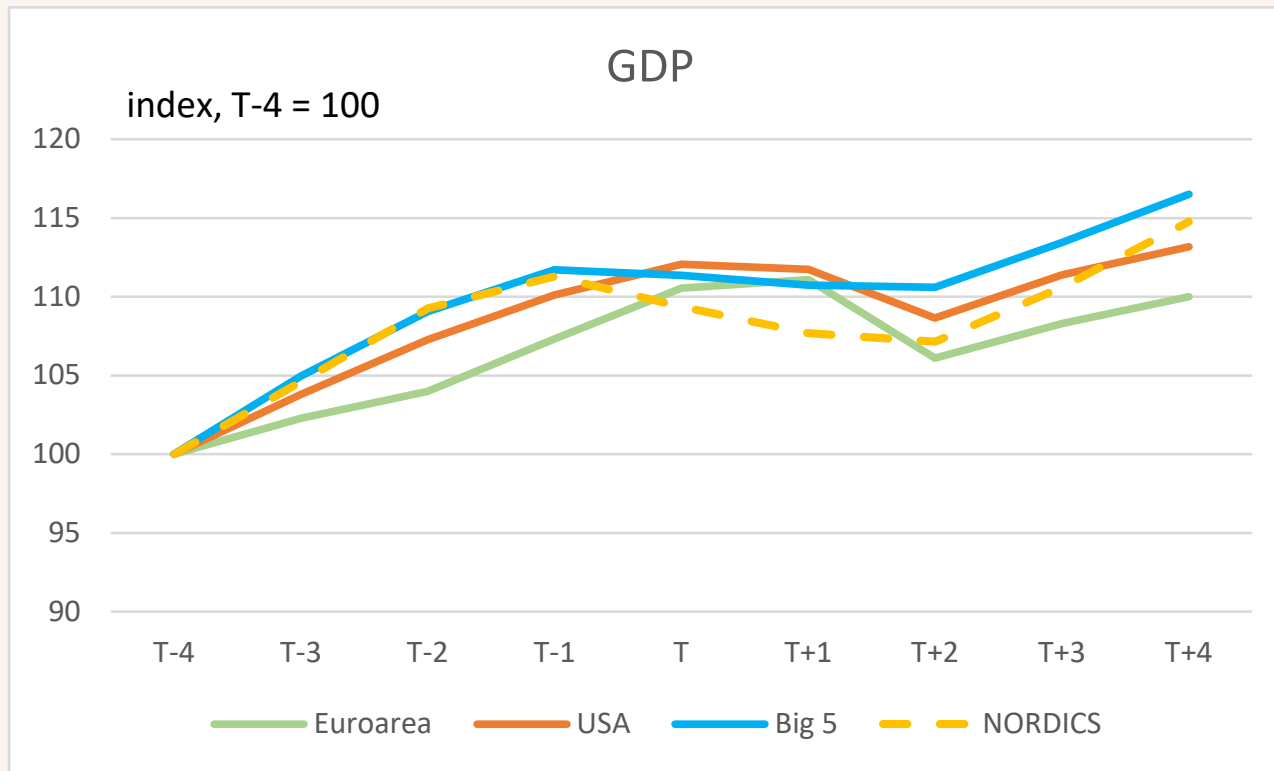
Note 1: Comparison to the average of the "Big Five" crises in advanced economies:

- Nordics (Finland, Norway, Sweden) in 1990s, Spain in 1980s, Japan in 1990s.

Note 2: T represents the year of start of the financial crisis in the next figures .



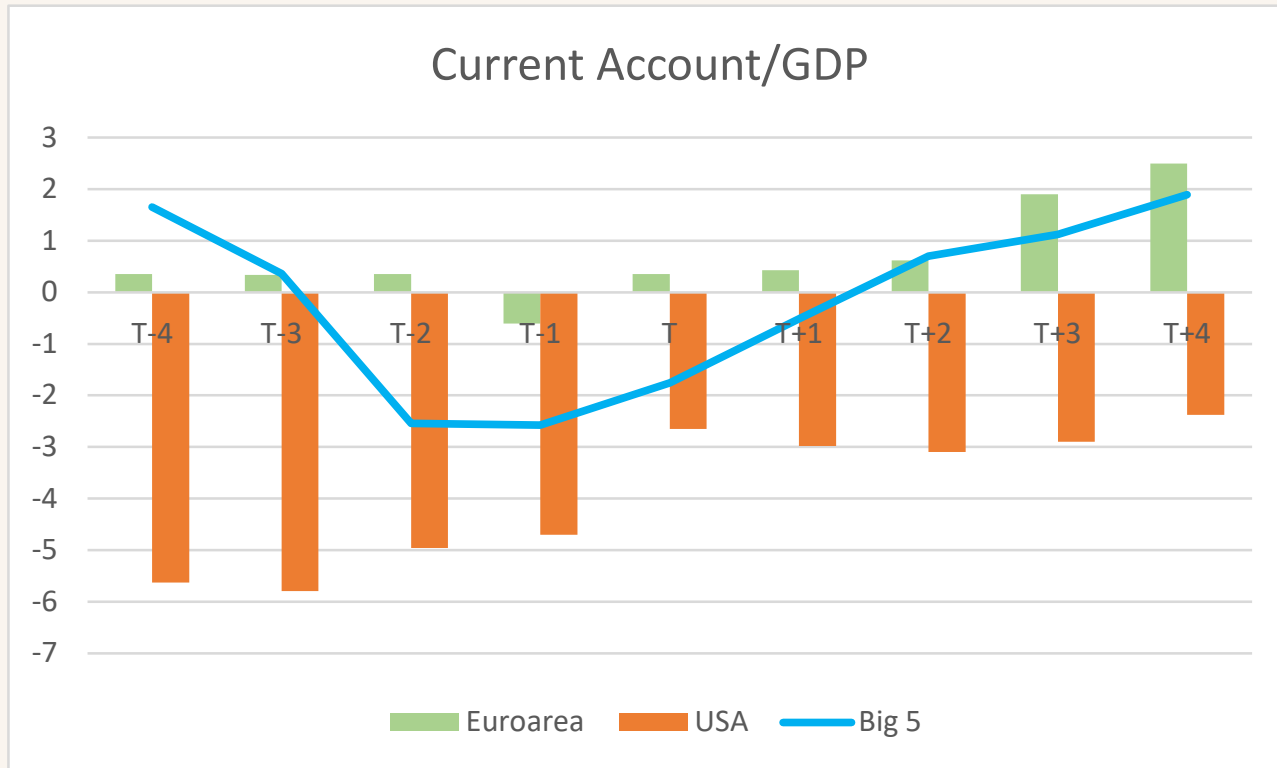
Gross Domestic Product



Source: Ameco database



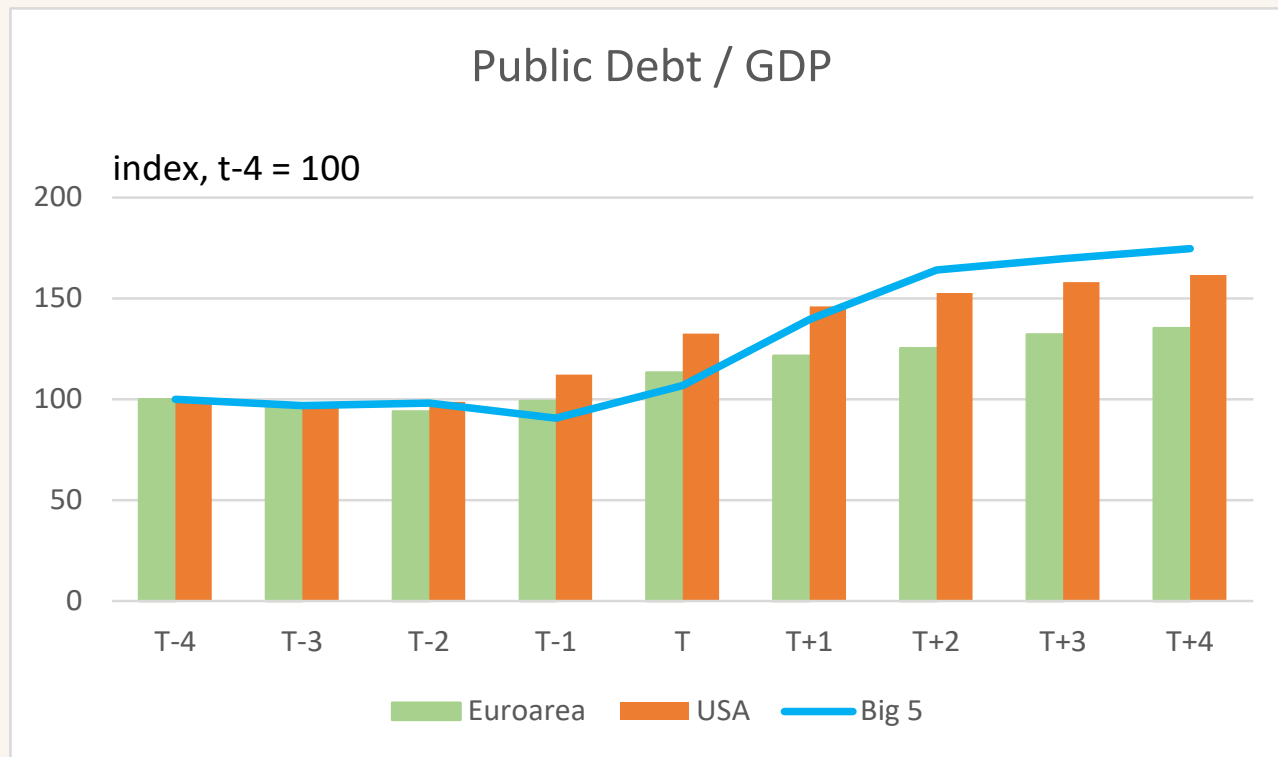
Current account to GDP ratio



Source: Ameco database



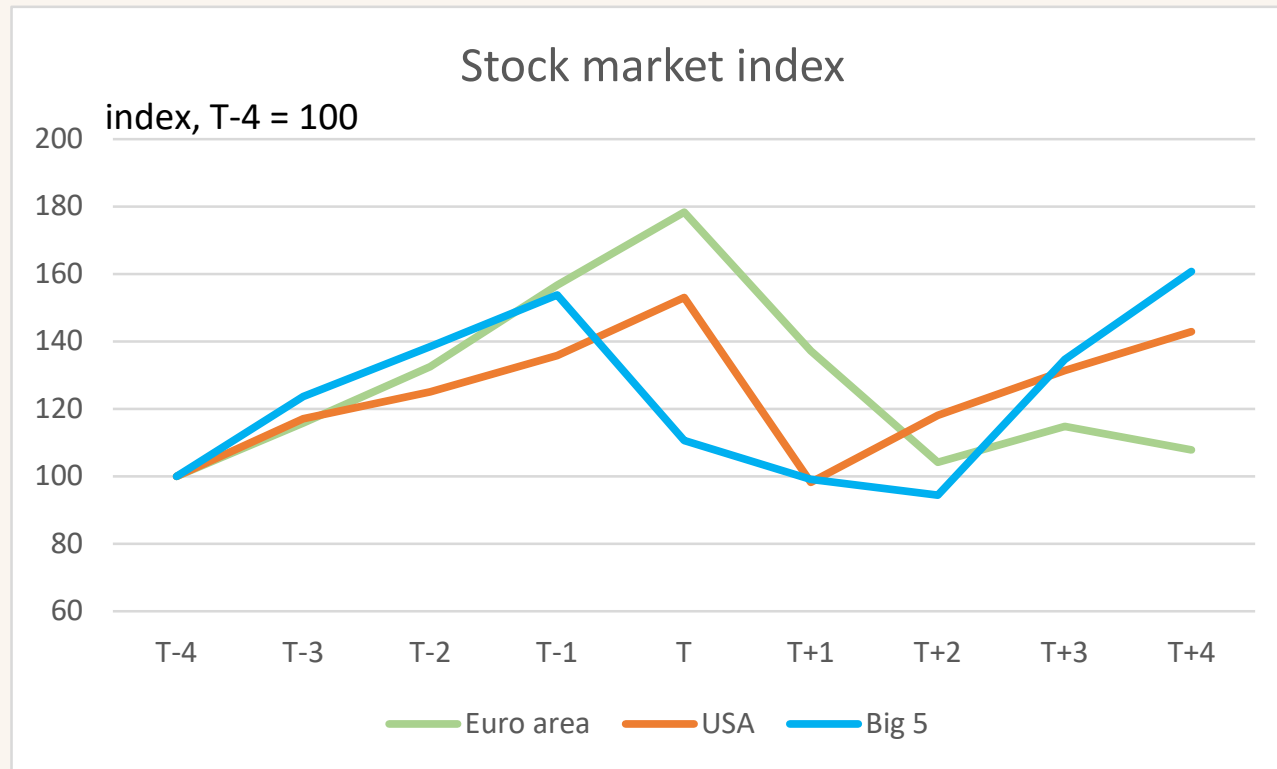
Public Debt



Source: Ameco database . Big five excluding Spain



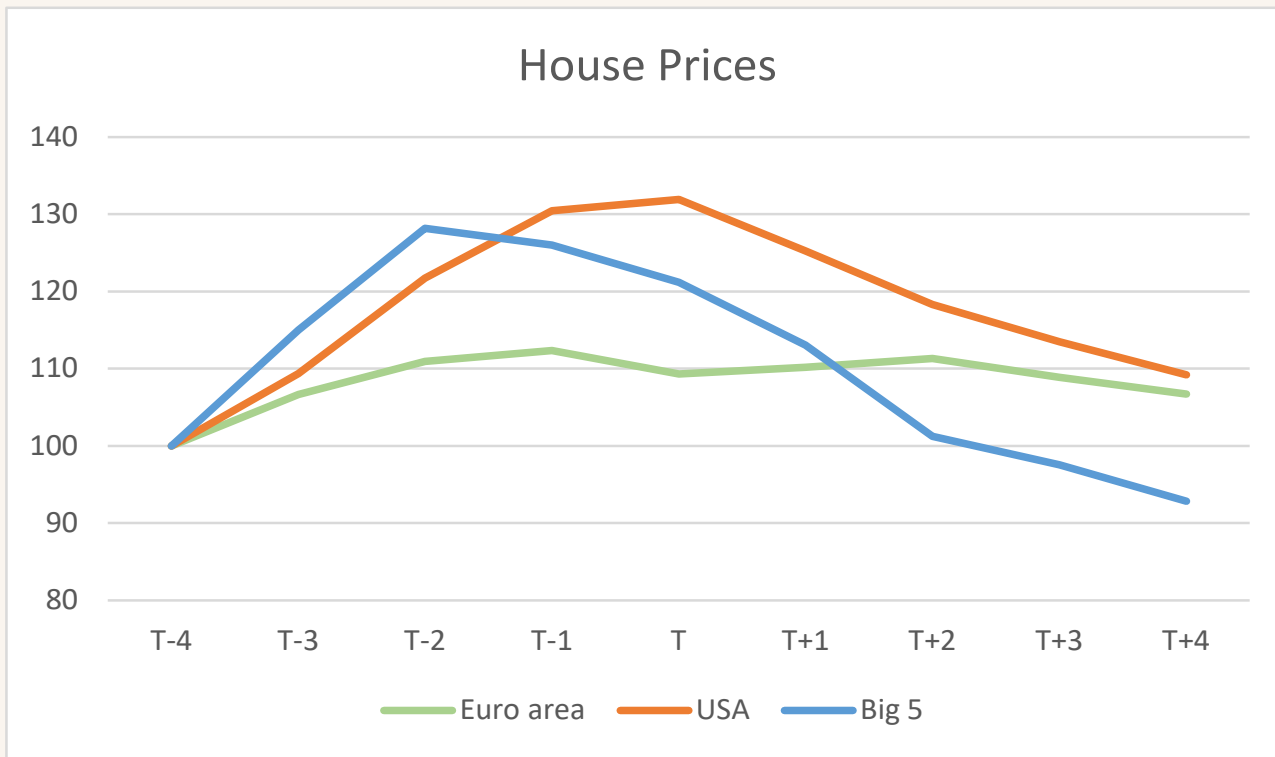
Stock Market index



Source: Bloomberg



House prices

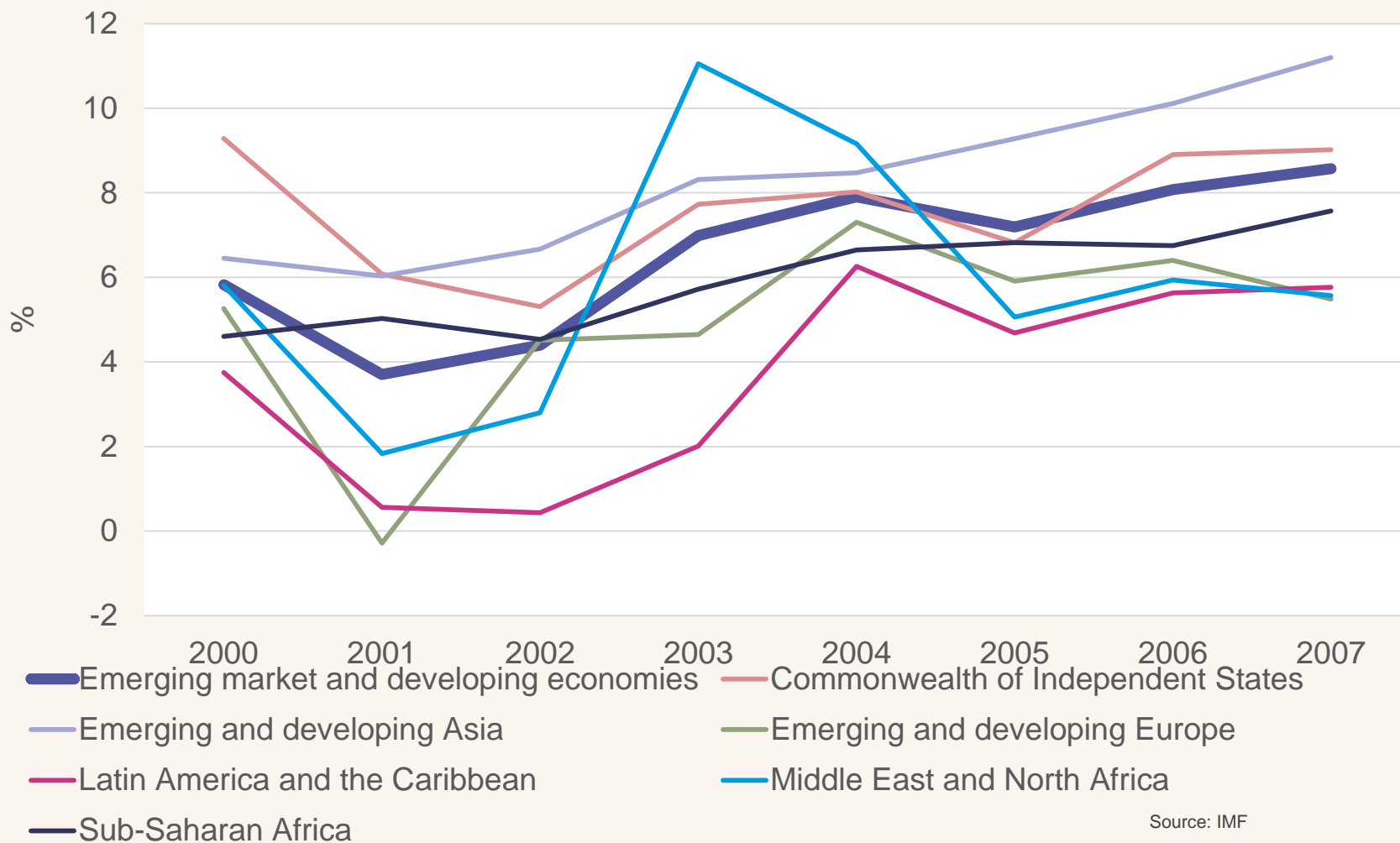


Source: OECD Economic Outlook



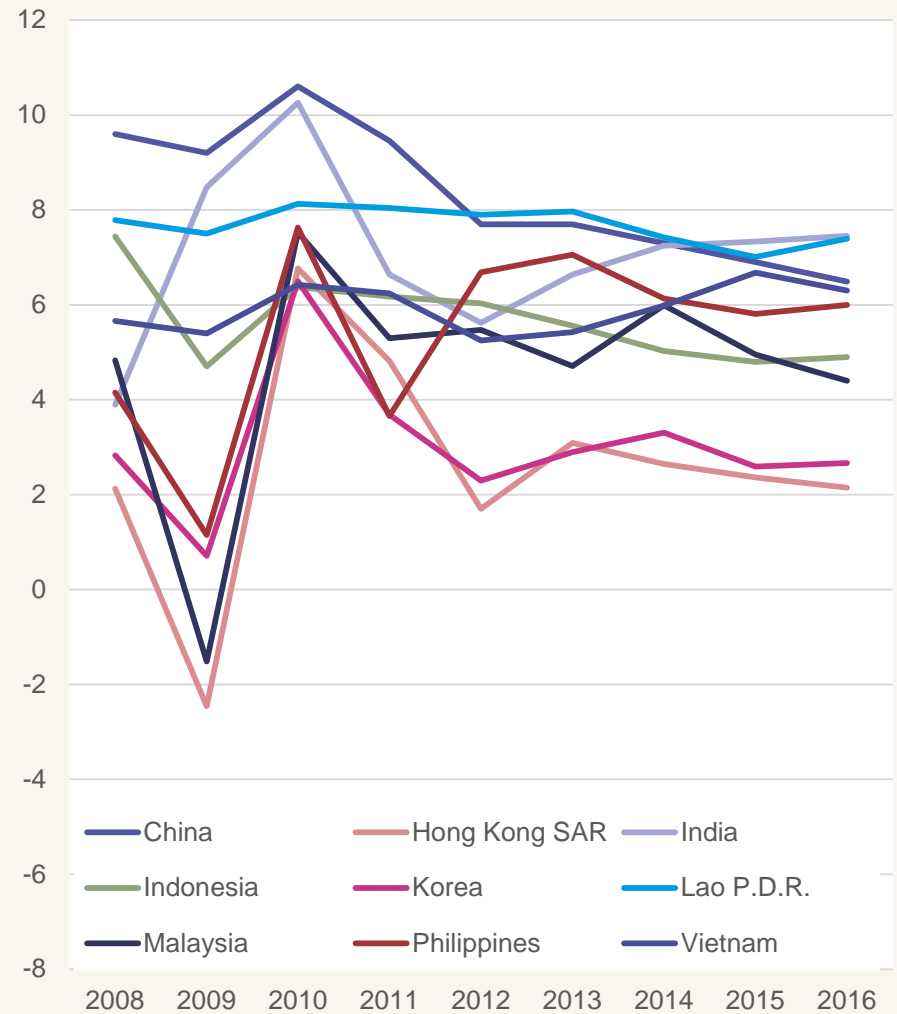
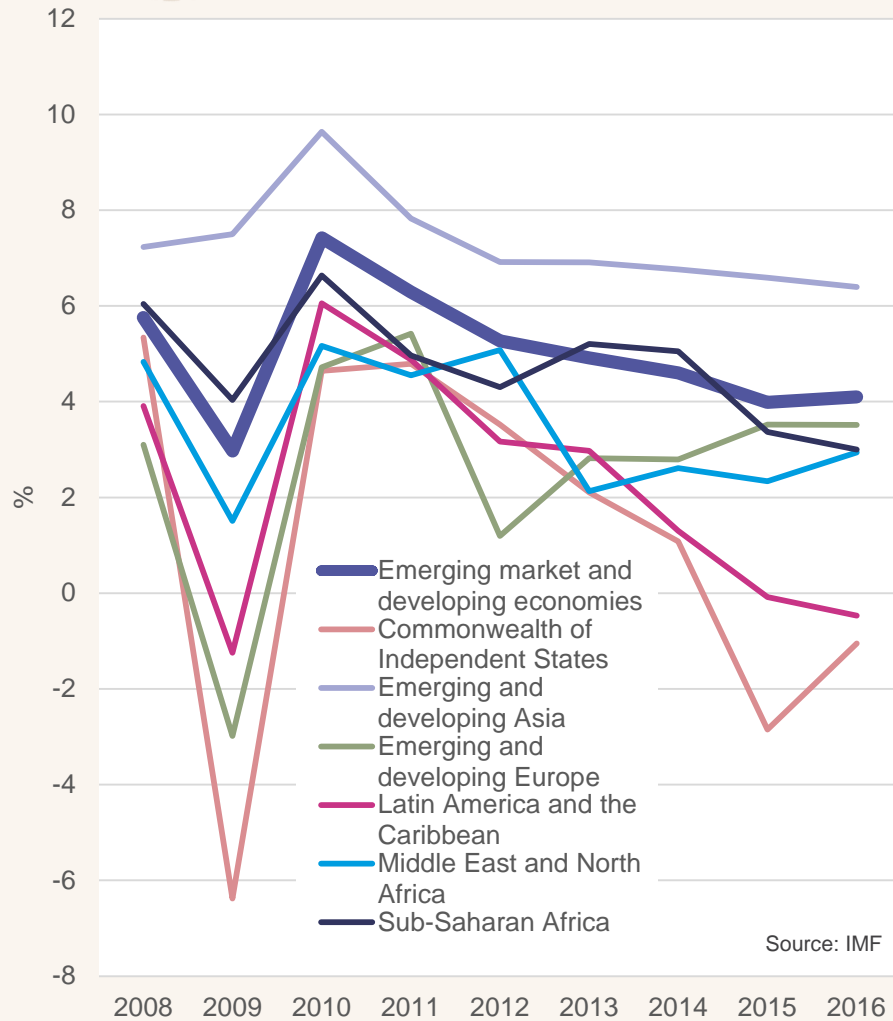
II.2 Emerging markets in 2000-2015

Growth of GDP in various regions, 2000-2007



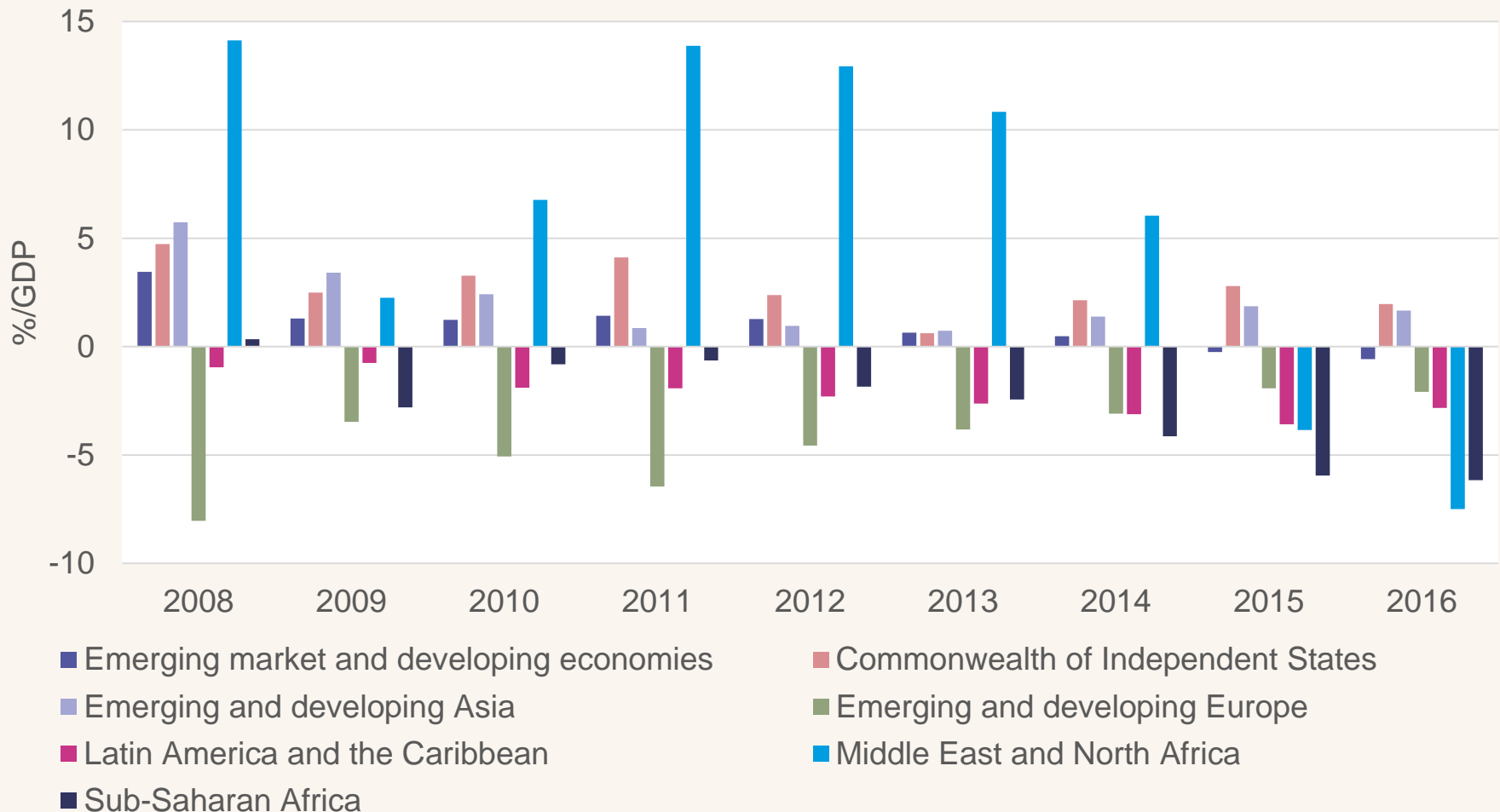


GDP growth 2008-16 in different regions and in selected Asian countries





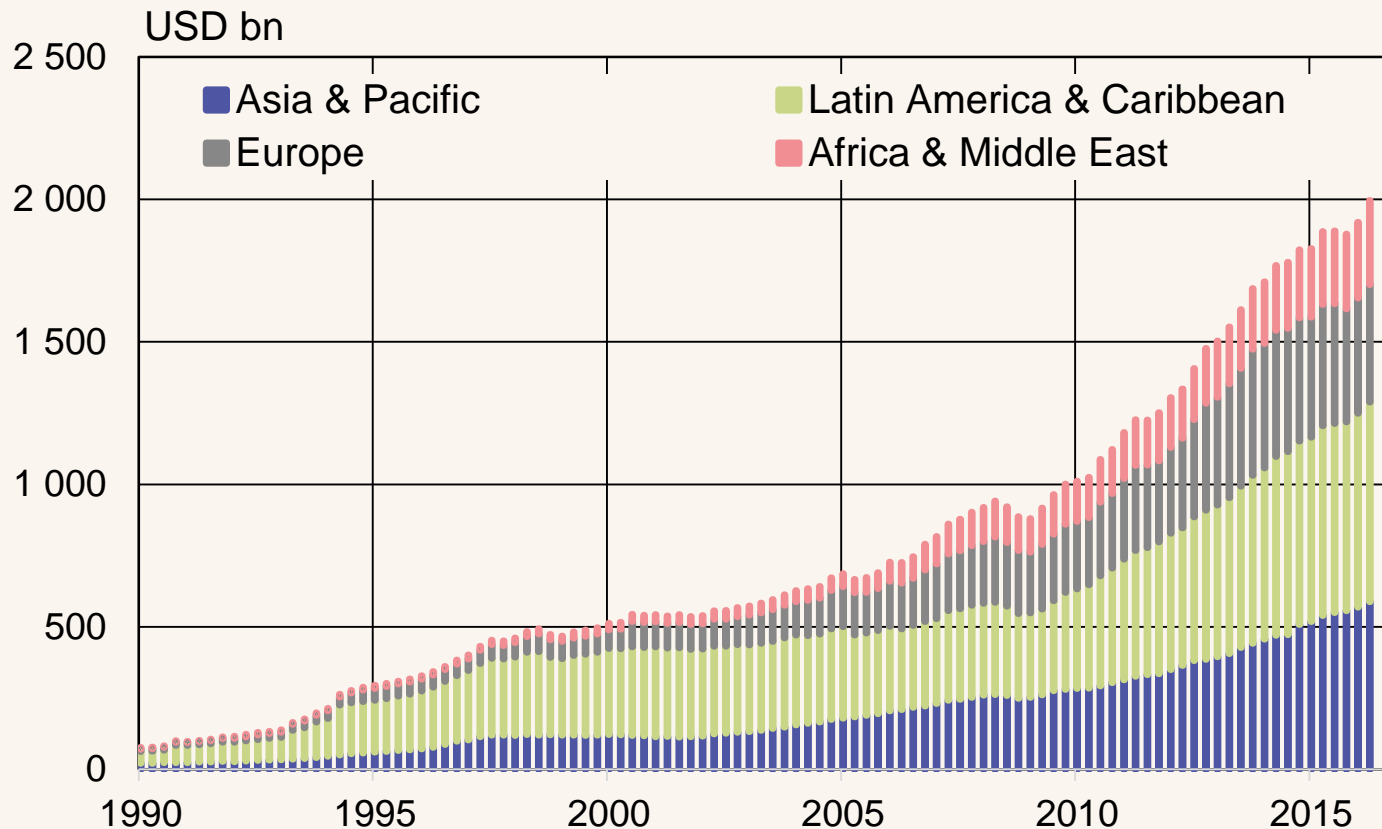
Post-GFC economic recovery has been marked by current account deficits in many regions



Source: IMF



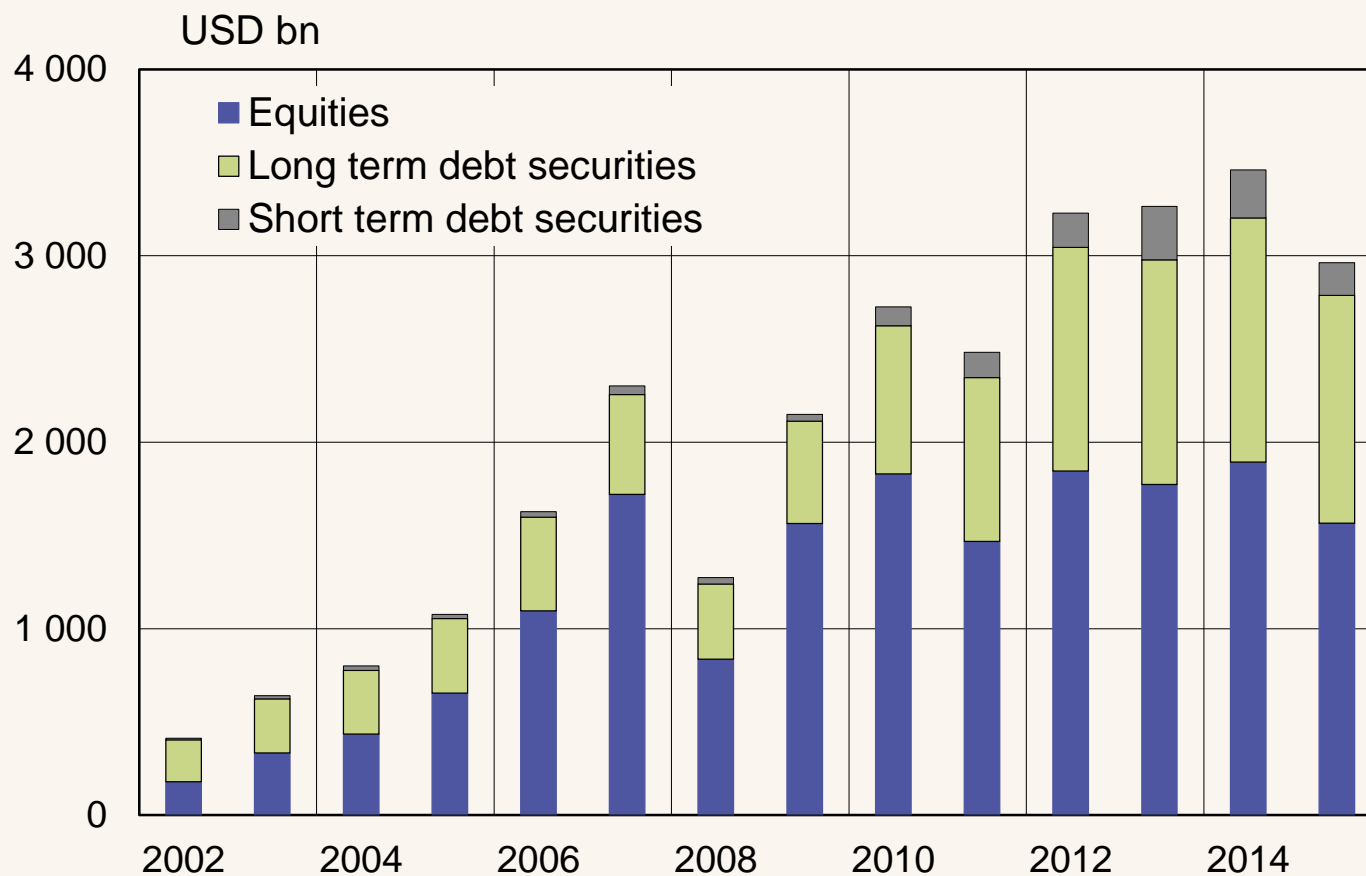
Developing Economies International Debt Securities



Source: BIS International Debt Securities Statistics



Developing Economies Portfolio Investment Liabilities



Source: IMF



III. Causes of financial crises

- Fragility of financial systems
 - Strategic complementarities
 - Asset-liability mismatches

- Asset price collapse

- Amplifying factors
 - Imperfect knowledge and limitations in human reasoning
 - High leverage

- Regulatory failures



IV. Crisis management

IV.1 Prevention of major crisis

- How to diagnose a coming crisis?
- Political-economy reasons can be a major obstacle in crisis prevention.

IV.2 Crisis management

- Maintaining confidence in the banking system is crucial
- The role of macroeconomic policy:
 - Coordinated macroeconomic response in the global crisis
 - Liquidity provision etc. by central banks
- Restructuring of the banking system
 - Capital injections to banks, Improving efficiency of banks
 - Government policies to direct restructuring



Thank you!