

## The Financial Crisis – the Path Ahead

*Governor Svein Gjedrem*

*The Norwegian Savings Banks Association's  
Annual Meeting, Stavanger  
22 October 2009*

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”Through both of these years, 1921 and 1922, ceaseless efforts had been made week after week to resolve a wretched situation. There was a constant stream of worries, one thing after another, one disheartening report after another, and minor setbacks were followed by major setbacks. It was reminiscent of an operating theatre. The task was onerous not only because of its proportions, but also because of the oppressive weight of the anxiety that accompanied it.”

Nicolai Rygg

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” The greatest risk lay in the fact that this anxiety had now become pervasive. The very foundations of confidence, the nation’s confidence in its own credit institutions had been shaken ... The most important objective was therefore to prevent an avalanche, seek to contain the damage, hang on and hold back. That was the dominant thought, to prevent total collapse, for the danger of this was indeed present... and the general atmosphere of nervousness manifested itself in the most peculiar ways. In the blind panic that ensued, attacks were made on institutions that were more than deserving of their depositors’ confidence.”

Nicolai Rygg

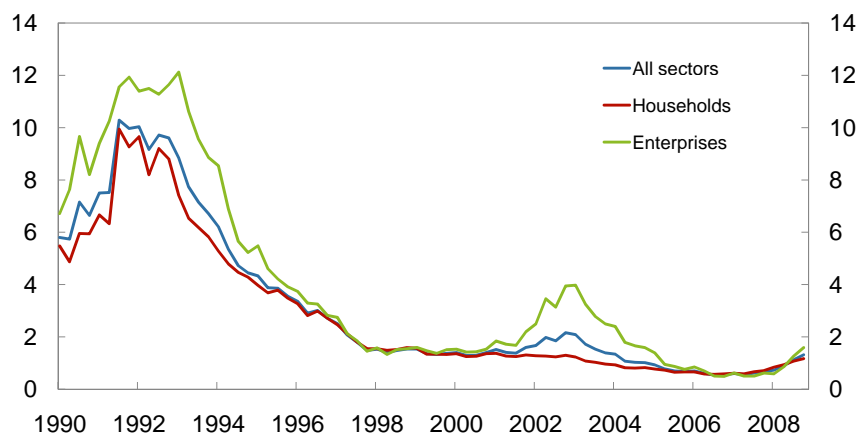
” In the context of the current crisis the surprise was **not** the decline in real estate prices or the fact that subprime mortgages were the first to be affected by this decline. Rather, the surprise was in the distress of many parts of the financial system, even those very distant from the subprime market itself, including all structured products, commercial paper, and interbank lending. At a moment’s notice, linkages became too complex and hard to understand, ... and panic ensued.”

Ricardo J. Caballero og Pablo Kurlat

(2009)

## Norwegian banks' <sup>1)</sup> gross stock of non-performing loans

Percentage of gross lending to sectors . 90 Q3 – 09 Q2

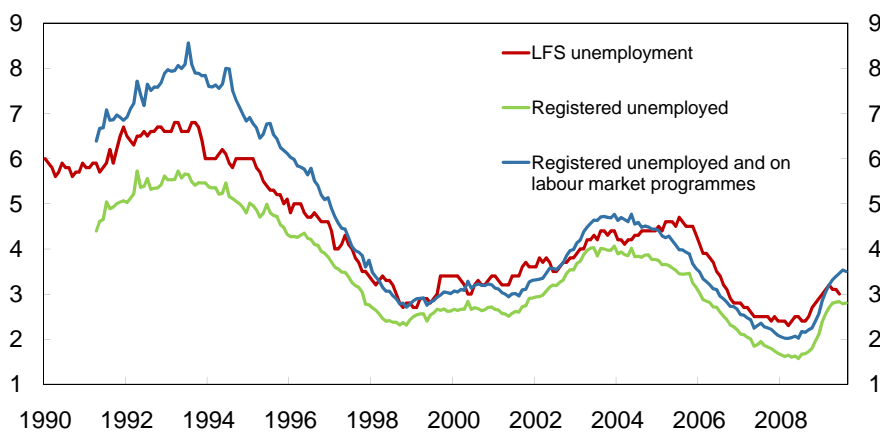


<sup>1)</sup> All banks in Norway

Source: Norges Bank

## Unemployment

Per cent. Seasonally adjusted. January 1990 – August 2009



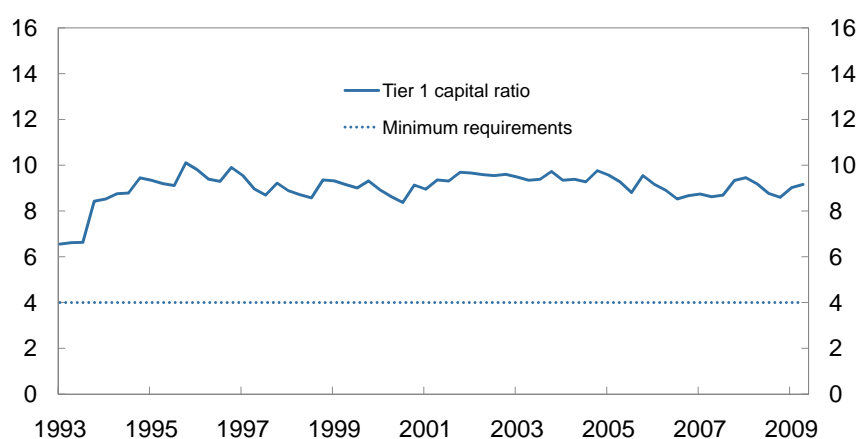
Sources: Statistics Norway and NAV

## Proposals to strengthen banks' capital base and liquidity

- Higher capital adequacy requirement and new minimum equity capital ratio requirement
- Strengthen quality of Tier 1 capital
- Build up buffers in good times that can be drawn on in periods of stress
- Regulation of systemically important banks more stringent than for other banks
- Increased and improved liquidity

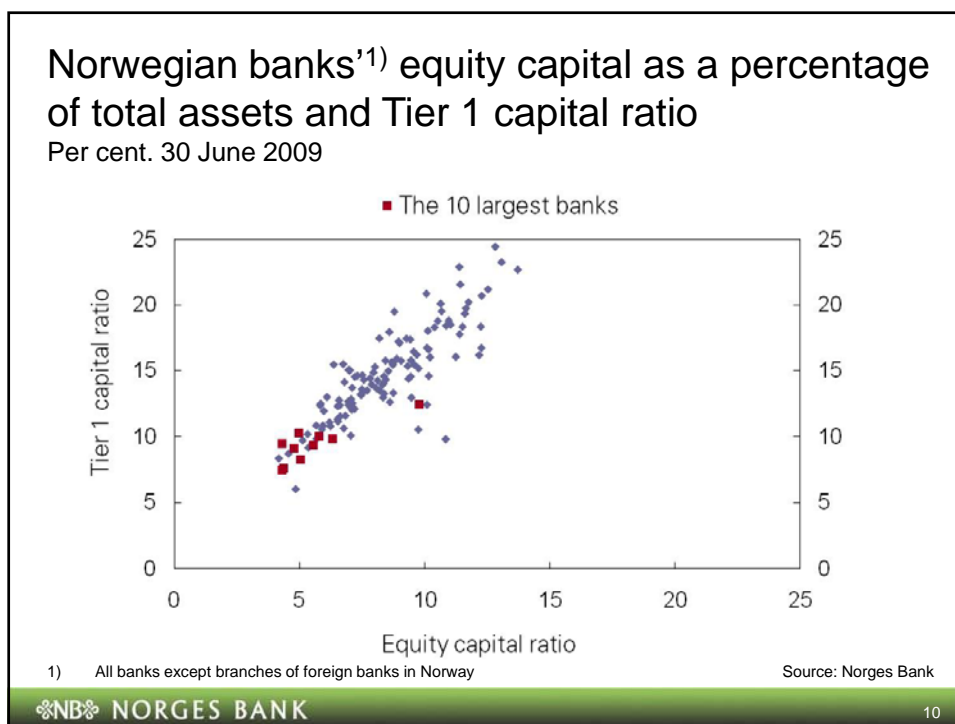
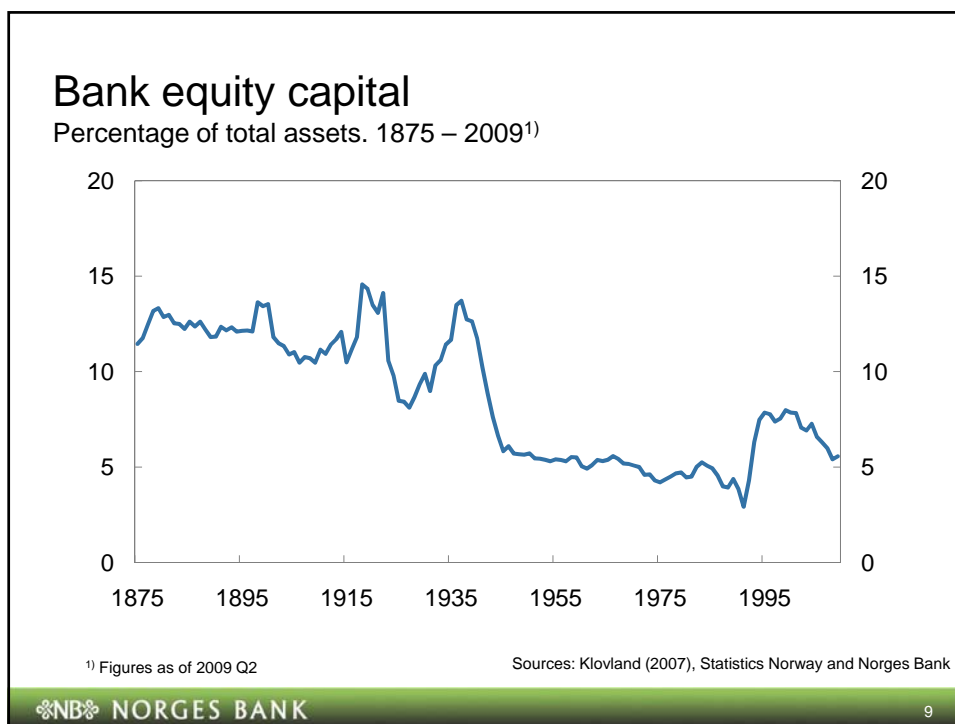
## Norwegian banks<sup>1)</sup> Tier 1 capital ratio

Per cent. 93 Q1– 09 Q2



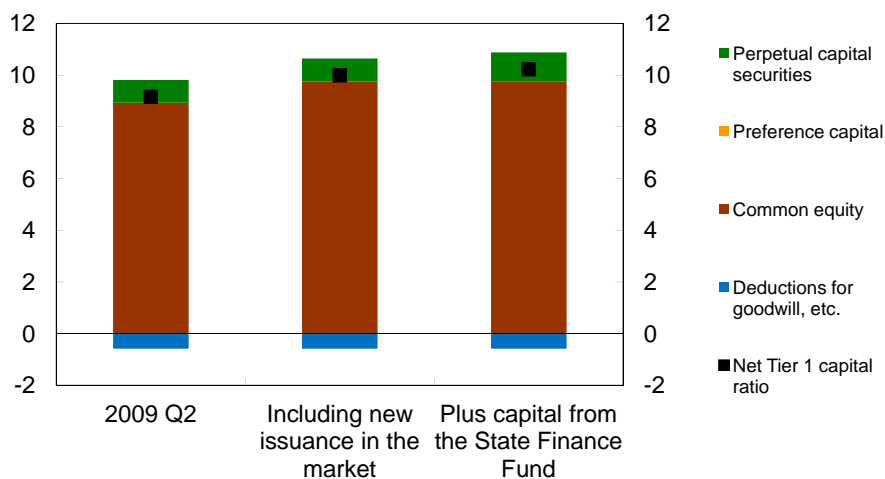
<sup>1)</sup> All banks in Norway except branches of foreign banks

Source: Norges Bank



## Norwegian banks' <sup>1)</sup> Tier 1 capital

Percentage of risk-weighted assets



<sup>1)</sup> All banks except branches of foreign banks in Norway

Sources: The Financial Supervisory Authority of Norway, the State Finance Fund and Norges Bank

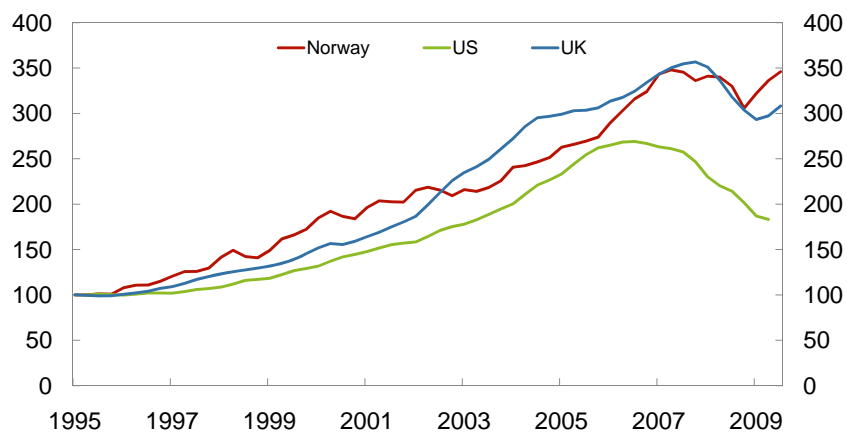
## The macro- and microprudential perspectives

	Macroprudential	Microprudential
Proximate objective	Limit financial system-wide distress	Limit distress of individual institutions
Ultimate objective	Avoid output (GDP) costs linked to financial instability	Consumer (investor/depositor) protection
Correlations and common exposures across institutions	Important	Irrelevant

Source: "Addressing Financial System Procyclicality: a Possible Framework", Note for the FSF Working Group on Market and Institutional Resilience, Bank for International Settlements, 1 Sep 2008

## House prices in selected countries

Index. 95 Q1=100. 95 Q1 - 09 Q3



Sources: Thomson Reuters, Association of Norwegian Real Estate Agents, Association of Real Estate Agency Firms, FINN.no, ECON Pöyry and Norges Bank

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“...(on) October 10, the G-7 met and agreed the following plan of action:

“Take decisive action and use all available tools to support systemically important financial institutions and prevent their failure.”

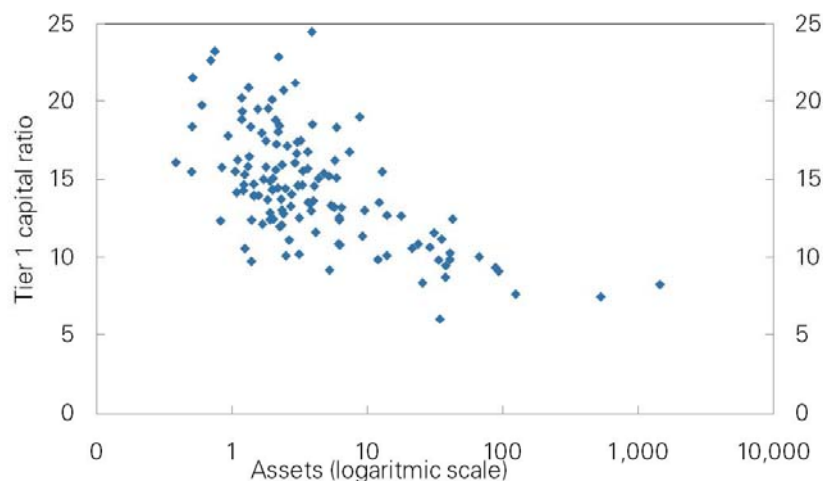
Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, October 11, 2008

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## Banks' <sup>1)</sup> assets in billions of NOK and Tier 1 capital ratio in per cent

As of 30 June 2009



1) All banks except branches of foreign banks in Norway

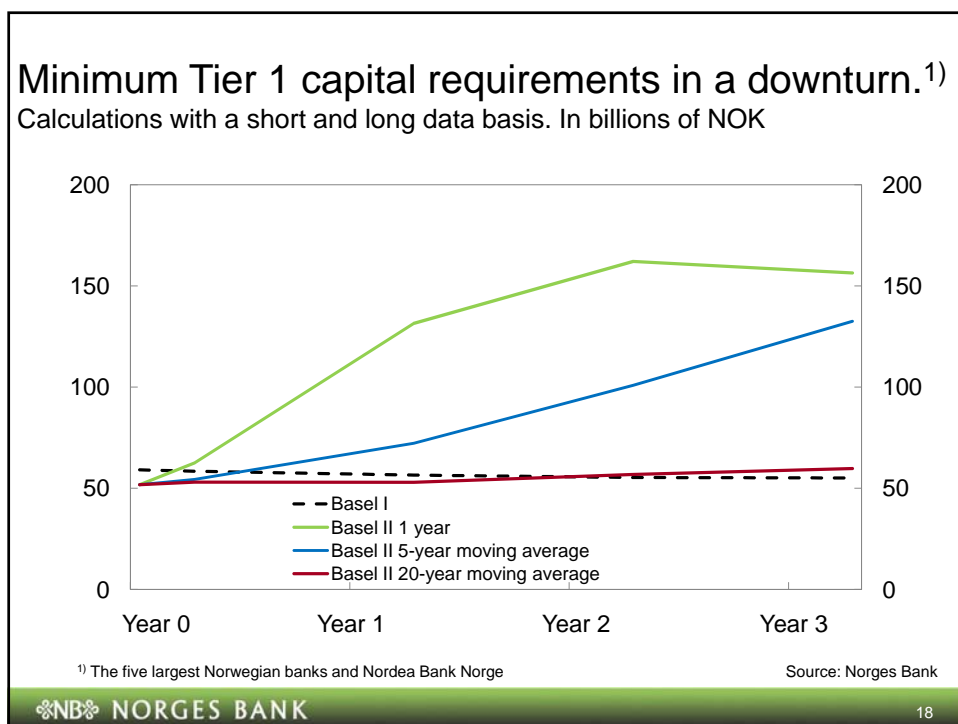
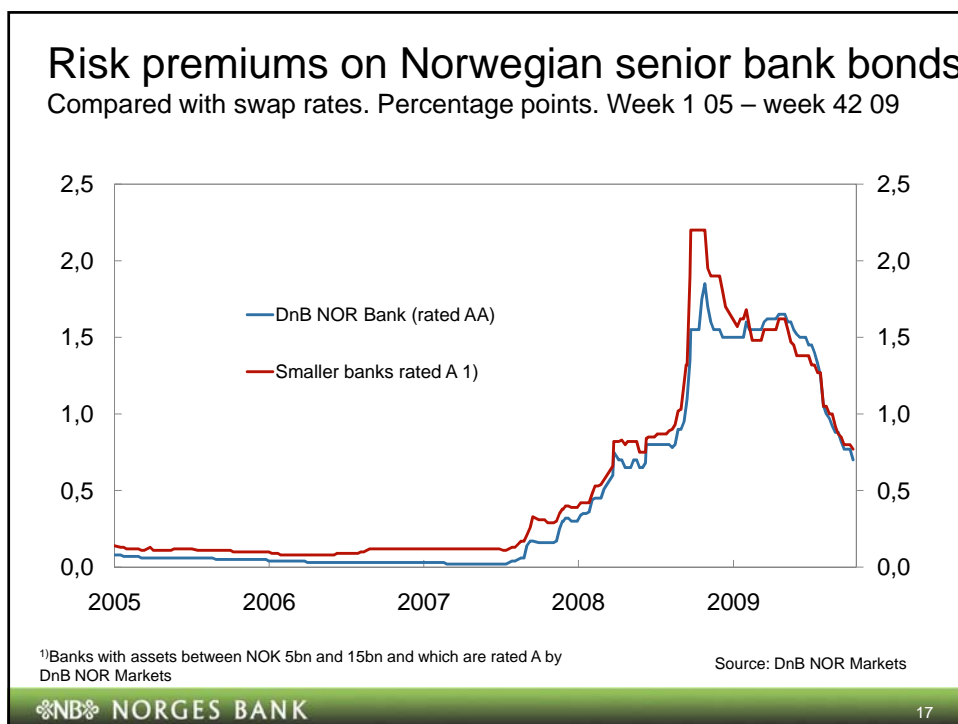
Source: Norges Bank

## Moody's on DnB NOR Bank's rating

“... the bank's debt and deposit ratings continue to benefit from a three-notch uplift from the BCA [Baseline Credit Assessment], which reflects the bank's systemic importance in the Norwegian banking sector as well as the part ownership by the government. Therefore, the ratings incorporate a very high probability of systemic support.”

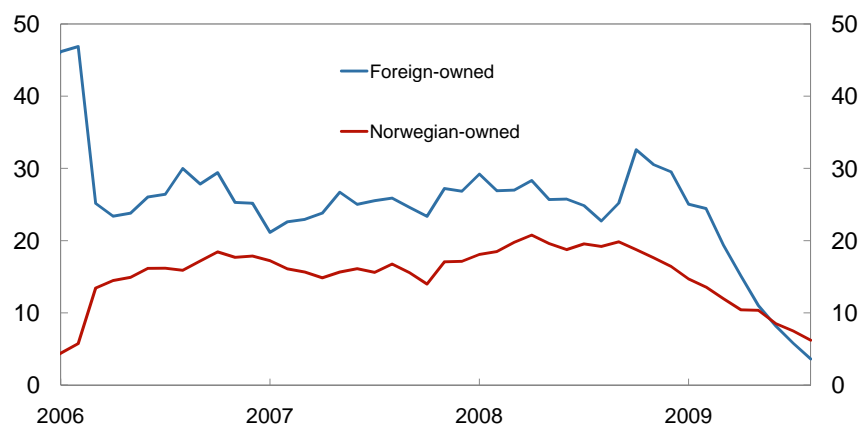
Source: Moody's, 8 Sep 2009





## Domestic credit to enterprises from banks and mortgage companies in Norway

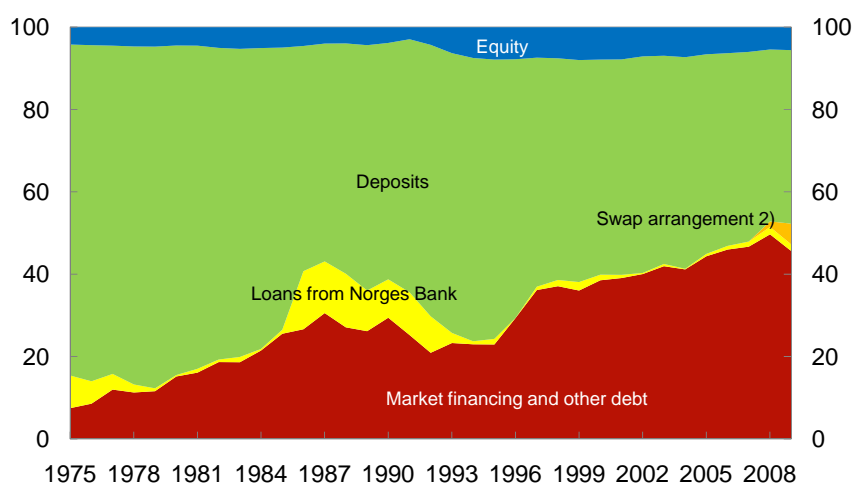
12-month rise. Per cent. January 2006 – August 2009



Source: Norges Bank

## Funding sources for Norwegian banks<sup>1)</sup>

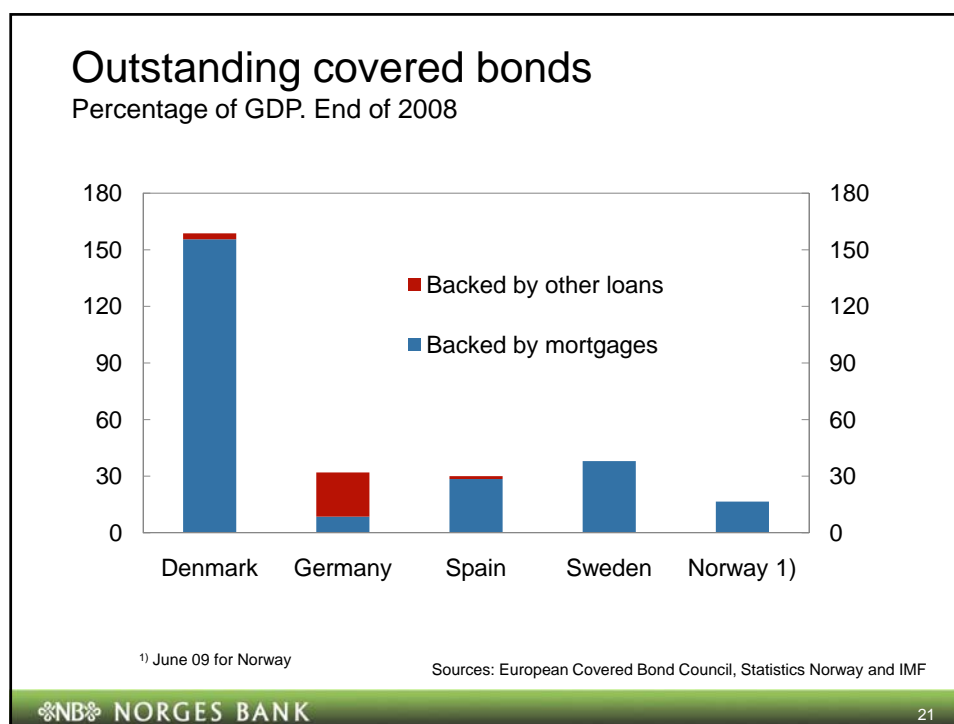
Percentage of total assets. 1975 – 2009<sup>2)</sup>



<sup>1)</sup> 09 Q2

<sup>2)</sup> The swap arrangement is registered in the banks' balances as debt to the government

Sources: Klovland (2007), Matre (1992), Statistics Norway and Norges Bank



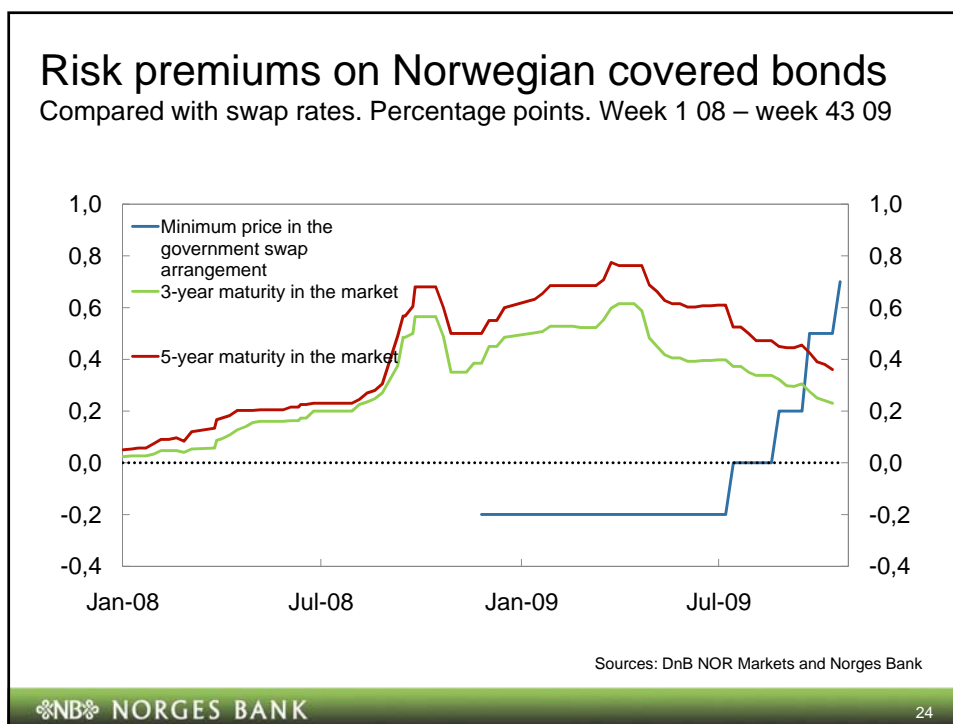
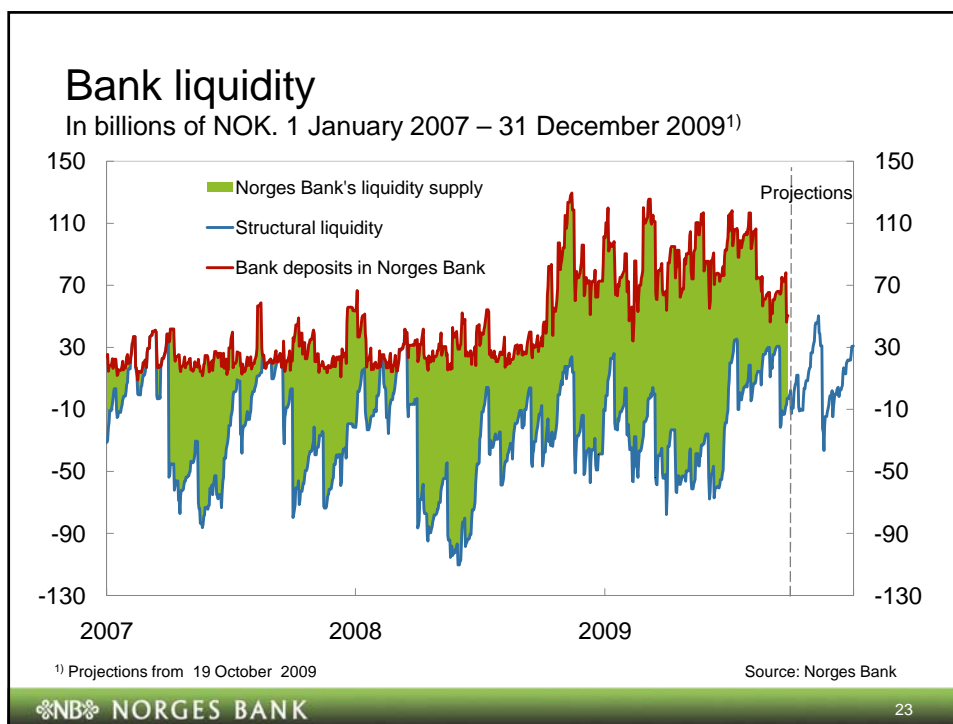
## Flexible inflation targeting

The **operational** target of monetary policy shall be annual consumer price inflation of approximately 2.5 per cent over time.

Norges Bank operates a flexible inflation targeting regime, so that weight is given to variability in inflation as well as to variability in output and employment.

Norges Bank's interest rate setting follows a **reaction function**

- Key policy rate = function of all factors influencing inflation and output

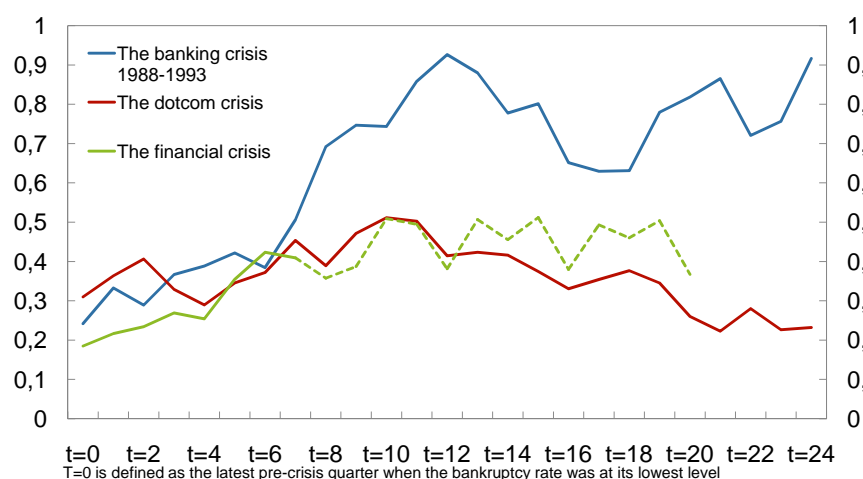


## Changes in collateral for loans in Norges Bank

- New securities under the temporary rules will not be approved as collateral as from 22 October 2009
- Securities already approved under the temporary rules may be pledged as collateral until maturity, at the latest until 15 February 2012
- Debt instruments issued by foreign banks are included in the bank quota as from 1 December 2010
- Securities issued by banks will no longer be eligible as collateral for loans from 15 February 2012
- Norges Bank will continue to accept covered bonds (OMF) as collateral for loans

## Bankruptcy rate during and following banking crises in Norway

Per cent



1) Projections from 2009 Q3

Sources: Statistics Norway and Norges Bank