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Q&A: Ken Rogoff Says Crises Are Like Heart Attacks, Predicting Timing Is Tough

*Few people on the planet can claim to know as much about financial crises as **Harvard University** economist **Kenneth Rogoff**. Together with **Carmen Reinhart** of the **Peterson Institute for International Economics**, he has created a database on banking, currency and debt crises going back to the 13th Century, and written an entire book on the uncanny human ability to ignore the lessons of financial history.*

*Today, those efforts — along with his work on monetary policy and exchange rates — have won him the **Deutsche Bank Prize in Financial Economics**, a 50,000-euro award presented every two years by the **Goethe University Frankfurt**'s Center for Financial Studies. On the occasion, we speak with him about how he sees the world faring in the wake of the latest financial crisis — and solicit some advice on exchange rates.*

Your work suggests sovereign-debt crises often follow banking crises like the one much of the world just experienced. Do you expect history to repeat itself?
Yes, though it could take years to play out. If you look at southern and eastern Europe, many countries have external debts that far exceed 60% of GDP. Historically, that's a very high number and many countries start resisting debt repayment at significantly lower levels. Greece is off the charts. Portugal is very high; Ireland looks like Iceland. And Hungary, Ukraine, Romania and the Baltic states, particularly Latvia, all have to be considered highly vulnerable. They're getting ample support from the International Monetary Fund, but that's something that can't go on forever.
The U.S., of course, is on an unsustainable path of its own. We have only, perhaps, five to ten years to make a significant correction in our fiscal policies. But the timing of crises is very difficult to call. It's like a heart attack. A good cardiologist can assess someone's risk, but it's very difficult to predict the timing.

Are policy makers wrong to try to smooth out boom-and-bust cycles? Some economists wonder whether, by stepping in to ease the pain when things go wrong, we are only setting ourselves up for bigger crises in the future.
Smoothing cycles is good, but unfortunately regulatory policy in the U.S. and elsewhere often did just the opposite. Regulation got easier as the boom continued, which is exactly the opposite of what you need to do.
Look at unemployment. It's now pretty clear that the equilibrium level is probably around 6%, or even higher. But during the boom, instead of saying 'Gee, the housing and financial industries seem bloated,' many policymakers concluded that they were running the economy brilliantly and the new normal for unemployment was around 4.5%. Had they realized that the economy was overheated, they might not have kept interest rates so low for so long.

You're probably best known in academic circles for your work demonstrating the benefits of having an independent central bank. In the wake of the Federal Reserve's unprecedented moves to bail out the banking sector and the broader economy, though, that independence is coming under fire. Are you concerned?
Throughout the financial crisis, recession and recovery, the central bank has been used as an end run around Congress, as a tool of fiscal policy. And we should be thankful for it. The Fed was able to act when Congress and the Treasury were paralyzed. Unfortunately, there is now severe political pushback that threatens to spill over into the area of monetary policy. That would be a sad day for macroeconomic stability.
There are serious people who believe we've solved the inflation problem, and we don't need central bank independence anymore. They think the stagflation of the 1970s was like teenagers experimenting with alcohol and it won't happen again.

I think that's very wrong-headed, particularly at a time when extremely high debt levels create a temptation for governments to inflate away part of the real value of the debt.

If you had to make a bet on the direction of exchange rates, what would it be?

The first thing to understand about exchange rates is that you can't understand them. You have to approach the market with a lot of humility.

That said, I think I would probably be a little bit short the euro. The risks are asymmetric: The chances of it going down 30% against the dollar seem to be a lot higher than the chances of it rising 30% against the dollar. That's because Europe doesn't have a coherent plan for digging its way out of a mountain of debt. Their plan seems to be to temporize wherever they can and avoid overt defaults in the short run. But their approach seems untenable in the long run. Maybe Europe will pull off a Houdini and escape from its debt handcuffs unscathed. But to me the risks are tilted to the down side.

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