

## Stanley Fischer: Lessons from the crisis

Address by Mr Stanley Fischer, Governor of the Bank of Israel, at the annual conference of the Association of Banks in Israel, Tel Aviv, 30 November 2010.

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The Governor of the Bank of Israel delivered remarks today at the annual conference of the Association of Banks in Israel in Tel Aviv. An abstract of his address follows:

I would like to congratulate the banking system for having returned to profitability and growth and for posting outstanding balance sheets by international standards. This is immensely important not only for the banking system but for the Israeli economy at large.

The global economy appears to have weathered the worst of the crisis, but the economic world in which we live remains very complicated because different countries are recovering from the crisis at different speeds. The United States, and a fortiori several European countries, are still finding it difficult to rebound and grow, whereas many countries in Asia and Latin America are growing at handsome rates. Let us not forget that the decoupling that we see today was not visible when the crisis began. In the first months, we saw the collapse of trade in many countries, affecting the entire global economy. Today, however, we do observe this decoupling as countries in the West, of all places – the destinations of most of Israel's exports – have encountered difficulties.

The Bank of Israel began writing a document describing how the crisis was confronted and how its lessons were learned, and next year the Bank will be organizing an international conference of central banks on the lessons of the crisis. The main lesson – as we see clearly today and has long been clear – is that the countries most affected by the crisis are those in which the crisis was not only macroeconomic but also financial – the United States, Ireland, and Iceland, to name only three. Countries that sustained no crisis in their financial systems recovered relatively quickly; Israel and many countries in eastern Asia fall into this group. As stated, however, the global environment remains complicated and we must beware of complacency.

Another lesson relates to the origin of a very large number of financial crises in the real-estate industry. The United States is a conspicuous example of this, of course. Another example is Ireland, which conducted an excellent economic policy except for one thing – its policymakers did not apply adequate supervision to their banking system and, among other things, the effect of the real-estate market on it. By implication, financial supervision generally, and Israel's banking supervision particularly, must remain vigilant in supervising the banking system generally and the mortgage-lending industry specifically. The structure of Israel's mortgage-lending market is different today than it had once been, and it is important to understand the risks that exist today, address them, and avoid complacency arising from the thought that this market was once considered especially stable.

The Bank of Israel is duty-bound by law to maintain financial stability in the economy at large. In this context, the concept of macroprudential supervision – supervision of stability at the macro level – has been mentioned recently. This concept means that even if the situation in any particular market or financial institution may look good, systemic problems that endanger overall stability may exist. In the U.S., for example, people thought that the subprime market was relatively small and that Lehman Brothers' balance sheet was not especially big. Both of them, however – the subprime market and Lehman Brothers – ultimately dealt the system a very grave blow when they collapsed.

The Bank of Israel has already taken macroprudential steps in regard to the real-estate market and the Government has taken measures that should increase housing supply. At the moment, there are indications – no more than indications – that the housing market is leveling off. Current data from various sources are painting contrasting tableaux; we need to

wait for the situation to become clear. If we find that real-estate prices are continuing to rise rapidly, we will have to take additional measures. We are also concerned about the growing use of nonbank credit to finance property investments in Eastern Europe. Complacency, as stated, is highly dangerous in this context. Even if no financial institution has collapsed in the current crisis in Israel, we should remember that it was a damn close run thin. We were forced, for example, to unfurl a safety net for the pension funds during the crisis, some domestic corporate bonds had to be reorganized, and so on.

One cannot rely on the regulators only. The key to a safe banking system is risk management at every bank and every financial institution individually. We need to remember that bad loans are issued in good times.

An important part of learning the lessons from the crisis takes place at the international institutions. The center of gravity in the global economy is shifting from west to east and this finds expression at the international agencies as well. These entities engaged, for example, in developing systematic bankruptcy mechanisms for insolvent banks, mechanisms for the approval of senior executives' remuneration, etc.

I would like to congratulate the outgoing Supervisor of Banks, Mr. Rony Hizkiyahu, for his excellent work in coping with crises. He is leaving the Banking Supervision Department in much better condition than he had found it. We thank Rony for his important contribution to Israel's financial system and economy. Much work awaits his successor, David Zaken. David, you will have to continue the processes that Rony began and then continue to plot the course in your own way. You have the personal credentials to succeed in the very difficult and important task that you have taken upon yourself. I wish you success.