

What can central banks do in a financial crisis?

Jean-Claude Trichet
President of the European Central Bank

Kellogg Distinguished Lecture Series
Evanston, Illinois

April 2010

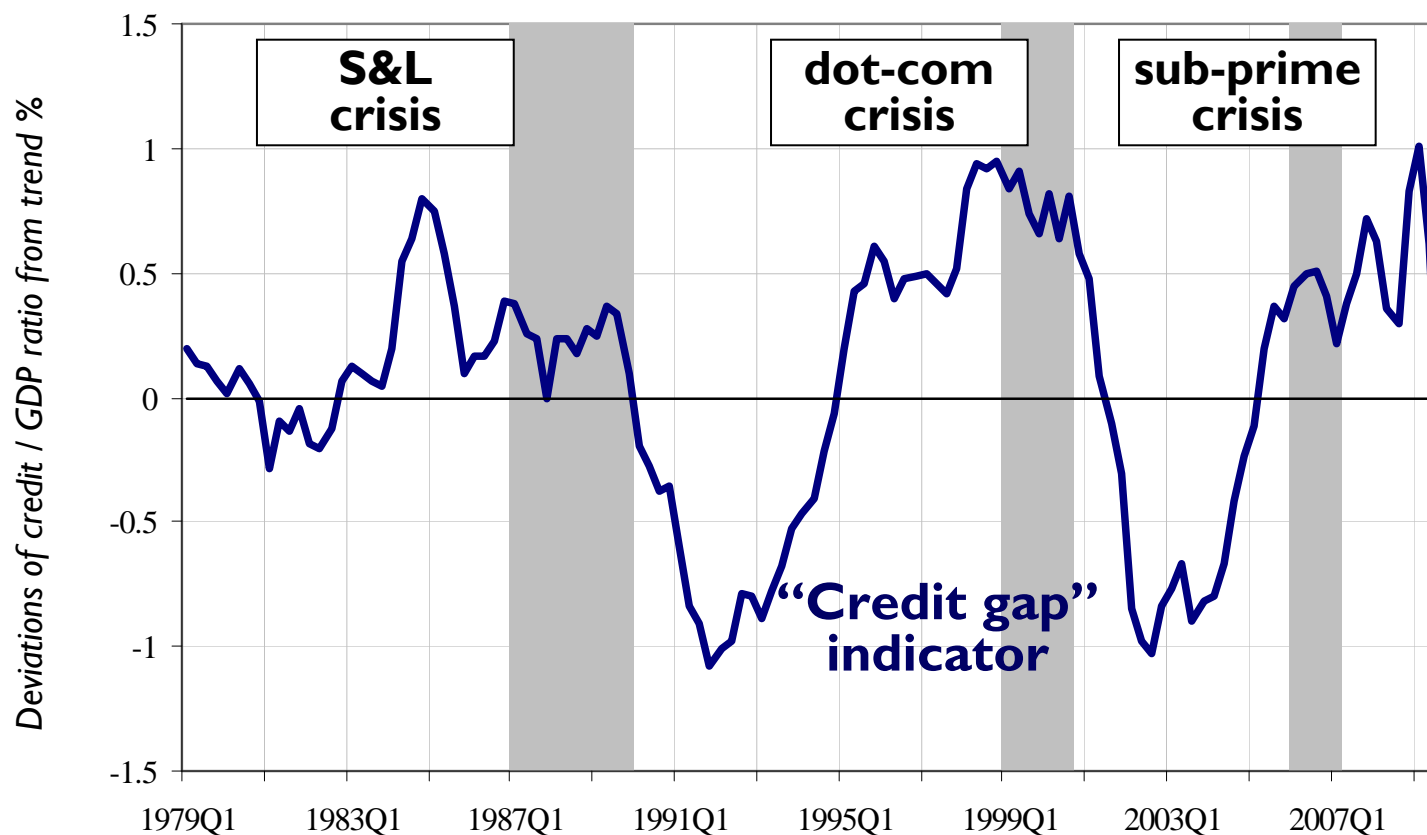
Recent experience of financial crises

- 1980s:** Developing countries' sovereign debt crisis
- 1992-93:** European exchange rate crisis
- 1994:** Mexican crisis
- 1997-98:** Asian crisis
- 1998:** LTCM crisis; Russian crisis
- 1998-2001:** Technology 'dot-com' bubble
- 2007-2009:** Sub-prime / Lehman / 'Great recession' crisis

Exploiting commonalities

- Evolution of financial crises exhibits **common features** across different episodes
- With hindsight, the belief that “*this time is different*” is an illusion
- Existence of such commonalities suggests **early detection possible**
- Need for additional tools and policies, e.g.
 - ✓ *enhanced monetary analysis;*
 - ✓ *macro-prudential surveillance and policies.*

One commonality: *Excess credit leads crises*



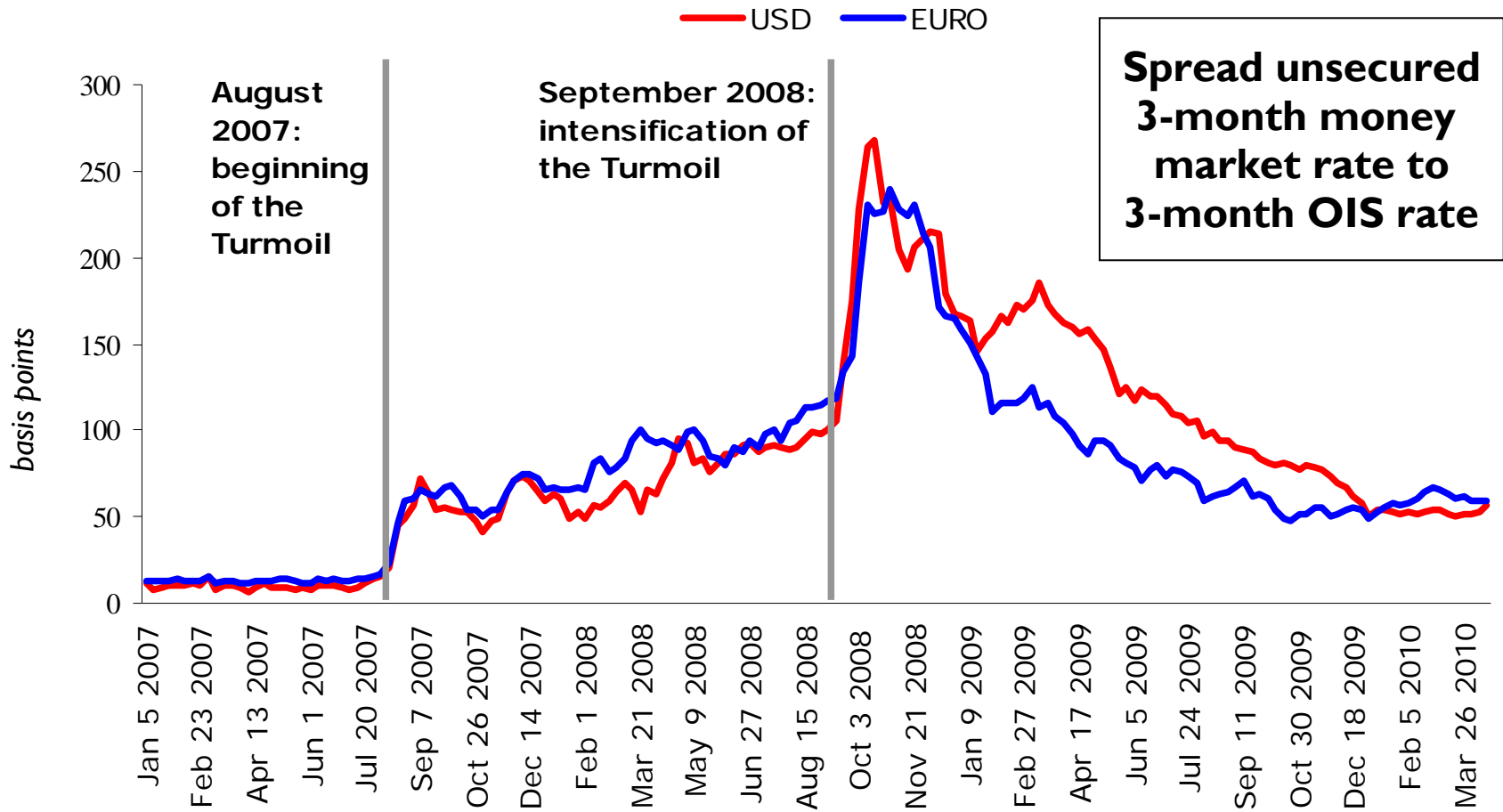
Note: The shaded areas denote widespread housing/equity boom episodes. The global credit gap is constructed using data on private credit for a panel of 13 OECD countries. Credit to GDP ratios are computed for each country and then averaged across countries by means of GDP-weights based on PPP exchange rates.

Source: Alessi and Detken (2009) based on BIS and IMF data.

Respecting specificities

- **Triggers and channels of propagation of crises vary across different episodes**
- **Specificities need to be identified quickly:**
timing of policy response crucially important
- **Current crisis required innovative response,**
e.g. ECB's enhanced credit support

One specificity: Money market turmoil, 2007-10



Note: Spreads are the difference between 12-month EURIBOR / Libor and Overnight Index Swap rates, in basis points.
Source: Reuters / Haver Analytics and ECB calculations. Latest observation 16 April 2010.

Conclusions

1. **Prevention is better than cure**

2. **Guard against complacency**

3. **Crisis management requires:**

both: **innovation and flexibility**

and: **respect for well-established principles**