# Ioannis Papadakis: Combatting the impact of the financial crisis

Welcome remarks by Mr Ioannis Papadakis, Deputy Governor of the Bank of Greece, at the European Bank Coordination Meeting, Athens, 19 March 2010.

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It is an honor and a pleasure to welcome you to Athens for the European Bank Coordination Meeting, hosted by the Bank of Greece and co-organized with the European Commission, the IMF and the EBRD. Moreover, I am very pleased to be given the opportunity to share with you some preliminary thoughts on the achievements of our efforts to support IMF programs in the region through concerted private sector involvement.

The financial crisis that erupted in 2007 is now in its third incarnation. Having started as a crisis affecting certain marginal financial markets in the US, it subsequently spread fast with its impact being felt on the financial and the real sectors of most economies in the world. In its current incarnation, it is turning into a fiscal crisis, as markets realize the true cost of the measures implemented to minimize the damages and the impact on the macroeconomy. In addition, the crisis has brought to the fore a number of weaknesses and deficiencies in the functioning of the international financial system, putting the effectiveness of the supervisory and regulatory framework under the microscope.

The discussion regarding the origins of the crisis and the work that needs to be done has created a long list of "do's and don'ts". It has also led to an even more lively and lengthy discussion about the appropriate means to achieve the ultimate goal and the timing of the required measures. Let me briefly mention five areas of action, which I believe deserve priority:

- First, there is need to deal effectively with short-termism in the quest for high profits, by protecting the system from the incentives created by excessive bonuses and the irrational pricing of risks.
- Second, the transparency of financial markets and structures needs to be enhanced by putting greater emphasis on risk disclosure by systemically important institutions, instruments and markets.
- Third, the pro-cyclicality of the financial system needs to be mitigated by improving both the quality and quantity of bank capital and by ensuring that banks create enough prudential liquidity buffers in good times to have reliable shock-absorbers on which to depend, if and when bad times come.
- Fourth, there is a need for a macro-prudential approach to financial supervision that takes into account not only the links between financial behaviour, economic activity and macroeconomic policies (e.g. the crisis triggered a freefall in economic activity that called for policy relaxation, the exit from which could postpone economic recovery), but also the interconnectedness between financial institutions, markets and cross-border activity.
- Last but not least, the whole system of checks and balances must not breed complacency in any of the actors involved, as the crisis has shown that tail events may be rare but are still possible.

With the benefit of hindsight, it would not perhaps be too unfair to say that the initial policy response to the crisis was timid and to some extent reluctant. Soon however, in the face of such unprecedented challenges, governments, national central banks, international financial institutions and supervisory and regulatory authorities around the globe all demonstrated a remarkable unity of purpose. The extraordinary magnitude of the crisis led to the acceptance that extraordinary measures were needed, if a repeat of the 1930s was to be averted. In order to forestall the impact of the crisis, policy makers deployed both conventional instruments (such as cutting key policy interest rates and increasing public spending) as well as a battery of non-conventional ones. I would add, if I may, that intellectually this has been an exciting period, as we were often driven to think outside of our usual toolbox. Indeed, sometimes we were forced to think the unthinkable, as we realized that in crisis situations the accepted wisdom is not always wise.

Even more importantly for our purpose, we all came to realize that in our globalized world "no country is an island." International interrelationships are today so strong that no country can go it alone in the open seas. This has led to enhanced international efforts to coordinate through both existing and new arrangements. The international financial institutions have played a catalytic role here. We must acknowledge this and thank them for it. The institutions themselves accepted that the magnitude of the crisis was such that it could not be addressed by any of the actors acting alone. The European Bank Coordination initiative started just a little over a year ago as an ad hoc effort to stabilize the flow of funds to a few economies in Central and Eastern Europe. It has now attained the stature of a successful coordinating mechanism, which is worth keeping and, when appropriate, replicating in other parts of the world.

This initiative of ours has achieved an admirable coordination between the official and the private sector. The mere fact that so many diverse actors were brought together to act in a consensual way for the common, as well as their own, good is an encouraging indication that the international community has matured. After years of endless theoretical discussions on the potential merits of private sector involvement in crisis management and resolution, the EBCI emerged almost spontaneously as the appropriate response to actual and acute problems. Coordinated international assistance to countries that both needed and deserved it has been crucial for mitigating the impact of the crisis. For example, the balance of payments support packages by the IMF and the EU to six European countries have helped to deflate the mostly exaggerated market concerns about the fundamental viability of the region's economies and banking sectors. The size and firmness of such a wide commitment is what acted as a catalyst to mitigate and reverse the negative mood toward particular countries in the region. The precision and timeliness of our mutual commitments is what marked the turning point that brought us back from the brink of a fully fledged regional crisis in late winter 2008/early spring 2009.

Given the importance of foreign-owned banks for the region's financial sectors, our co-ordination was pivotal in addressing the reversal of capital flows and in dampening the economic cycle. The precise and firm commitment by each and every one of the parties involved allowed us to promptly address potential co-ordination failures, shape a macro-prudential approach for dealing with the impact of the crisis on the region and, by doing so, enhance the efficiency of the policy measures taken by each individual country. We at the Bank of Greece are proud to have been supportive of this initiative, right from its inception. Needless to say, we shall continue to support it whatever the circumstances. As the initiative now stands, we are even in position to successfully tackle the details where the devil often lurks. For example, how should the need for adequate external financing and reserves build-up be balanced with the need to strengthen financial stability and avoid excessive lending expansion.

The European Bank Coordination initiative owes much of its success to the efforts made by each and every one of us. What we have achieved so far provides us all with the impetus to continue our efforts towards more and better cooperation in concert. Here in Europe, the Memorandum of Understanding of 2008 among the supervisory authorities is already fostering better and deeper cooperation, while the creation later this year of a new institutional framework for financial supervision and regulation will also provide a firm basis for effective coordination. What we all wish and strive for is the enhanced and long-lasting stability of the European and, ultimately, the international financial system.

I congratulate you all for your good efforts over the last year to bring about and safeguard stability in the countries involved. I thank you for participating in today's meeting. The Bank of Greece as host owes a special thanks to the European Commission, the IMF and the EBRD for the help they have provided us in organizing today's event. I wish you all a fruitful meeting and a pleasant stay in Athens.