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Lessons Learned: Steven B. Kamin

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Lessons Learned

Steven B. Kamin

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Steven B. Kamin was the deputy director of the division of international finance at the Federal Reserve Board during the Global Financial Crisis (GFC) and was appointed director in 2011. He was responsible for research, policy analysis, and reporting in the areas of foreign economic activity, US external trade and capital flows, and developments in international financial markets and institutions. This Lessons Learned is based on an interview conducted with Kamin on August 16, 2019; [the full transcript may be accessed here](#).

We need to be careful about excess savings because they can cause interest rates to drop and impact current account balances.

Former Federal Reserve chair Ben Bernanke coined the term "global savings glut" to draw attention to the excess of savings around the world and how it was pulling down interest rates. Kamin studied this phenomenon and how it affects the current account balances of countries.

> Some people believe it was a primary factor [behind the GFC]. Basically, it did so by creating a lot of savings that were intermediated in our financial system, going into mortgages that were not always well advised, and leading to the crash in the financial system."

Having established effective communication and coordination among central banks before there is a crisis is invaluable for ensuring a quick, effective, and forceful response.

The ability to borrow in US dollars became very important internationally during the crisis. Although foreign banks had a lot of dollar assets, they did not have much dollar liquidity. This made swap lines a necessary lifeline for banks abroad so they could continue to function and lend, ensuring that the global financial system continued to function. Kamin explained that swap lines could be established thanks to the cooperation among foreign central banks and the Federal Reserve, which also had the role of the coordinator of swap lines.

He described how significant these efforts were: In October 2008, following the collapse of Lehman Brothers, major central banks coordinated to set interest rate levels. This signaled to the markets that global authorities were cooperating and were ready to respond forcefully to the crisis and, thereby, restored confidence. Furthermore, international cooperation was also seen within the Group of 20 (G-20) countries, which convened and coordinated their support with each other through fiscal policy. Kamin stressed that "in situations where you have global challenges, coordination globally is very important."

According to Kamin, coordination among various countries should not be limited solely to monetary or liquidity policy but should also be established in regards to supervisory regulations. In the case of the Global Financial Crisis, Kamin said, such lines of communication were already established before the crisis hit, and that helped make the response more efficient.

> I would say that it was the swift lines of communication before the crisis that permitted the types of global responses that I was referring to before . . . . There is also a great deal of coordination that goes on amongst supervisory authorities to have globally coordinated regulations, as can be seen with the Basel Committee on Banking Supervision. However, that, too, was already in process beforehand.

Our focus should be not only on crisis response but also on of monitoring vulnerabilities in the financial system to prevent the eruption of new crises.

While it is important and useful to learn how to respond better to a crisis, Kamin also stressed that if we want to prevent future financial crises, we should focus on crisis prevention as well, and in particular, monitor developments in the financial system. Kamin discussed a paper he had written on how the US housing slump turned into a global crisis.[1] The paper found little evidence of "direct contagion" from the United States to the rest of the world, but instead noted that the impact of "indirect contagion" across a number of channels had been powerful. He pointed out:

> Accordingly, channels of "indirect contagion" may have played a more important role in the global spread of the crisis: a generalized run on global financial institutions, given the opacity of their balance sheets; excessive dependence on short-term funding; vicious cycles of mark-to-market losses driving fire sales of MBS; the realization that financial firms around the world were pursuing similar (flawed) business models; and global swings in risk aversion. The US subprime crisis, rather than being a fundamental driver of the global crisis, may have been merely a trigger for a global bank run and for disillusionment with a risky business model that already had spread around the world.

Following on this, Kamin emphasized that regulators should monitor vulnerabilities in the financial system as the Federal Reserve now does with its biannual Financial Stability Report. This process could identify potentially troublesome developments, such as an explosion in new financial products or a preponderance of troublesome business models. With such knowledge, regulators could understand the risks involved and take early action to reduce the opacity around such products and business models, possibly moderating the chances of them becoming triggers for a new crisis.

[1] Steven B. Kamin and Laurie Pounder DeMarco. 2010. "How did a Domestic Housing Slump Turn into a Global Financial Crisis?" FRB International Finance Discussions Paper No. 994. April 7, 2010. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1585195.

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