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Lessons Learned: Stefan Ingves

Maryann Haggerty

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Lessons Learned

Stefan Ingves

By Maryann Haggerty

Stefan Ingves was head of Sweden's central bank, the Sveriges Riksbank, from January 2006 through December 2022. During Sweden's banking crisis of the early 1990s, he was undersecretary and head of the Financial Markets Department at the Ministry of Finance. Previously, he previously was chairman of the Basel Committee on Banking Supervision and held leadership positions at the International Monetary Fund (IMF) and the Swedish Bank Support Authority. In November 2021, he was elected to a three-year term as vice-chairman of the Bank for International Settlements (BIS). This Lessons Learned summary is based on an interview with Ingves on December 6, 2022, shortly before he stepped down from the Riksbank; the full transcript may be accessed here.

Institutionalizing lessons from crises experiences and maintaining those processes, even in quiet times, will help prepare for future crises; there is usually little time to research and create crisis-management tactics in the midst of a crisis.

Stefan Ingves was involved in responding to several financial crises throughout his career—Sweden's banking crisis of the early 1990s, the international crises of the late 1990s, the Global Financial Crisis (GFC), the eurozone crisis, and the COVID-19 crisis. Knowledge gained in one crisis can improve responses to later ones, he said, and should help authorities be better prepared.

Sweden maintained financial sector controls—interest rate caps, loan ceilings, foreign exchange controls, and more—longer than most developed countries, Ingves said. But by the 1980s, it became apparent that deregulation was needed. However, post-deregulation, credit increased rapidly, as was expected, but "given the exuberance in the system as a whole and given the inexperience with taking risks," the whole system grew far beyond expectations until the Swedish system "blew up." By the early 1990s, he said,

> We had a foreign exchange crisis, we had a fiscal crisis, and we had a banking crisis. And we had all of these at the same time. For a hundred years, we hadn't really dealt with a banking crisis, so there was no actual knowledge at all about how you actually deal with it and what you do. And there was zero experience on the public sector side in taking over a bank.

With no system in place for addressing a failing banking system, Sweden's Finance Ministry used its civil code rules surrounding bankruptcies or near-bankruptcies to recapitalize failing banks through government takeovers. It relied heavily on outside consultants who were experts in investment banking and corporate finance. Ingves recalled,

> One example of our lack of knowledge was that, in the early days (when this was all managed in the Finance Ministry before the Bank Support Authority days), we ended up actually recapitalizing some of the savings banks, what is called Swedbank today,

> three times. And that's of course just another way of saying that the first time we were clueless.
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> [. . .] We didn't have any rules or regulations in place. And you are always better off designing the chair that you're going to sit on earlier than later. And it's not good to try to knit on the [fireman's] hose when the house is burning. You are much, much better off preparing.

In the wake of that crisis, Sweden established a bank resolution system via the Bank Support Authority, which had wide power to clean up the remains of the failed banks. It was successful, Ingves said. However, in the years that followed, those legal authorities lapsed. Ingves said,

> All the rules and regulations and the law that was put in place had sunset clauses. After a few years, there was no need for the Bank Support Authority, and everything disappeared. So, we had nothing on the books when things started going south again. Everything had to be restarted. [. . .]
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> It would've been better, of course, if we had maintained some of these things. But keep in mind that if you go to the late 1990s, early 2000s, conversations about global systemically [important] financial institutions, bail-in, living wills—all this stuff that came after the Global Financial Crisis—did not exist. So basically, I guess that the idea back then was to say that this is over, and if things start going wrong again, then we do a rerun of what we did in the early '90s, but then we'll put those rules in place when all these things happen.

Given this experience, Ingves strongly recommends that countries establish a framework to respond to banking crises ahead of time and keep it active through periodic crisis management exercises.

> I do think you are always better off if you have some sort of rules that you can read up on when you run into trouble, compared to having none, because that gives you a bit of a guidance. When a crisis happens, one crisis is rarely identical to another, but directionally, it's a very good thing that you have guidance, because it's easier to create a vision of where to start, who does what, when, and why. Doing all sorts of exercises, crisis management exercises, that's a good thing. It's never similar to what it is like to decide things at three o'clock in the morning, but at least it gives you an element of the mindset that you need to be in when you decide on these things. And that's a good thing.
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> And then, you actually need to make sure that you have the capacity to do what you have to do. And that's really hard because it's essentially running an institution waiting for what to do. It's like owning a Cadillac, but most of the time it's just idling. But all of a sudden one day, you have to put the pedal to the metal. And if you have no idea how to do that, that's really a bad place to be in.

Even healthy systems are subject to contagion from outside their borders. The risks of interconnected financial systems and trade should be recognized and planned around.

Ingves became governor of the Riksbank in 2006. At the time, Sweden's fiscal position was strong and so was its economy. The banking sector had grown, expanding internationally, especially with lending in the Baltic countries, and Icelandic banks had been operating in Sweden offering very aggressive rates to retail depositors. But then, elsewhere, the GFC was mounting. Ingves said,

> The setup is very different because in the early '90s, to oversimplify, we were not okay, but the rest of the world was reasonably okay. Now fast forward to 2007, '08, and '09, we are actually as a country, as a nation, okay, but the rest of the world is not okay. [. . .]
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> Now in this environment, all of a sudden what happens is a perfect storm around us, because you have all the problems that you had in the US—mortgage market collapsing, all these other things going on basically on Wall Street in one form or the other. The Fed having to step in, the FDIC doing its bit—all of this is well documented. At the same time, given the openness of our system, our banks are quite dependent on funding in the dollar market.

Banks in the Baltic countries and in Iceland began to run into trouble. Ingves said,

> That created all sorts of issues and problems. This creates a very, very complicated environment, where we try to, in some sense, do what we can in the Baltic countries so that we don't import all the problems from the Baltic countries, and we don't want to import all the other problems from Iceland. And we try to manage this perfect storm around us.

And then, the US mortgage market cratered, and so did Lehman Brothers, and the dollar market froze. Ingves said,

> And then of course, when that happens, then our whole system also goes down if we don't get any dollars. And then, we had to struggle through that, which we did quite successfully together with the Federal Reserve, while at the same time we're dealing with the Baltic banks together with the IMF, and we're also dealing with Iceland, also eventually together with the IMF.
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> Then we try to run these things as best as we can by lending more and more money, in one form or the other, to the banks, both in Swedish krona and in US dollars. One failure of ours was that when the whole system froze, we at the central bank could not lend to the banks. So, the National Debt Office had to do it instead for about a week or two weeks, because no one had ever expected that to happen.

The lesson, Ingves said, is that:

> You have to be very careful in a small open economy, because even in this particular case, when everything seems to be okay at home, you can still run into trouble. Because this time it wasn't for us about solvency; it was about liquidity. And when the global market freezes up, then you've got to get dollars from somewhere. And then you have to have enough foreign exchange reserves, or you need to borrow, or you need to find some way of dealing with that.
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> You are actually better off doing these things sooner rather than later. Because like it or not, it's not good enough to say that we are fine when the rest of the world is not. Because in a small, very, very open economy with a very large financial sector, you are very, very exposed.

The eurozone crisis that followed on the GFC also affected Sweden, but to a lesser extent. (The country does not use the euro but is part of the European Union.) Ingves recalled,

> We didn't really understand whether it would affect us a lot or not. Given that we were not part of the euro, we were in some sense bystanders and onlookers. Now from a macro perspective, the euro crisis wasn't good at all for us, because about 50% of our exports actually go to the eurozone. So, if the eurozone is in trouble, eventually we will end up in trouble, in one form or the other. [. . .] One way of expressing this domestically was for me to say, "You want to debate whether we should lend money to the Greeks or not. And you are worried about that, but keep in mind that if the Greeks don't have any money, they can't buy Volvo trucks." And that catches the difficulty in all of this and how to deal with it.

In addition to being the lender of last resort, a central bank should be "the risk-taker of last resort."

The Riksbank was one of the first central banks to set policy interest rates below zero, and it stuck with negative interest rates for five years, finally inching back to zero in early 2020. And then COVID-19 was declared a pandemic. The Riksbank did not move rates back down. Instead, Ingves said, there were other ways to keep the economy as stable as possible.

> We felt that it was very important to make sure that there was a stable supply of credit in the economy. Not that we, in the spring of 2020, could tell what was going to happen, because that was impossible, nor did we have any idea at all how long the shutdown period would be and how long the pandemic would last. But we wanted to make sure, or do at least what we could do, to ensure that the pandemic would not, at the end of the day, also produce a banking crisis.

To address the effects of the pandemic, the Riksbank started lending to banks. It bought mortgage-backed securities, a big part of Sweden's bond market. It bought municipal bonds and corporate debt.

> All these measures pushed down the level of rates in the system as a whole; spreads narrowed in the system as a whole. And we felt that that was what we could do in order to keep things moving. [. . .] Basically, we felt that during these conditions, make

sure that the pandemic doesn't morph into a financial crisis; during these conditions, there is no one else out there willing to accumulate debt and to take risk.

And our job is to . . . be the lender of last resort, but also be the risk-taker of last resort. And that's what we did, and that's why we did what we did. And in that environment, we also felt that it was much more important to push down spreads than to deal with 25 basis points on the policy rate, because the policy rate was at zero already. And the policy rate as such, we felt, was not a major impediment to keep credit markets working.

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