

FINANCIAL CRISIS MANAGEMENT

INTERNATIONAL CENTRAL BANKING COURSES
EXPERT PANEL
8–10 JUNE 2009



Centre for Technical Central Bank Cooperation

Financial crisis management |

Report on the expert panel, 8–10 June 2009, held at the Bundesbank in Frankfurt/Main. Prepared by Dr Franziska Schobert, Financial Market Adviser, Centre for Technical Central Bank Cooperation

From 8–10 June 2009, the Bundesbank conducted an expert panel on financial crisis management as part of its programme of international central banking courses. Participants included 16 visiting experts from partner central banks (Algeria, Brazil, Bulgaria, Croatia, Czech Republic, Georgia, Indonesia, Iran, Israel, Kyrgyz Republic, Lithuania, Mongolia, Poland, Philippines, Romania, Russia), two external experts from the Federal Financial Supervisory Authority and the Financial Market Stabilization Fund in Germany and experts from the Bundesbank. They exchanged their views, experiences and knowledge about (a) the causes and consequences of financial crises and how central banks responded, (b) the German historical experience in stabilizing banks' balance sheets, (c) supervision and crisis prevention, (d) the functioning of the Financial Market Stabilization Fund to help the financial sector enterprises in Germany and (e) other German aid systems for banks.

Participants' central banks reported that their countries had been affected mainly by the global financial turmoil following the collapse of Lehman Brothers in September 2008. They mentioned trade flows and workers' remittances as the most frequent channels affecting their respective economies. Foreign ownership in the banking system sometimes also played a role, especially where parent banks had large exposures to structured products or failed counterparties.

The structural liquidity position of the banking system influenced how participants' central banks responded to the crisis. In contrast to the Eurosystem, in many participants' countries the banking system has a liquidity surplus during normal times. Thus, monetary policy operations usually focus on absorbing excess liquidity – especially with the help of minimum reserve requirements. Consequently, the most frequently reported response to emerging liquidity shortages during the crisis was a reduction of minimum reserve requirements. Furthermore, changes in selected autonomous factors tended to dampen liquidity pressures in some participants' central banks, as the demand for banknotes decreased and holdings on government deposits were reduced. This also contrasts with the Eurosystem, in which a higher demand for banknotes – probably also reflecting higher demand from abroad – and larger holdings of government deposits additionally absorbed liquidity.

Many central banks reported lowering policy rates in the face of pressures in the financial markets. Exchange rate concerns seemed to play a secondary role in interest rate setting; only a few central banks reported increasing interest rates temporarily amidst exchange rate pressures. Central bank intervened in foreign exchange markets; at the same time, exchange rates were also allowed to depreciate. In contrast to this general pattern, the participant from Israel reported that its central bank even managed to increase foreign reserve holdings during the recent financial turmoil.

Due to a general shortage of adequate collateral in the financial systems of many participants' central banks, there are limits to a widening

of the eligible collateral during crises. Some participants reported that their central banks had to engage in uncollateralized lending to banks. However, the participant from Bulgaria mentioned that its central bank suffered substantial losses during previous crises in the early 1990s due to uncollateralized lending, which eventually led to a recapitalization of the central bank by the Ministry of Finance.

Discussions also included historical experience of stabilizing banks' balance sheets after financial crises and monetary disruptions and of catalysing improved banking supervision: Cited examples included the introduction of German equalisation claims after the end of the Second World War, the Bankhaus Herstatt and SMH-Bank failures and the creation of the

Liko Bank which still works as an aid system for problem banks, yet on a smaller scale. It was interesting to see that, although equalisation claims worked well in German history, this mechanism is fairly unknown in other countries, as could be observed from the reactions of the participants.

The last day of the expert panel included a presentation on the Financial Market Stabilization Fund that was set up in October 2008 in Germany in order to help to overcome liquidity squeezes and to strengthen the equity base of financial sector enterprises. It was followed by discussions of the structure and financing of funds with similar objectives in participants' countries.

For more information please contact:

Deutsche Bundesbank

Centre for Technical Central Bank Cooperation

Dr Franziska Schobert

Financial Markets Adviser

Wilhelm-Epstein-Strasse 14

60431 Frankfurt am Main, Germany

E-mail: Frankziska.Schobert@bundesbank.de

tzk@bundesbank.de

Tel +49 69 9566 6605

Fax +49 69 9566 6527

Internet: www.bundesbank.de/tzk/tzk.en.php