



Comments on
“Currency Crises” by
Italy Goldstein and Assaf Razin

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Paper: Literature Review plus

- Contribution:
 - Theory: comprehensive survey of the literature:
 - generations of currency crises, credit frictions, asset bubbles, market freezes
 - review of EMU design failures
 - Policy: some implications for the Euro Area (EA) debt crisis

Paper: Conclusions

- Theory: need to have a model that integrates all the driving factors of financial crises:
 - coordination failure, incentive problems, asymmetric information, etc
- Policy:
 - all driving factors are present in the recent crisis
→ it is complex crisis to deal with
 - for the Euro Area: better, more integrated union on the policy level

General Challenges:

- Integration of all driving factors of crises
- Interaction between crisis factors (one or all) and specific challenges of the currency union:
 - Inform the policy on:
 - How much of a union is a better union:
 - Banking crises, fiscal crises, asset bubbles
 - What sequence is a right one:
 - Asset bubbles, credit frictions, market freezes

Euro Area debt crisis: What literature tells us

Keynes' savings paradox

If private sector deleveraging is coupled with government austerity measures → economy can get into a deflationary spiral → amplify the crisis

Absence of lender of last resort

The lack of LoLR for both banks and (especially) governments can lead to self-fulfilling liquidity crisis

Financial supervision and bank resolution at national level

Strong relations between national banking systems and common monetary policy, bank supervision and resolution at the national level

EA debt crisis: Remarks

Keynes' savings paradox → fiscal multiplier debate

Absence of lender of last resort

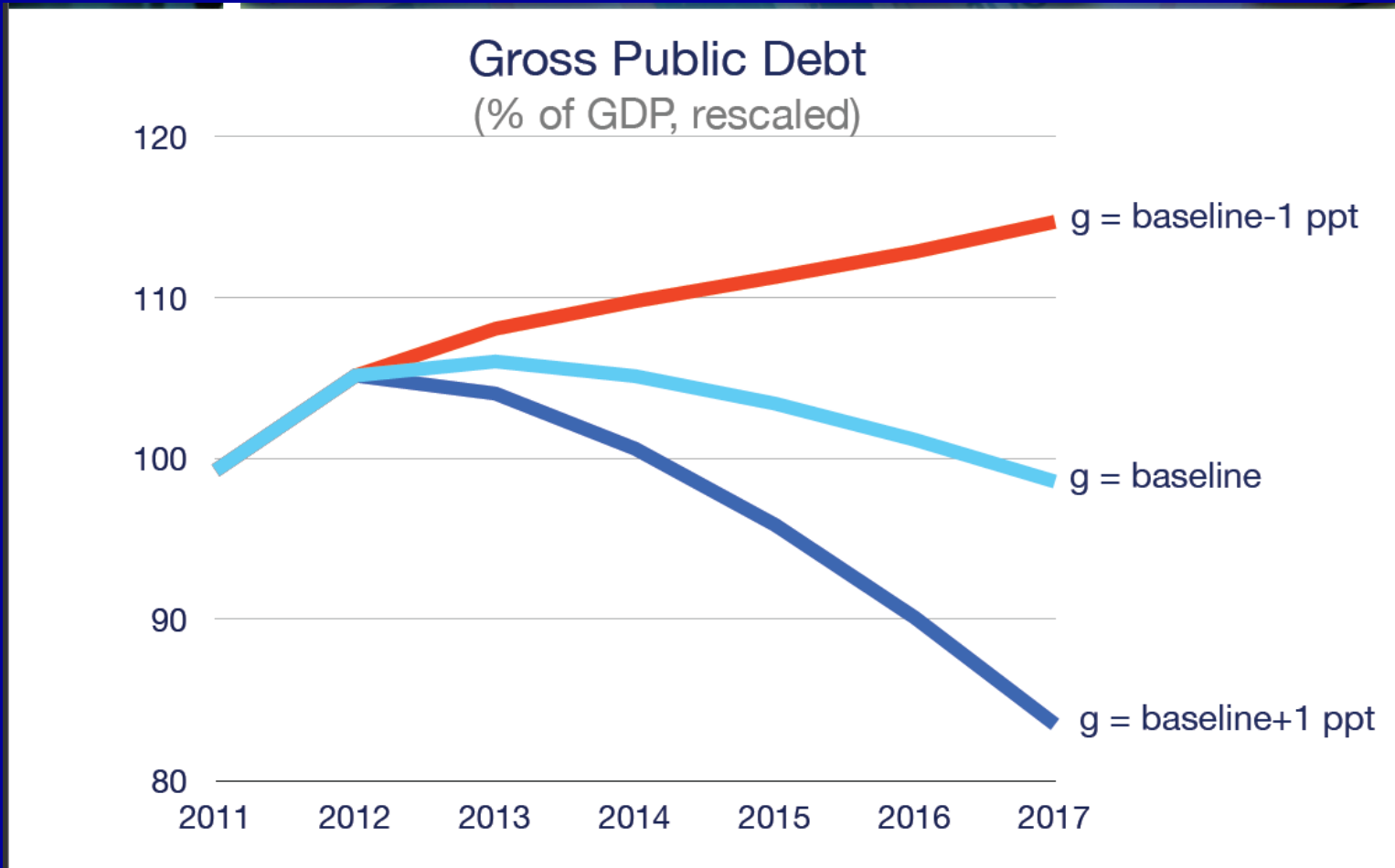
Financial supervision and bank resolution at national level

Empirical results: fiscal multipliers higher-than-expected for advanced countries at the beginning of the crisis (Blanchard and Leigh, 2013):

- Simultaneous adjustment by private sector and sovereigns
- Simultaneous adjustment by many sovereigns and weak global growth
- No ex-ante foresight how deep the crisis will be

→ Improperly done fiscal adjustment can hurt growth and in turn negatively affect fiscal sustainability and amplify the crisis

Growth impacts debt



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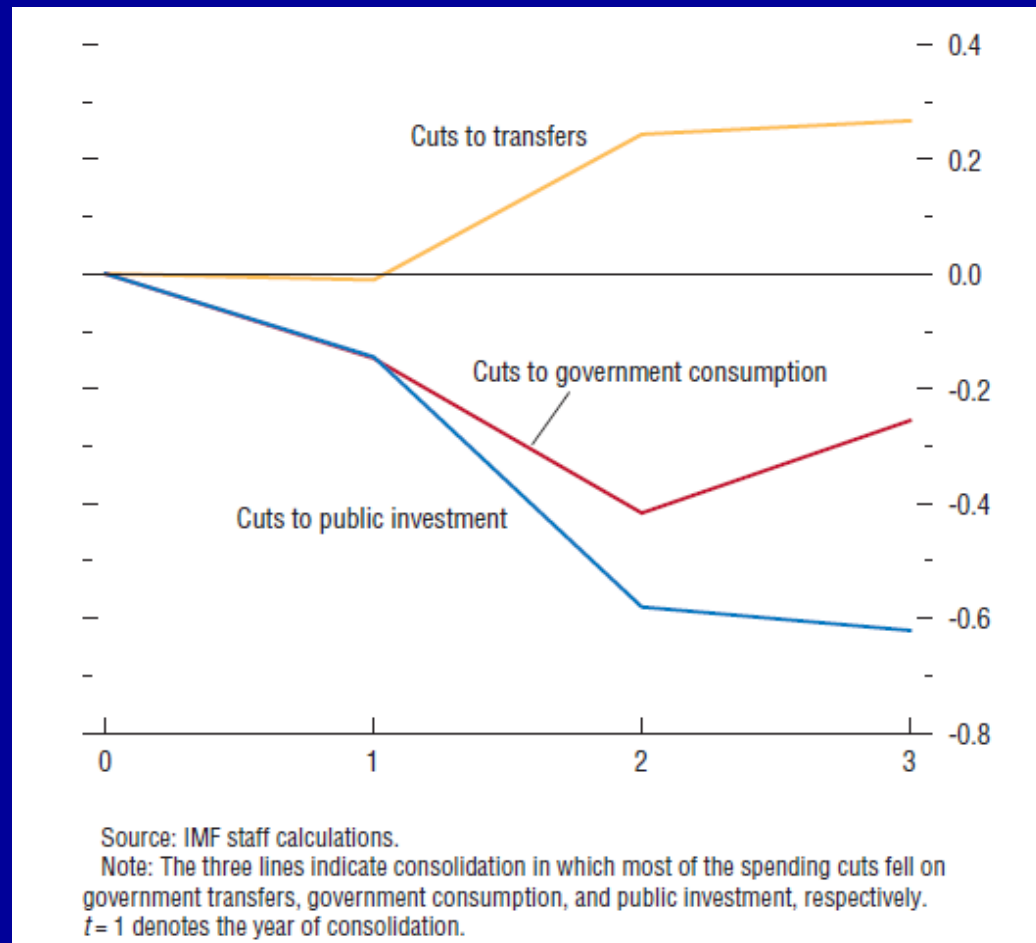
More focus on the quality, not only quantity, of fiscal adjustment:

- If debt is high adjust you must
- Focus on structural measures that result in better fiscal balance and higher growth in the medium/long term, thereby resulting in sustainable debt path not on across-the-board austerity measures
- Do other reforms too

Challenge: requires longer-term strategic thinking, can be politically daunting

Fiscal Adjustment: Good Structure Matters for Growth

Impact on GDP of a 1% of GDP spending-based consolidation



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A LoLR can provide funding to solvent but illiquid sovereigns/banks → can avoid liquidity crisis

- However, sovereigns/banks should be incentivized to operate in a prudent way → fiscal union, banking union
- The ECB's OMT and the setting up of the ESM are important steps

Challenge : ex ante known limits vs credit frictions

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IMF (Goyal et al. , 2013): „integrated banking systems require integrated prudential oversight”

- Single Supervisory Mechanism is an important step
- Further, more difficult steps are needed: the single resolution mechanism, common deposit insurance, financial backstop
- Not a panacea (see other countries)