

Preface

It has been ten years since the Norwegian banking crisis ended. Although many papers have been written about the Norwegian banking crisis, it may be time to consider the crisis in retrospect. Actually, it is our impression that a comprehensive, but reasonably compact description in English of the Norwegian banking crisis is lacking. With this publication, we try to fill this gap.

In the first chapter of this publication, Bent Vale gives an overview of the Norwegian banking crisis. Vale discusses the typical features of the crisis in order to see what general lessons can be learned from the Norwegian case. He concludes that there is little doubt that the Norwegian crisis was systemic. During the crisis, banks accounting for almost sixty per cent of bank lending to the non-financial domestic sector were in trouble. The chapter draws on the contributions of the five subsequent chapters, which deal in more detail with the various aspects of the crisis. However, each article may be read independently of the others. Although a major objective of Vale's chapter is to present a comprehensive review of the crisis, it is not our intention that this chapter shall constitute "an official Norges Bank assessment" of the Norwegian banking crisis. Views and conclusions expressed in the various chapters are those of the authors and do not necessarily represent the views of Norges Bank.

In the second chapter, Erling Steigum addresses the lessons from Norway's boom-bust cycle and banking crisis and compares this with what happened in Finland and Sweden. The deregulation of the credit market triggered a lending boom that made the Norwegian economy very vulnerable to adverse shocks when the exchange rate was fixed. A major policy conclusion in this chapter is that the pro-cyclical monetary policy due to the fixed-exchange-rate regime was one of several important factors explaining the weak performance of the Norwegian economy, the sharp decline in real estate prices, and the banking crisis.

In the third chapter, Knut Sandal examines the resolution methods and fiscal costs of the Nordic banking crises. In much of the literature on financial crisis, the Nordic banking crises are regarded as one crisis, or three rather identical ones. However, the three crises differed, even if they had many common features. In fact, the resolution of the Norwegian crisis differed in some important ways

from the resolutions applied in Finland and Sweden.

In the fourth chapter, Cristoph Schwierz reviews previous estimates of output losses for the Nordic banking crises and presents some alternative estimates. The new estimates for output losses are found to be lower than in previous studies. The wide variation of the estimates illustrates the methodological difficulties involved in isolating the effects of a banking crisis per se.

In the fifth chapter, Karsten Gerdrup compares three booms and busts and banking crises in Norway since the 1890s. Although the crises occurred in different institutional environments and monetary policy regimes, it seems that the banking crises reflect an unwinding of financial fragility built up in the preceding booms. All boom periods were characterized by significant bank expansion, considerable asset price inflation and increased indebtedness.

In the sixth chapter, Hans Petter Wilse deals in some detail with the actual management of the Norwegian banking crisis and the establishment of state ownership of commercial banks. While the solvency problems of the banks up through 1990 were largely handled by the banks' own deposit insurance funds, the crisis reached such proportions in 1991 that extensive government support was necessary. As a result, three major Norwegian banks ended up as government property.

Appendix A contains the concluding remarks of the Parliamentary Commission on various causal factors linked to the banking crisis. The Commission's report also examines possible efforts to prevent future financial crises, and many of these efforts have been followed up. The commission was appointed by the Storting (parliament) in May 1997 and completed its report in June 1998. In Appendix B, Harald Moen describes in some detail the calculations of the present value of government investments in and support to the Norwegian banks during the banking crisis.

The various chapters cover different aspects of the Norwegian banking crisis. While most seem to agree that the resolution of the crisis in Norway was fairly successful, it may be argued that the building up of the crisis could have attracted attention at an earlier stage. Moreover, it may also be asserted that one of the main problems was the commitment to a fixed exchange rate, which led to a procyclical monetary policy in the boom as well in the recession. However, this is said with the benefit of hindsight. In retrospect, it is easy to list factors that could have led to a less severe course of events. The right timing of measures and policy choices will always be complicated, given the political constraints and the information available when the policy decisions have to be made.

In light of the experiences from the previous Norwegian banking crises – and the fact that many other countries have experienced similar crises prior to the 1990s – one may wonder why the experiences from the previous crises were not drawn upon more heavily. During the four decades after WW II, no major changes in the thinking about crisis prevention and resolution appear to have

taken place. This is in sharp contrast to developments since the early 1990s, where issues related to banking and financial system soundness have moved to the centre stage.

The experiences from the Norwegian as well as the Nordic banking crises show that a balanced macroeconomic development is important to secure a stable financial system once the credit markets are deregulated. In an inflation targeting regime, the possible policy conflicts of monetary stability and financial stability are markedly reduced. Furthermore, an important lesson from the crises is the need for macro-orientation of prudential regulation and supervision. In recent years, much has been done, nationally and internationally, to strengthen the macroprudential framework. International organizations such as the IMF, the World Bank, and the BIS, as well as central banks and supervisors, have been working systematically on strengthening the regulatory, legislative and analytical framework for financial stability.

At Norges Bank, we have strengthened our surveillance of the soundness of our financial system. Since 1997, Norges Bank has – as the first central bank – published twice a year its financial stability report. This report addresses the risks to the present and future solvency of the financial institutions in Norway. There is also an extensive exchange of information with supervisors. Moreover, a relatively large part of the Norwegian banking industry is part of Nordic banking groups, and a structure for cross-border crisis management is therefore evolving.

Even though it is important to follow up the lessons learned from the previous banking crises, there is no guarantee that the same recipe will be successful in future crises or in other countries. We will have to consider new approaches to crisis resolution as the financial system and its participants are continuously changing. Nevertheless, we hope this publication will not only serve as a review of the Norwegian banking crisis, but also prove useful in preventing and if necessary handling future financial imbalances.

During the work with this publication we have benefitted greatly from comments by our colleagues. In particular, we will mention Solveig K. Erlandsen, Einar Hope, and João Santos. Fredrik Lundberg, who has had an internship in Norges Bank in 2004, has provided invaluable editorial assistance, not the least in transforming the publication into L^AT_EX. Finally, we owe a great deal to our late colleague Henning S. Strand who initiated this publication and inspired the authors to write their contributions.

Jon A. Solheim