Managing and Preventing Crises

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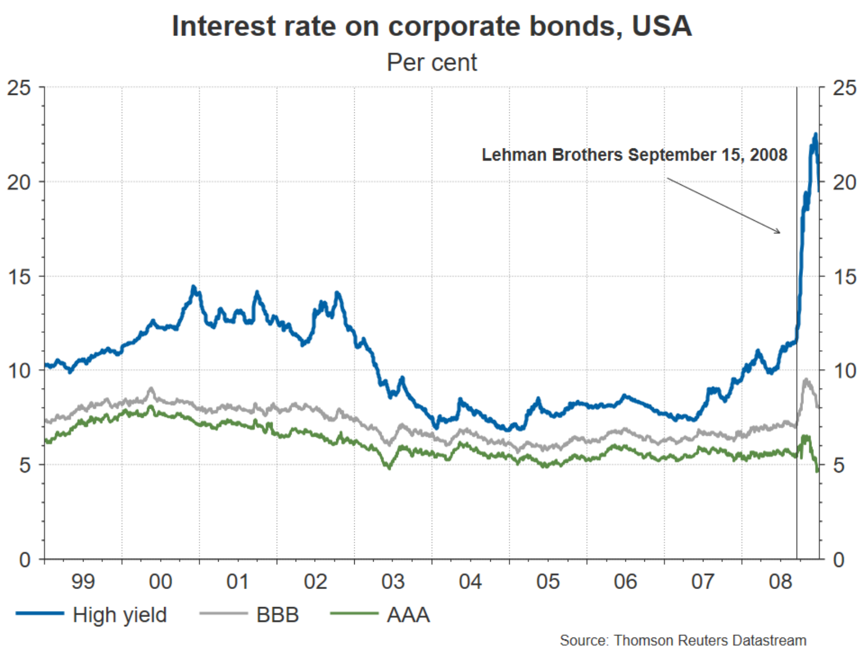
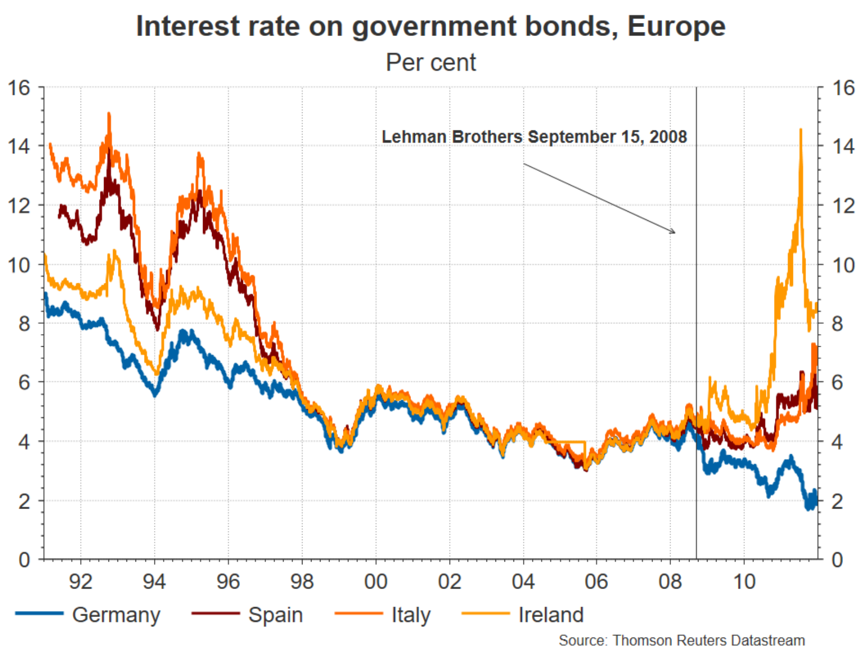
Financial crises come and go…

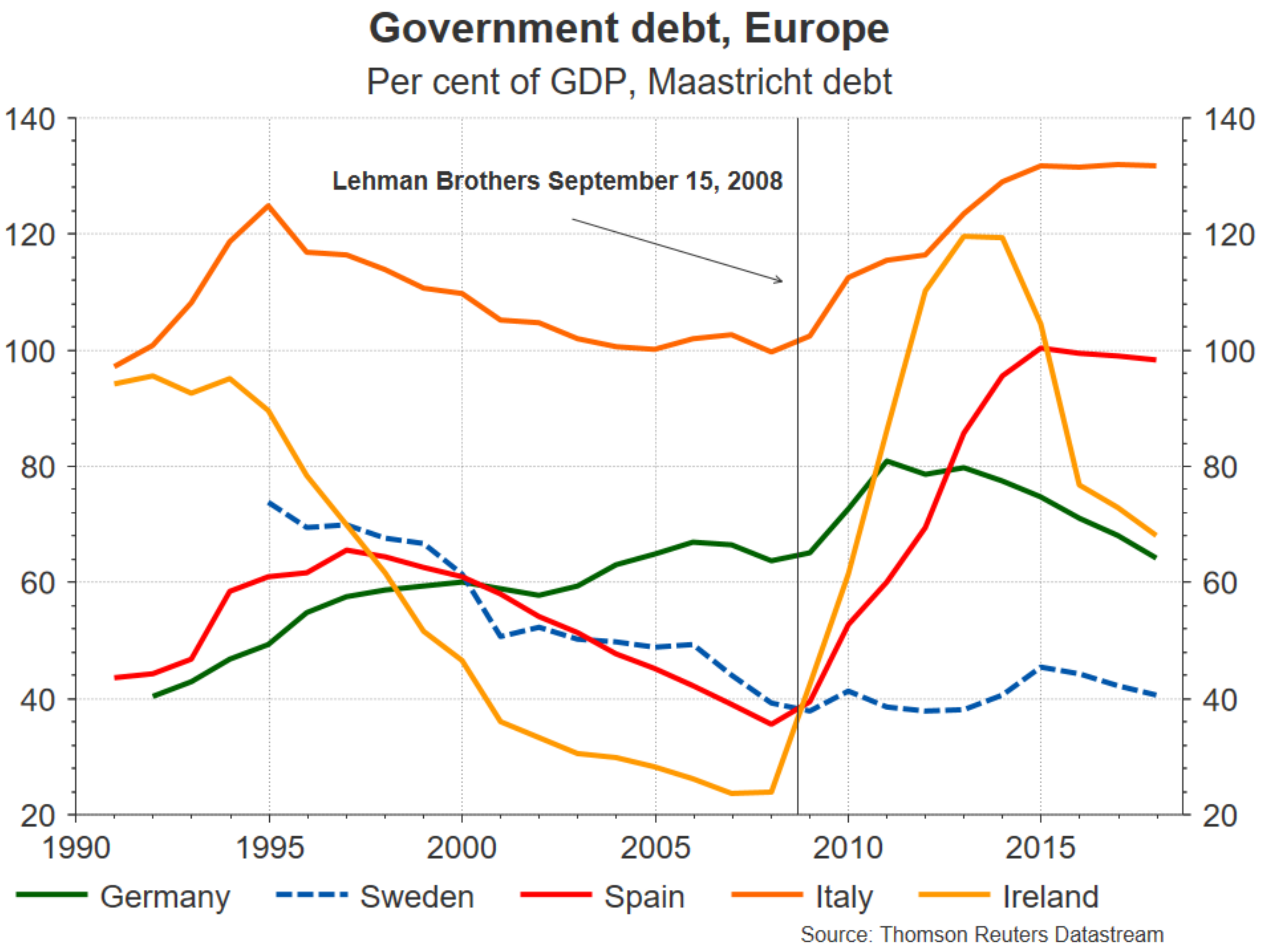
- History shows that financial crises occur repeatedly over time, although with different intervals.
- A financial crisis is one of the most severe economic shocks that can hit a country.
- Experiences from 2008/2009 are important.
  - Easy to forget and think that everything is fixed…
- Preventing and managing crises consists mainly of three parts:
  - Strong public finances and balanced private debt levels.
  - Financial stability.
  - Robust and prompt fiscal- and monetary policy actions.

Increased risk taking and regulatory deficiencies prelude to financial crisis



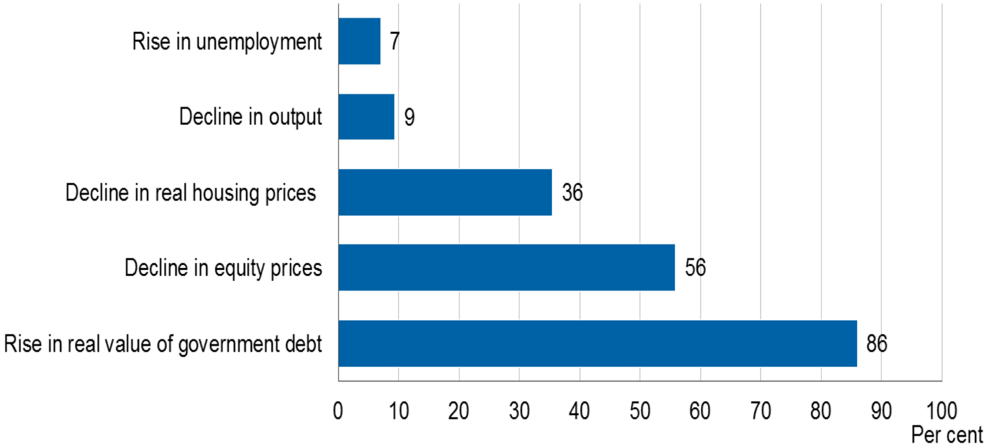


Sweden managed the crisis well



Debt anchor important part of Swedish fiscal policy framework

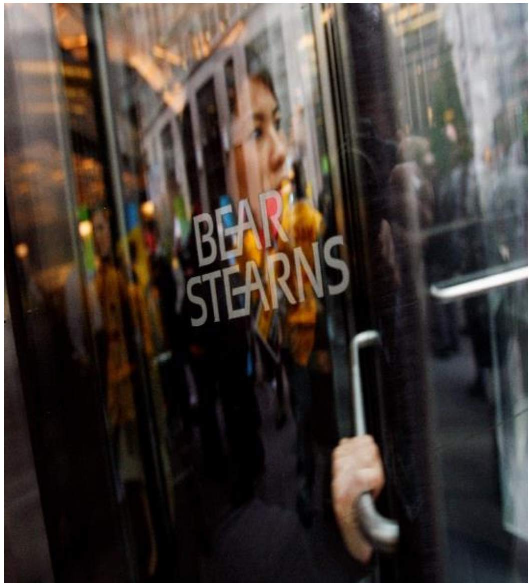
Average effects on selected macroeconomic variables after a financial crisis

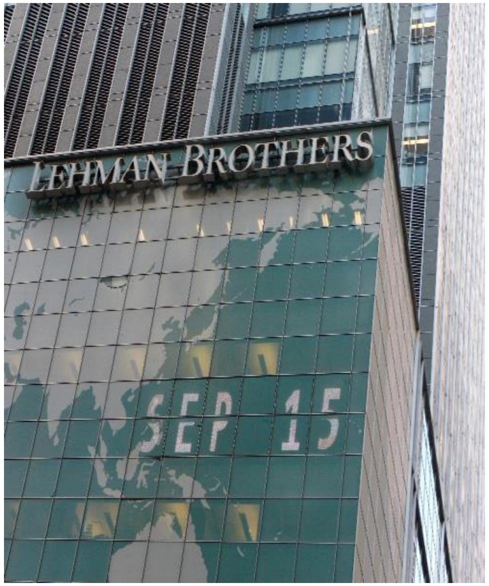


Source: Reinhart and Rogoff (2009).

- Strong public finances prerequisite for successful crisis management.
- Debt anchor part of Swedish fiscal policy framework starting in 2019.
  - Benchmark for entire general government sector consolidated gross debt (Maastricht debt): 35 per cent of GDP.
  - Implying central government debt of 25-30 per cent, which is reasonable.
    - Close to present level.
    - Considerable margin to problematic levels of central government debt of 80-100 per cent of GDP.
    - Sufficient margin to EU Growth and Stability Pact level of 60 per cent.

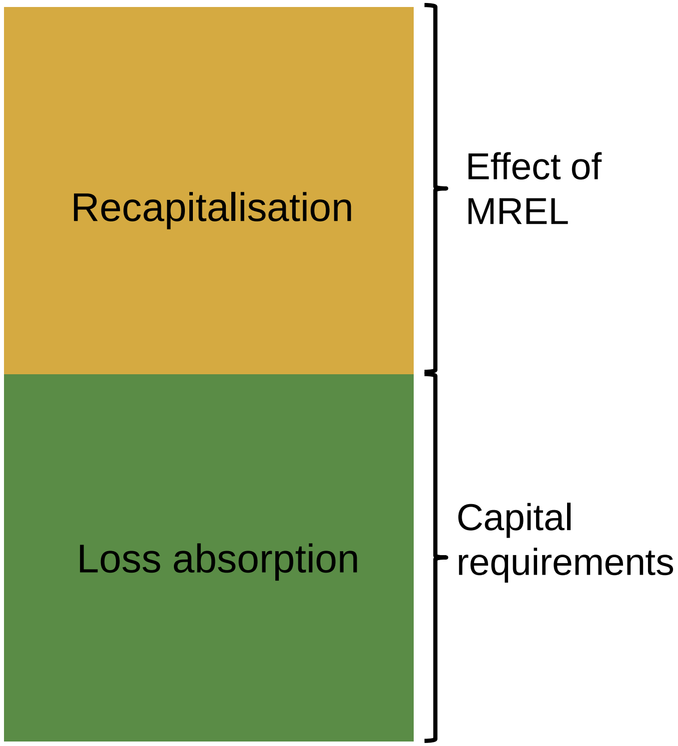
A prudent framework for failing banks is essential





Preparing Swedish banks for resolution

- 10 institutions are systemically important ex ante. Full-scale resolution plans and MREL requirements in place.
- MREL ensures that banks can be resolved without the use of public funds.
- Guiding principles for the SNDO: adequate volumes, right type of instruments, predictability.
- In practice: Recapitalization amount should be met with debt instruments and they should be subordinated by 2022.
- Effects: Market expectations of public support have decreased. Crisis are less likely and less costly

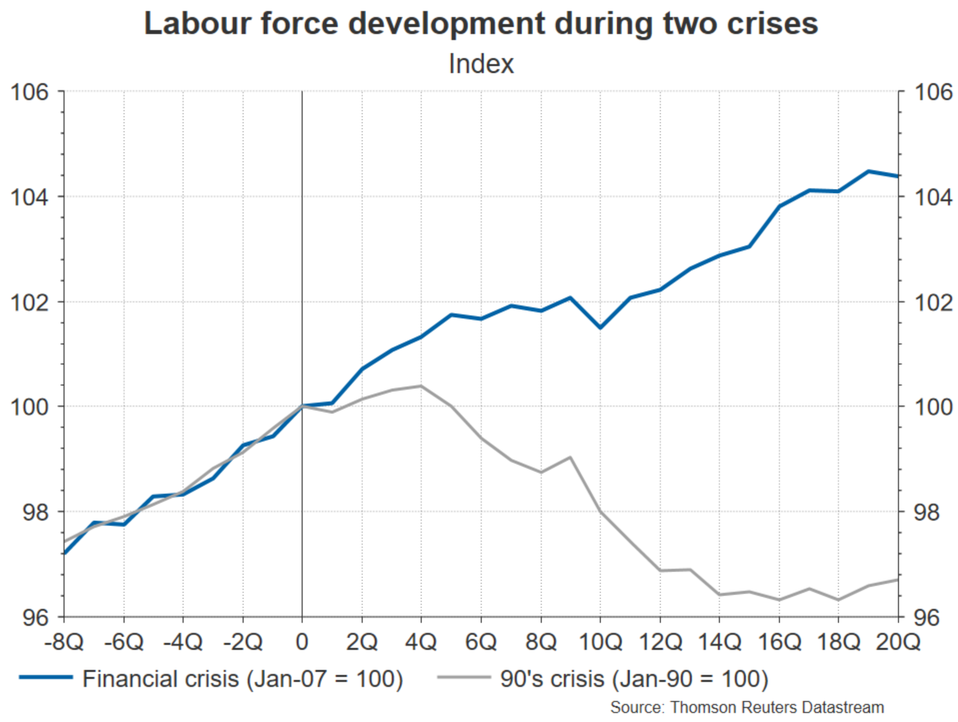


Continuous improvement of banks' resolvability

- Adjustment of balance sheets
- Technical completion of the resolution framework
- Clarity in advance and anchoring expectations
- Cooperation between authorities and dialogue with banks

Resolvability

Fiscal policy actions focusing on structurally efficient measures during the financial crisis



- Designing policy actions.
  - Safeguard sustainable public finances.
  - Maintaining trust for the public contract.
  - Reasonable distribution profile; important to have acceptance.
  - In general: structurally efficient measures.
    - Increasing labour force supply (earned income tax credit, education measures and so on).
    - Increasing demand and labour force demand (ROT).
    - Preventing unemployment from getting stuck at high levels.
    - Robust: Better roughly right than exactly wrong
    - Quick effects.

Lessons going forward

- Sweden today.
  - Functioning fiscal policy framework.
    - Solid public finances.
  - Framework for financial stability.
    - Strong banking sector.
- Important with ”stabilization policy-memory”.
- Implications for present situation.
  - Safeguard existing well-functioning structures.
  - Continue implementing and establishing new features (for example macro prudential policy, FSC).
  - Do not forget that crisis preparations can be made well in advance.
  - Transparent and active communication.