

# The Norwegian Banking Crisis 1988 – 1992

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Presentation at Bank of Slovenia Conference 28 October 2005

\*Views and conclusions those of the speaker, not necessarily those of Norges Bank

# Some features of the Norwegian banking crisis

- First industralized economy after WW II to suffer a systemic crisis.
- Banks accounting for 60 pct. of bank lending needed support, 3 of the 4 largest banks failed.
- Happened after financial deregulation and a rapid boom.
- Crisis resolved rapidly
- No depositors lost money
- Rapid economic recovery after crisis
- Low resolution costs to the taxpayers.

#### The sequence of the crisis

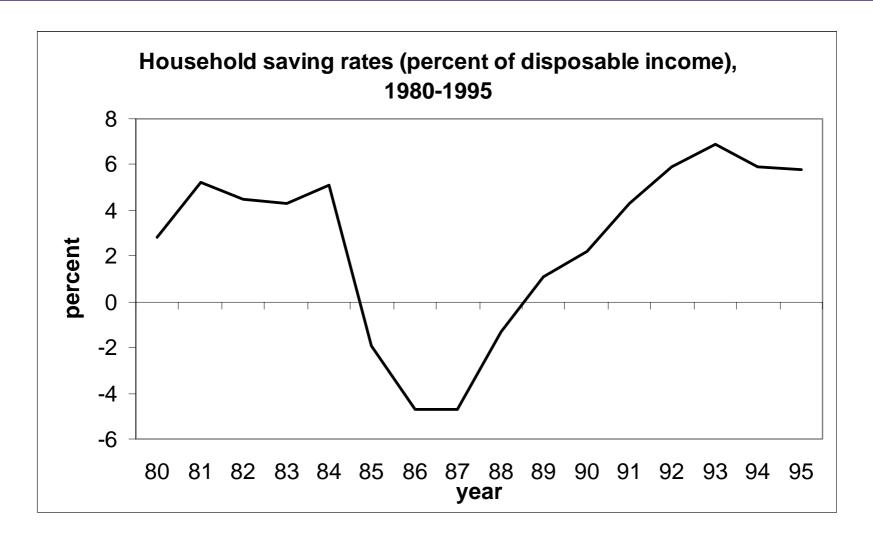
- 1984 1987: Financial deregulation and boom
- 1988 1990: Failures of small banks
  - resolution mostly financed by banks' own collective guarantee funds
- 1991 1992: Systemic crisis, peak 1991
  - government intervention
- 1993: Crisis ended



#### Macroeconomic background

- Old regulation regime collapses: deregulation of credit markets in 1984 to 1985
- After deregulation huge growth in bank credit and domestic demand 1985 to 1986
- Money market interest rate politically controlled until 1987
- Fixed exchange rate regime since W W II
- Sharp fall in oil price 1985, major export commodity
- Capital outflow sterilized by unsecured lending from central bank to the bank sector





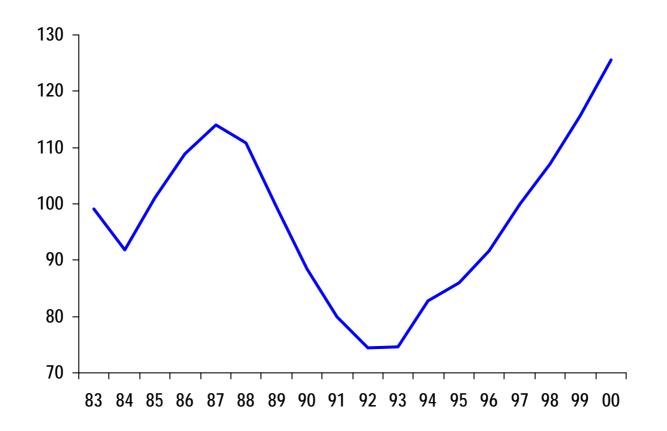
Source: National accounts

#### Macroeconomic background

- Need for consolidation during the late 1980's
- Deepest recession since world war II
- Fixed exchange rate regime caused procyclical monetary policy
- High real interest rate during the recession
- Norwegian krone de-peged in Dec. 1992, interest rate down and macro recovery



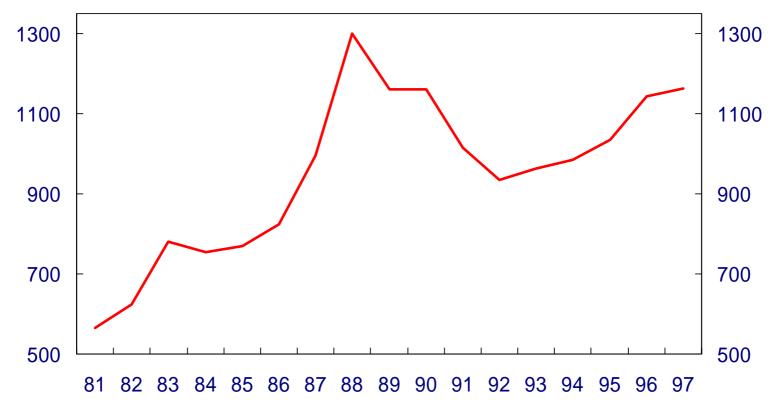
# House prices Real prices (index 1997 = 100)





# Rental prices for office space.

NOK per sq.m. 1980 - 1997



Source: DnB (1981 -92) and own calculations (1993) based on information from Dagens Næringsliv and Eiendomsspar AS



## Regulation and supervision

- Capital requirements were gradually eased prior to and after deregulation.
- During liberalization on-site inspection scaled back in favor of document-based inspections.
- After deregulation the Financial Supervisory Authority had problems recruiting experts.

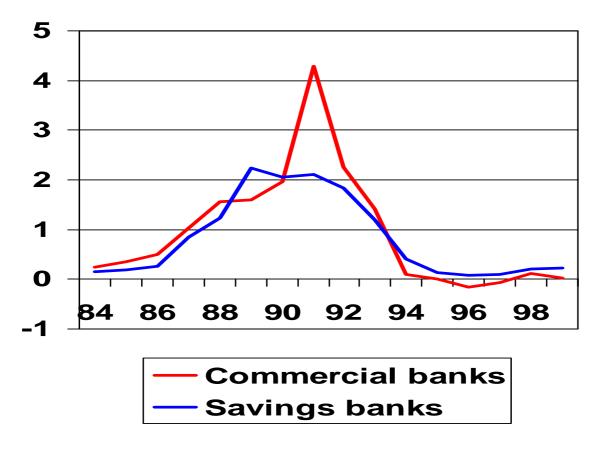
## Bank behavior right after deregulation

- Little or no experience with competitive credit markets
- "New breed" of bankers, sales oriented not credit risk oriented
- Aggressive marketing
- Herd behavior



#### Development of the crisis, loan losses

Loan loss provisions, pct. of total assets



Source: Drees and Pazarbasiouglu (1998) and OECD (2002, 2003)

#### Resolution methods

- Before crisis systemic: The banks' own guarantee funds
- When systemic: Conditional capital injection from the government in problem banks common
- Additional general government support to banking industry common
- LLR common
- No AMC or "bad bank" N
- No blanket creditor guarantee N

#### Purpose of support measures

- During small bank crisis (1988 1990): Avoid contagion to large banks due to their overseas funding
- During the systemic crisis (1990 1992): Avoid collapse of the banking system
- The three large problem banks had 50 pct. of bank lending, closing them would implied huge credit crunch. No private capital available
- Resolution at low fiscal costs

## Conditional capital injections from the GBIF

- No private investors willing to invest new capital into the distressed banks
- Government, the "owner of last resort"
- Strict conditions tied to capital injections from GBIF:
  - original share capital written down
  - all share capital lost is written down to zero
  - board of directors and senior management replaced
  - supported banks prevented from exploiting the situation visà-vis non-supported banks



#### No blanket creditor guarantee

- Moral hazard
- Future expected government outlays may increase
- Government measures already taken had the necessary credibility

#### Results of the Norwegian crisis resolution

- Crisis over by 1993
- No depositors lost money
- No money market lenders lost money
  - (with a few exceptions at a small bank before the systemic crisis)
- Avoided run and severe credit crunch
- Low fiscal costs
  - Net fiscal costs (discounted) end 1993: 0.8% of GDP.



#### Fiscal costs of crisis resolution

- Gross fiscal costs (discounted):
  - By year end 1993: 2.9 pct. of GDP
- Gross fiscal costs (simple sums, not discounted):
  - Sweden 3.6 pct. of GDP in 1997
  - Norway 2.0 pct. of GDP in 1997
- Net fiscal costs (discounted):
  - Norway end of 1993: 0.8 pct. of GDP
  - Sweden mid 1997: 1.4 pct. of GDP
  - Norway end of 2001: -0.4 pct. of GDP

Sources: St. meld 39 (1993-94), Jennergren and Näslund (1998), and Moen (2003)



#### Lessons learned, causes

- Macroeconomic boom, procyclical monetary policy
- Financial deregulation
- Weakened capital requirements
- Weak supervision



#### Lessons learned, resolution

- Focus on saving the system, not the individual bank
- Owners first in line to take losses
- Board and senior management of failed banks to be changed
- Blanket creditor guarantees not necessary