



## Lessons Learned Oral History Project Interview

<b>Interviewee Name and Crisis Position</b>	Mike Leahy <sup>1</sup> Associate Director, Federal Reserve Board of Governors (2008-2010)
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<b>Date of Interview</b>	October 22, 2020
<b>Lessons Learned No.</b>	2020-25

### Introduction:

The Yale Program on Financial Stability (YPFS) contacted Mike Leahy to request an interview regarding Mr. Leahy's time as Associate Director at the Federal Reserve Board's Division of International Finance during the Global Financial Crisis, 2007-09, (GFC) and the immediate aftermath.<sup>2</sup>

Mr. Leahy worked at the Federal Reserve Board from 1986 until he retired in 2017. During the GFC, Mr. Leahy was an important player in the establishment of swap lines between the Federal Reserve and foreign central banks. Examining the experiences of other central banks, he also studied interest payments on depository institutions' required and excess reserve balances.

In 2010 Mr. Leahy became Senior Associate Director of the Division of International Finance, a role he held until 2012 when he became Deputy Director of the same division until his retirement in 2017.

Mr. Leahy has been a consultant for the International Monetary Fund since March 2017. He was also Senior Economist and Principal Administrator at the Organization for Economic Cooperation and Development (OECD) in Paris between 1999 and 2001, on leave from his position at the Federal Reserve Board as Chief of Financial Markets Section.

***This transcript of a phone interview has been edited for accuracy and clarity.***

### Transcript:

**YPFS:**           **Could you please elaborate on your role in helping solve the financial crisis of 2008 to 2009?**

**Leahy:**           Sure. I am an economist. I worked at the Federal Reserve Board in Washington, D.C., as part of a team of many who worked on the Global Financial Crisis, both

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<sup>1</sup> The opinions expressed during this interview are those of Mr. Leahy, and not those any of the institutions for which the interview subject is affiliated.

<sup>2</sup> A stylized summary of the key observations and insights gleaned from this interview with Mr. Leahy is available in the Yale Program on Financial Stability's *Journal of Financial Crises*.

at the Fed in Washington, D.C. and at the Federal Reserve Bank in New York. We worked on lots of different aspects of the crisis. I was in the International Finance Division, so I covered the foreign institutions, worked a lot on the swap lines that central banks established during this period, and I also helped out doing some other work. One of these projects was the paper I worked on with David Bowman and Etienne Gagnon<sup>3</sup> on trying to assess the foreign experience with some of the domestic monetary policy tools that the Board and FOMC were considering, to address some of the concerns that had developed during the crisis.

In your invitation to me to be part of this history project, you asked about my work on interest on reserves. To put that into perspective, interest on reserves was only one part of the overall policy response during the crisis. There were lots of different things that came up during the period and I worked some on the interest on reserves. I also worked a lot on the swap lines and did a little bit on some other things, too, mainly looking at things from the international side.

**YPFS: Talking about the interest, how was it decided to pay interest on the depository institutions' required and excess reserve balances? Why was it found necessary to do this?**

Leahy: Back in 2006, after negotiations with Congress, the Congress decided to give the Federal Reserve permission to pay interest on reserves. At that time, the law that was passed said that the Fed could pay interest on reserves starting in 2011, a delay that would give the markets and the institutions some time to adjust to the new policy. That, of course, was before the crisis.

The idea behind it, at that time, was to discourage wasteful behavior that had developed in response to reserve requirements. Because banks were required to hold reserves against certain kinds of accounts they offered and because these reserves did not earn interest, banks took steps to try to minimize the accounts that they had to hold reserves against. The reserve requirements acted like a kind of tax on the banks. In response, banks were expending resources trying to avoid that tax. What they came up with were operations that automatically swept funds out of accounts with reserve requirements right before the requirements were assessed. The funds were moved back into the original accounts after the assessment period had ended. As a result, these operations generated extra transactions only to avoid reserve requirements. This churning did not seem like an efficient use of resources.

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<sup>3</sup> David Bowman, Etienne Gagnon, and Mike Leahy "Interest on Excess Reserves as a Monetary Policy Instrument: The Experience of Foreign Central Banks." Board of Governors of the Federal Reserve System International Finance Discussion Papers. Number 996, March 2010. <https://www.federalreserve.gov/pubs/ifdp/2010/996/ifdp996.htm>

That was the impetus for getting Congress to authorize the Fed to pay interest on reserves. Previously, the Federal Reserve had no authority to do so. So, then the financial crisis comes along, and in response to that, the Fed asks Congress if they could start paying interest on reserves earlier. Congress assented, and the Fed got permission to start in October of 2008.

Concern still existed that this sort of reserve avoidance behavior by banks was inefficient, but in the context of the crisis there was also a monetary policy issue that was becoming important.

The Fed was injecting lots of liquidity into the market to meet the liquidity concerns of financial institutions. That was driving the interest rates in the market, in particular the fed funds rate, below what the Fed was targeting. Paying interest on reserves seemed to provide a way to separate the provision of liquidity, which was needed to support financial institutions, and control over the fed funds rate, which was needed to manage overall economic activity and inflation. The power to pay interest on reserves was seen as offering a second tool that the Fed could use to influence market rates. It is always better to have more tools to achieve your goals.

So that was the motivation for what happened back then. Paying interest on reserves would improve efficiency and it allowed for better policy.

**YPFS: How was this implemented? I am sure there were challenges. Where were they and how did you determine the rates of interest that were going to be paid?**

Leahy: Economists had done some research analyzing these kinds of regimes. As noted in some of the work that I did with David Bowman and Etienne Gagnon, foreign central banks had used this kind of policy before, but the Fed had not. The Fed had not had the authority to pay interest on reserves.

Essentially, there is this idea that one way to control interest rates is to set up a sort of corridor. You have a target, say for the overnight interest rate, the fed funds rate, and that rate can bounce a little bit around your target, which is usually considered fine, it is not serious loss of control, but you do not want the variation to be too wide. These corridor systems established two rates. One was a ceiling rate so that, if funds became scarce and the fed funds rates started going up and up and up, banks could borrow from the Federal Reserve at the ceiling rate. Presumably, banks would not borrow from one another at rates higher than that because they can always go to Fed to borrow at the Fed's administered ceiling rate.

Similarly, on the bottom, if liquidity became excessive and rates started moving below the fed funds target that the Fed had set, then the interest rate the Fed would pay on reserves could serve as a floor. Because financial institutions could deposit the money at the Fed at this administered floor rate,

market rates should not go much below that. Why would you lend money at a rate lower than what you could get depositing the funds at the Federal Reserve? So, this system created incentives for banks to keep the market rate within a corridor set by the administered lending rate at the top and the administered deposit rate at the bottom.

That was the idea, and other countries had used these corridor systems. There were some technical issues about how wide to set the corridor, which helped determine how much to allow the market rate to vary around the target. These differed across countries. But the basic idea was the same.

In the crisis period, what we were seeing was that rates were falling below the target for the fed funds rate because there was so much liquidity being injected into the market. With the ability to pay interest on reserves, central banks with corridor systems could let their market rates drift down towards the interest rate paid on reserves. In some cases, policy authorities set the interest rate on reserves as the target. As an aside, I would note that in the United States, we have a technical issue that complicates slightly the use of a corridor system for the setting of rates. The FOMC [Federal Open Market Committee] does not set the interest rate paid on reserves. It is determined by the Board in Washington, D.C.

I don't know if I need to explain the difference between the policy authorities of the FOMC and the Federal Reserve Board. The FOMC is comprised of the members of the Board in Washington and the presidents of the 12 reserve banks across the country, and that committee sets the monetary policy objectives in terms of the fed funds rate target. However, they cannot set the rates at which banks borrow from and deposit at the Federal Reserve. That is done by the Board. Fortunately, the Board and the FOMC are always working together, and that obviously happened during the crisis as well. As a result, this policy distinction is just a technicality.

In any case, the basic idea is that the FOMC could target a rate very close to the rate on reserves. In that case, you would want to set the rate of interest on reserves at whatever the target rate for the fed funds rate should be or perhaps very near that. That was the basic idea on how to set the rates. That was the strategy.

You asked about challenges... There was a challenge, and you could say there still is: The fed funds market is a market essentially populated by big financial institutions, mostly banks. However, there are some other important players in that market that are not banks, and perhaps most relevant for this discussion, organizations like Fannie Mae and Freddie Mac, which are often called "government-sponsored enterprises" [GSEs].

They are active in the fed funds market, and they could hold their funds at the Federal Reserve, but the Federal Reserve was not authorized by the law to pay interest on deposits that those institutions made at the Fed. The Fed was only authorized to pay interest to banks. So, that technicality in the law complicated things. Because not every institution in the market could get the rate on reserves, the market rate might actually drift below the interest rate paid on reserves when liquidity in the market is high. The same interest rate floor did not exist for all the relevant institutions.

As a result, these non-banks appeared to be willing to lend funds at a lower rate to earn some rate of return on them, and that could drive the fed funds rate in the market below the rate of interest paid on reserves. In that sense, the floor of the corridor could be “leaky.” If the leaking was severe, then paying interest on reserves could not be relied on to provide a floor for the market interest rate.

So, that was an initial concern, and that was part of the impetus for this study that I worked on, on the floor experience to see how leaky the floor could be. What experience did foreigners have with any kind of leakage like that? Further, could we examine the foreign experience to learn how much to expect that the fed funds rate or the overnight money market rate would drift below the rate of interest paid on reserves?

It turns out there are lots of different types of markets and different types of financial institutions in foreign countries. For the most part, when all major financial institutions shared the ability to earn the interest paid on reserves, the floor looked pretty good. There were not many exceptions to that rule. The problem with what we saw in the floor experience abroad is that it did not tell us as much about the US as we had hoped, perhaps because there was not a market that had a similarly significant segment of financial institutions that could not take advantage of the interest rate paid on reserves.

That was a challenge because it did turn out that once this corridor was set up, rates did seem to drift below the floor. The Fed then responded with another tool. They could not pay interest on deposits of GSEs at the Fed, so they set up—I am a little less familiar with the operation in this because I did not work on it specifically—a “reverse repurchase facility,” under which, if GSEs had extra liquidity, they could deposit it at the Fed temporarily and get in exchange some Treasury securities.

These repurchase operations were priced in a way that market participants could buy Treasury securities from the Fed at one price and sell them back the next day at a slightly higher price to earn a positive rate of return. In that way, the GSEs could essentially get the same floor rate as banks could get if they had funds they could leave on deposit at the Fed.

So, it was a little different kind of transaction, and that facility came on later. It actually helped quite a bit in keeping rates pretty close to the target the FOMC had set for the fed funds rate during the time the target was close to the rate of interest paid on reserves. That was the basic idea. The main challenge was trying to make sure that the Fed could use the rate of interest paid on reserves or something close to it, such as this reverse repurchase facility rate, to put a floor on the fed funds rate. This would help control the rate and keep it close to the target that the FOMC had set.

**YPFS: Did it end up doing what it intended to do? Did it work?**

Leahy: I think so; that regime persists today as far as I know. My understanding is that the Fed is happy with the way things are working. After the Global Financial Crisis, a few years ago, the Fed started raising rates. There was still quite a bit of liquidity in the market, but the Fed was able to raise market rates nonetheless using this corridor system. So, by that measure, I think that paying interest on reserves turned out to be successful.

**YPFS: How was the adaptation of the foreign experience in this? You mentioned a number of times that you looked at the foreign systems and how they were handling those and then kind of adapted that to the American market. Was the American market very different?**

Leahy: The answer to that is “yes and no.” Probably not so different qualitatively, but the other central banks seemed to have a different set of regulations, a different set of laws that governed what they could do in the markets. The Federal Reserve was a little more restricted in what it could do, such as pay interest on reserves. Then, when it could, it could only pay interest to banks. It had to become creative in dealing with these legal constraints. Changing laws is not always easy or fast, and in this case, a solution was needed quickly, and the new tool that was developed offered a good alternative.

Central banks in other countries often had more straightforward systems. Their ability to supply liquidity and take deposits from all the major financial institutions and markets was not so restricted. This allowed them to establish the corridor systems in a little more straightforward way. Then of course, the dollar funding markets, and particularly overnight markets, in federal funds and eurodollars... these are huge markets, much larger than overnight funding markets in most other countries' currencies.

It is possible that the euro area might be getting close in size now. I have not looked at the numbers recently, but I am guessing the dollar funding markets are still the biggest markets in the world. The dollar is used all over the world, so there is a wide range of agents that participate in dollar markets.

With the authority to provide the right incentives to the participants in overnight money markets, central banks can control the prevailing interest

rate in those markets. The experience of other central banks was that these corridor systems did work if they could be implemented in a way that provided opportunities for all the major players in their overnight markets. And the Fed's experience has provided further support for that finding.

**YPFS:** **In a March 2010 paper, you wrote, and later in another paper in 2013, you confirmed that the interest rate paid on the balances has seemed to provide an effective lower bound for market interest rates, and that tightening by raising the interest rate paid on the balances has been possible without draining those balances. Could you please explain that?**

**Leahy:** Prior to the establishment of the ability to pay interest on reserves, the Fed controlled the overnight rate, the fed funds rate, by going into the market every day and either injecting funds or withdrawing funds.

So, these operations would create either a scarcity or abundance of liquidity, which would drive the market rate in one direction or the other. This operation was based on a daily assessment of needs in the market. There was a sophisticated system for estimating the demand for funds on a daily basis that took into account different seasonal factors, tax payments, etc.

The goal of the operations people at the Federal Reserve was to try to keep the market rate close to the target that the FOMC had set for the fed funds rate. One implication of this framework is that the amount of liquidity in the market at any one time was bound up with what the fed funds rate was going to be.

That is, if you supplied too much, you would drive the rate lower than you wanted; if you did not supply enough, the rate would go higher than you wanted. So, under this policy framework, you could not separate the market outcomes for the rate and the amount of liquidity that the Fed was supplying on a day-to-day basis. What the interest rate on reserve balances did was allow a separation of the quantity of liquidity in the market and the prevailing market interest rate.

During the financial crisis, there was essentially a seizing up of markets, people did not want to lend to one another because they were concerned that they would never get their money back if they lent it out. Many firms were failing, which led people in the market to be suspicious about the health of the financial counterparties that they were dealing with. Instead of lending, financial institutions hoarded funds, and their unwillingness to lend imposed a huge constraint on the ability to do business. That was a key part of the problem with the Global Financial Crisis: The panic in the financial market made it difficult for households and businesses to get the funds they needed to conduct normal economic activities.

The Fed's initial response was to try to increase liquidity, but the FOMC still had a target for the fed funds rate. Prior to the adoption of the policy to pay

interest on reserves, if you increase liquidity, you would drive the market rate down, perhaps below the target set by the FOMC and possibly even to zero given the quantities that were needed to meet these panic concerns in the market. With the interest on reserves, the Fed could set a floor for the market interest rate. In that case, if you increased liquidity, you would drive the market interest rate down, but only to the interest rate paid on reserves. At that point, banks would no longer have an incentive to lend excess funds into the market and drive the market rate down further. Instead, banks could hold the liquidity and earn a safe return by depositing their liquidity at the Federal Reserve. They would not need to lend at rates lower than the rate of interest on reserves. So, one could actually increase liquidity in the market without putting downward pressure on the market interest rate.

Alternatively, even with no change in the amount of liquidity in the financial system, you could move the market rate by moving the rate of interest paid on reserves. With liquidity high enough to drive the market rate down to the rate of interest paid on reserves, an increase in the rate paid on reserves would prompt banks to lend to the Federal Reserve instead of to the market, by making a deposit at the Federal Reserve. That breaks the link, in some sense, between the amount of liquidity and the prevailing market rate. As long as the interest rate paid on the reserves was an effective floor for the market rate, policymakers could essentially use that rate to raise (and possibly lower) market interest rates without having to change the quantity of liquidity that they supplied to the market.

Our assessment of the foreign central banks' experience with this was that, yes, they were able to raise rates without draining liquidity, by raising this effective lower bound, which is the rate of interest paid on the reserves. That is the lower bound in this quote that I was talking about. So, that is one of the benefits of this policy: It allows for the Federal Reserve to separately address two objectives: conditions in credit markets and the rate of interest that seems appropriate for the economy.

When you have two tools, with liquidity provision as one tool and the rate of interest paid on reserves as the other, you stand a better chance of achieving both objectives: providing sufficient liquidity to foster healthy lending and credit conditions in the economy and prompting the market rate to trade at a level appropriate for price stability and overall economic activity. However, when you had only one tool, the amount of liquidity supplied, it could be more difficult to achieve both goals. So, in sum, this tool essentially helps the Fed Reserve meet the target that the FOMC sets for the overnight rate without having to change the quantity of liquidity in the market.

**YPFS: Can we talk a little bit about swap lines? Why were they necessary? What was their main objective? What were the challenges? Because it was international, was it difficult to explain to the other countries?**



Leahy: Oh, no, other countries were very eager at the time, during the crisis. As I said, dollar funding markets are global, dollars are used all over. When the dollar funding market seized up, it was a global phenomenon. Many of the banks that initially started having troubles in the markets were foreign banks, they were having trouble getting dollar funding.

From the US point of view, the issue was that disruptions in dollar funding markets in Europe or in Asia or elsewhere in the Americas could easily spill back to the United States and disrupt the economy here because the markets are so open and linked. When there is a shortage of dollar funding in one market, it spreads throughout the world, and it would spread to the United States.

The Fed certainly is not in a position to know all about foreign institutions: It does not supervise them; they are not part of the Fed's regulatory purview. However, the Fed certainly does not want to allow disruptions in dollar funding markets abroad to spill back into the United States. This is actually where swap lines come in. They have a history. They were used as a tool for intervening in foreign exchange markets for many years during the Bretton Woods period when exchange rates were pegged, but we have been away from that for quite a while.

When the swap lines were reactivated during the financial crisis, they were set up a little differently. The idea was that, for the dollar funding swap lines, the Fed would swap currencies with a foreign central bank, say the European Central Bank [ECB]. The Fed would sell the ECB dollars, and the ECB would sell to the Fed, in exchange, euros. The Fed would then hold euros, and the ECB would hold dollars. Then, the ECB would have these dollars that they could lend out to their local financial institutions that were finding it hard to raise money in the markets.

It was up to the ECB to assess the conditions in its jurisdictions. Were their financial institutions just facing a non-functioning market or were they in trouble? Did they have credit risk? The ECB would have to make a decision on whether it should lend to those institutions or not, but that is something that they can do because they followed those institutions in those markets and the Federal Reserve did not.

The idea was that the Fed would do a transaction with the other central bank, it would get the other central bank's currency as collateral, and then that would be unwound after some set period, depending on how the local swap was set up for them. At the end of the transaction, the Fed would sell the euros back to the ECB, and the ECB would provide the dollars back to the Fed Reserve.

It was a way for the Federal Reserve to help foreign central banks provide dollar liquidity, which they did not necessarily have lots of, to deal with market conditions in markets that were outside the United States. There was quite a bit of interest in swap lines and it was not hard to persuade the foreign central banks to set up the strategy.

In fact, it was almost the opposite problem. Everybody wanted one, and the Fed did not necessarily want to set up a swap line for every country in the world. Not every country has a major dollar funding market. Moreover, the Fed did not have the sort of long-standing relationships with every country that it had with the ones that it ended up setting up the swap lines with because, as I said, there was sort of this long history of having swap lines back from the Bretton Woods period.

There was a lot of familiarity with the central banks that were party to the agreements in the past. It wasn't hard to set up the lines; it was not setting up something from scratch. The basic idea was to try to meet dollar funding needs outside the United States and to help the foreign central banks play the role that only they could play in figuring out how to help keep funding functioning in their local markets. In my assessment, it worked amazingly well; it really was quite successful. The Federal Reserve provided liquidity, the foreign central banks always returned that dollar liquidity, there were never any losses that the Fed had to bear.

You could see the success in market rates. At the times when the swap lines were set up, all of a sudden, interest rates would decline; markets would relax. It was as if market participants said, "Oh, the central bank now has access to the dollar liquidity, so maybe we do not have to be quite so panicky about getting dollar funding." It really was a quite successful enterprise, and it was quite large, too, in the sense of the amount of dollar funding that was provided. It was one of the biggest programs that the Fed set up during the global financial crisis. It worked very well.

**YPFS: You said that once a swap line was reached out to the foreign country, markets relaxed. Did the fact that they received swap lines provide confidence in the markets?**

Leahy: I think that is exactly the right word to use. The idea was that their local central bank, with the swap line, had access to dollar funding. That central bank could then provide dollar funding to the market. It provided another source of comfort, of confidence, that dollar funding would be available. If a financial institution could not get dollar funding in the market, well, it could probably draw it from the central bank, unless the institution had some serious problems, but if it was reasonably healthy, it could probably draw dollar funding from the local central bank.

Further, the banks' counterparties would say, "Okay, so BNP Paribas has access. They are going to be able to get money from the swap lines, so we can lend to them. We feel certain that we can get the dollars back. If they need it, they can get it from their central bank." Therefore, they did not need to be quite so stingy with their funds. It helped free up markets.

**YPFS: You said that the Fed couldn't reach out these swap lines to every country that applied for it. The countries that these were offered to, how were they chosen?**

Leahy: Initially, the swap lines were set up with some of the counterparties of the Federal Reserve that had had lines during the Bretton Woods period. This included Canada, Japan, and many European national central banks. The ECB wasn't around then, but many of the European central banks that were part of the euro system, with the ECB at its head, had been part of the Bretton Woods swap network. In fact, after the Bretton Woods period, the Fed continued to have working relationships for many years with these central banks, in part by maintaining deposit accounts with central banks in the group. Therefore, there was already in place an element of cooperation and trust, which was helpful in making this all work. It was useful to have this history.

By the time of the financial crisis, there were a few other economies that had major dollar funding markets. Had disruptions occurred in those markets, they could have spilled back into U.S. financial markets. Singapore, for example, is one country that has a big dollar funding market. Therefore, the Federal Reserve decided to set up a swap line with Singapore. It turned out that that swap line was never used, but the fact that it existed created an important signal and helped calm markets down. Concern about disruptions in dollar funding markets abroad spilling back into US markets and the US economy was a key factor in these decisions. For that reason, the Fed also set up lines with some of its largest trading partners, such as Mexico.

Those were the kinds of considerations that were relevant. Ultimately, as you worked through the list of countries in the world, the Fed wanted to be comfortable that the swap lines would function as they were intended to function, and that, if a swap were initiated, the Fed could expect to get the dollars back at the expiration of the swap. The Fed also wanted to be comfortable that each line could be justified in terms of its contribution to financial and economic stability in the United States.

If we were talking about a swap line with a country that was a struggling economy, one that did not have a major international currency or did not have an important dollar funding market, well, then the request for a swap line becomes a bit more like a request for a different kind of financial assistance, a kind that falls outside the mandate of the Federal Reserve. In that case, the request probably should go to the International monetary fund (IMF).

Requests were considered on a case-by-case basis. These were the kinds of considerations that Fed policymakers had in mind when they were making their decisions.

**YPFS:** **Now, looking back, more than 10 years later, at the Global Financial Crisis of 2008 and '09, would you do anything differently? Do you feel like “this is what we did right, and this is what we did wrong, we could have done this a little differently?” Is there anything like that?**

**Leahy:** The thing that comes to my mind, and this pertains not only to the Federal Reserve but to other policymakers around the world, is that we just did not pay enough attention ahead of time to systemic risk in the financial system. Bank supervisors looked at individual banks, and, in general, individual banks looked like they had little risk, because their risks appeared to be hedged.

However, all hedging does is shift risk, it doesn't make risk go away. In this case, one of the initial problems was that there were some bad loans made for real estate housing that could not be paid back, and then once the losses started, they propagated quickly throughout the financial system. The subprime mortgage market was riskier than many had appreciated.

Part of the risk was systemic. Financial institutions all thought they were hedging somehow. You could package these risky loans and sell them off thinking somebody else would hold the risk. However, the risk did not go away, it was just getting redistributed, in ways that were not transparent. As soon as concern about those loans materialized, the markets seized up because nobody knew for sure who had the bad loans in their portfolios or how to assess the risk of dealing with any counterparty. Institutions were unsure of the safety of dealing with one another, and it became a general panic. Part of the problem was that the global financial community did not really look at this risk in a systemic way.

That was something the Fed and other policymakers could have done differently had they recognized the problem. Since then, of course, there has been a reaction. There are greater systemic elements in supervisory surveillance: For example, the Federal Reserve set up a financial stability function and began conducting regular stress tests for financial institutions, among other things.

**YPFS:** **How about now? The current crisis... It was COVID-19 and then it became an economic crisis as well. How is it different from the 2008-9 crisis?**

**Leahy:** The current crisis is pretty different, mainly by its cause. This is really a public health crisis that spilled over to the economy, whereas the Global Financial Crisis in 2008 and 2009 started with financial problems, essentially the subprime loans and poor handling of the risks associated with those.

Therefore, the solution strikes me as much different. Central banks, including the Federal Reserve, are doing what they can to maintain liquidity and market function. There has also been fiscal policy response. However, what is really going to solve this crisis is getting rid of the public health problem. As long as people are scared to do business with one another because they are worried about getting sick, there is no monetary policy that is going to solve that. So, it is a different issue.

**YPFS:** **Because this has become an international crisis, do you think that international collaboration can be achieved, at least economically, to find a solution to it?**

Leahy: It can help address some of the symptoms. The swap lines are still active between central banks. Some of the financial policies that were established during the Global Financial Crisis have been resurrected and used in the United States for financial markets here. However, they are really just helping the markets deal with the slowdown in the economy that is driven by this public health issue. International cooperation, certainly among public health officials makes a lot of sense. However, if you are talking about central bank corporation, I am not sure that anything new or novel is needed here. I think the idea is just to use the tools that we have already and wait for the solution to be found to the public health problem.

**YPFS:** **International monetary institutions like the IMF, where you are consulting, or the World Bank... Can they help the most horribly hit countries economically?**

Leahy: Well, I think they can help in the sense that they can help these countries set up and establish financial stability if it is being threatened in their economies because of the crisis. I don't know the World Bank so well, but I know they have lots of different kinds of programs, some of which may help. The IMF has ability to provide funding for countries that are temporarily under duress for financial stability and financial liquidity needs, etc., that may be associated with the result of the crisis.

They have a role to play. I do not see them as being the leaders in the public health arena to try to deal with the medical aspects of this. However, certainly in trying to stave off greater economic distress by helping provide liquidity and funding and lending to financial institutions and countries that might need it until the medical solution arrives, that makes some sense.

**YPFS:** **What do you see as the biggest systemic risk that we are facing today?**

Leahy: A systemic risk in the financial system like the one we saw in 2008-09 is always hard to predict. Risk assessment is a tricky thing. Financial markets tend to be creative and innovative and they try new things, and they build new kinds of investment packages. etc. It is often difficult to know immediately

what kinds of risks these innovations might entail. Often times the innovations are quite good and useful, but they may also carry risks and it is not always easy to foresee them.

It is important to pay attention to those kinds of things. Whether that is going to be the biggest systemic risk for the US or internationally, I do not know. The thing with the U.S. is that, if we're talking about a risk to dollar credit markets, that becomes almost instantly an international problem because the dollar still has a pretty important role in global funding.

I think that the lesson from the Global Financial Crisis is that sometimes innovation is a good thing, but we need to pay attention to the risk. That could be the key challenge: understanding the risks associated with new things.

**YPFS: Thank you. Did I miss out anything or anything you would like to add?**

Leahy: One thing that I read about, which I thought was interesting, was a recent study by some researchers at the University of Chicago looking at the economic effects of the [COVID-19] crisis. One of the questions was how much of the economic slowdown is associated with government lockdown policies.

They found that actually a very small part of the result in economic slowdown seemed to be related to the policy measures. The economic slowdown was due more to people's fear about doing business in public, going out to restaurants and shops, etc. The extra constraint imposed by the policy measures was not so big. I thought it was pretty interesting. If you wanted to know or think about how the crisis needs to be addressed, it really is a public health issue.

People need to become confident again to go out and interact. That strikes me as certainly an interesting lesson.

**YPFS: Here, you used the word "confidence" again.**

Leahy: Confidence is an important factor. People have to trust one another to some extent if they are going to make deals and do business. It is certainly true in the financial markets because you are dealing with transactions where you expect somebody to perform in the future in exchange for something you give them today. The problems are similar. If you are not sure that people are going to be around (which was the sort of problem with the financial markets in 2008-09, that they didn't know whether the companies would be in business the next day to repay them) or if you are not sure that the person you are dealing with is healthy or if you are going to be healthy after you deal with them [the COVID issue]. . . that really can constrain economic activity.

Going back to your previous question, there is one more thing I would like to add. Your questions prompted me to remember some of the long days and nights many of us at the Federal Reserve experienced when we were working

on the crisis. The teamwork and dedication were really something. It was all-hands-on-deck. Everybody was pulling at the oars. And while there is no denying that it was a bad time for the global economy, it was also an interesting time from an economist's point of view because we were doing lots of creative things to respond to the crisis. And we discovered that several of those creative responses were useful and helpful. I felt fortunate to be able to be at the Fed during that time and to be able to help work on dealing with this crisis.

Suggested citation form: Leahy, Mike, 2022. "Lessons Learned Interview by Yasemin Sim Esmen, October 22, 2020." Yale Program on Financial Stability Lessons Learned Oral History Project. Transcript. <https://ypfs.som.yale.edu/library/ypfs-lesson-learned-oral-history-project-interview-mike-leahy>

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