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The 2008 Economic Crisis: Implications and Responses in the Banking Sector

Honest Prosper Ngowi [1]

Abstract

This article documents and discusses the impacts of and responses to the 2008 global financial and economic crisis (GFEC). General impacts and responses are outlined with some example from some specific countries. The discussion on the general impacts and responses are followed by discussions on the impacts of and response to the crisis in the banking subsector of the broader financial sector. The major findings of the study indicate that there have been substantial impacts of the crisis in the banking sector in the more economically and financially developed and integrated part of the world such as Europe and North America than in the less developed and intergated part of it such as Africa. Within Africa, the more economically developed and financially integrated countries such as South Africa and Nigeria were more affected by the crisis in general and in their financial sector in particular. There have also been various responses to the 2008 economic crisis in general and within the banking sub-sector in particular both globally and within Africa. The model that has been developed by the author indicates among other things that some of responses to economic crisis by the banking sector can lead to yet another chain of impacts, both positive and negative. The paper is mainly informed by a desk research in form of intensive literature review and discussion of the same.

Key words: 2008 economic and financial crisis, impacts, responses

[1] Senior lecturer, Economics Department, Mzumbe University, Dar Es Salaam Business School, Tanzania., pngowi2002@yahoo.com

Introduction

The 2008 global financial and economic crisis (GFEC) started to manifest itself officially on 15th of September 2008 in the United States of America (USA). Since then it has spread not only to the financial sector but also to the real sectors of the economy. Geographically, it has spread to many parts of the world especially in Europe and Asia where the first round effects were rapidly experienced. In Africa in general and Tanzania in particular, the crisis has been mainly seen in form of second round effects (bounce-on effects) in the real economy.

The 2008 crisis is also termed the credit crunch, economic turmoil, economic downswings, global downturn, and financial meltdown. For the purpose of this work, the term economic crisis will be used. The crisis has been termed 'the current' to distinguish it from a similar crisis that was experienced in the 1930s that resulted into the Great Depression. The 2008 crisis manifested itself in form of severe credit, banking, currency, and trade crisisThe crisis has many and closely linked causes, impacts and responses as well as many results of the responses. Within less than three years after the crisis, there have been many, far-reaching and closely linked impacts of the crisis at individual, household, community, country, sub-region, region and global levels.. There have also been many and far-reaching responses to the crisis. The responses have aimed at halting the crisis, reducing its negative impacts, preventing a new crisis in the future and even exploiting opportunities that have unfolded from it.

The crisis has been among the leading current and contemporary global discourse issues since it saw the light of the day. This is so in the academia, policy and decision making, among practitioners as well as the general public. According to Eghan (2010), economic crises usually refer to a long-term economic state characterised by slow growth or setback in economic activity; rising unemployment; low prices; and low levels of trade and investment. Moyo (2010), outlines some of the underlying factors that set the stage for the 2008 crisis. These include but are not limited to prolonged economic boom for two decades preceding the crisis accompanied by surging house prices at a rate which was unsustainable especially in United States of America; rapid expansion of credit leading to accumulation of debt several times the size of Gross Domestic Product (GDP)[2] with significant proportion of the credit owed by marginal, doubtful and barely credit worthy clients (sub-prime borrowers) in the U.S; and emergence of new, innovative types of financial instruments and over-expansion of predatory lending practices such as adjustable rate mortgage that tended to obscure the true position of lenders and capacity of borrowers to service their liabilities.

Moyo (ibid) further outlines that the crisis was also caused by the rapid expansion of securitization whereby loans (mainly to none credit worth borrowers) were bundled together and sold to other lenders. Then the resulting paper transaction was used as a basis for further lending thereby making the financial markets highly leveraged. Inter alia, sub-prime mortgages were bundled into mortgage-backed securities or collateralized debt obligations and sold to investors.

Weak regulatory mechanisms and oversight is another cause of the crisis that has been correctly outlined by Moyo (ibid). This cause has also been captured by Ngowi (2009 and

[2] In the U.S. for example, GDP of U$14.2 trillion was supporting a total debt of U$49.9 trillion in March 2009 (*Pianim, 2009*)

2010) and Adei (2010). The key argument is that the monetary authorities (The Federal Reserve Bank of USA) did not catch up with things till it was too late. This was made more difficult because balance sheets of the financial institutions had become more complex as the companies exploited earlier American legislation to hide the true state of the companies

Similar to other scholars, such as Adei (ibid) and Ngowi (ibid) Sikod (2009) attributes the crisis to asset price bubble. This interacted with new kinds of financial innovations that masked risk with companies that failed to follow their own risk management procedures and with regulators and supervisors such as the Federal Reserve Bank (the Fed) that failed to restrain excessive risk taking. Rwegasira (2010) citing the Bank of Tanzania – BoT – (2008) captures very well the fact that the turmoil in global financial markets has resulted in lack of confidence in financial markets that has severely curtailed credit in global markets (the credit crunch). The source of the crisis was sub-prime mortgages offered by financial institutions in the United States. The effects of those mortgages quickly spread across the West and other parts of the world.

According to Oke (2009), the global economic crisis is also called the Great Depression II of 2009 and it is several times more severe than the Great Depression of 1929. This cannot be perfectly correct because the crisis began in 2008 and not in 2009. Oke (ibid) correctly argues that the crisis was triggered by the failure of sub-prime mortgage loans in the United States and it became prominently visible in September 2008. As alluded to by many other authors, this author captures well the fact that the crisis began with failure of large financial institutions in the United States of America. It then rapidly escalated into a global credit crisis. As a result there was a number of US and European banks failures. Also there were declines in various stock indices.

Mutahi (2009), argues that the crisis began in July 2007 when a loss of confidence by investors in the value of securitized mortgages and banks in the United States started. However, this is not exactly the case. This was just among the signs of the crisis and not the beginning of the crisis itself. Akbar (2008) correctly argues that the crisis has been a major financial crisis. It became prominently visible in September 2008 with the failure, merger or conservatorship of several large United States-based financial firms including but not limited to Goldman Sachs, Morgan Stanley, J.P. Morgan, Bank of America, Merrill Lynch, Citigroup, Wells Fargo, Bank of New York Mellon and State Street.

According to Akbar (ibid), *Evans-Pritchard (2007) and The Economist (15th May and 22nd May, 2008), t*he underlying causes leading to the crisis had been reported for many months before September 2008, with commentary about the financial stability of leading U.S. and European investment banks, insurance firms and mortgage banks consequent to the sub-prime mortgage crisis.. The failures of large financial institutions in the United States rapidly evolved into a global crisis resulting in a number of European bank failures and declines in various stock indexes, and large reductions in the market value of stock (*Norris: 2008)* and commodities worldwide (Evans-Pritchard, ibid).

The crisis is having many and far-reaching direct and indirect and short-term and long-term impacts across the globe. Given the source and nature of the crisis, it is the developed countries that have been more affected than the developing ones. However, the impacts of the crisis are continuously unfolding.

Some literature on the various impacts of the crisis have emerged in less than three years after the onset of the crisis. The literature include but are not limited to Ngowi (2009a) on

employment and official development assistance (ODA); Ngowi (2009b) on investments in human capital; Ngowi (2009c) on the climate; Ngowi (2009d) on Tanzania and Ngowi (2009e) on Africa. Other scholars who have laboured on the impacts of the crisis include Biekpe (2009) on foreign aid in Africa; Myburgh (2009) on correlations between Sub Saharan Africa (SSA) currencies during the 2008 financial crisis; Kiptoo (2009) on African economies and International Monetary Fund – IMF – (2009) on Africa.

Adei (2010) dwelt on the impacts of the crisis on developing economies while Turysingura (2009) worked on impact of the crisis on foreign capital flows in Africa. Other works on the impacts of the crisis are those of Nabaho (2009) on employment and labour markets in Africa; Moyo (2010) on mining, industry and trade sectors; Lee (2009) and Park (2009) on Korea; Oyavbaire (2009) on Nigerian public administration system; Rwegasira (2010) on Tanzania and Ssonko (2009) on Uganda.

The general and common factor among the cited works on the impacts of the crisis include liquidity problem and the de-leveraging of financial institutions especially in the United States and Europe, which further accelerated the liquidity crisis. It is causing fears and declining consumers and investors sentiments in the market thereby reducing aggregate demand. Other impacts include currency crisis with investors transferring vast capital resources into relatively stronger currencies. This in turn is leading many emergent economies to seek aid from the International Monetary Fund. (Landler, 2008 and Fackler, 2008, quoted on Ngowi, 2009a).

Other general impacts of the crisis include reduced aggregate demand of goods and services across the globe. This is due to limited liquidity and related problems such as all-times low consumer sentiments that are emanating from the crisis. The reduced aggregate demand in turn is leading to reduced production of goods and services with the necessary result of reducing demand for and employment of factors of production including labour. The implications of reduced employment of factor inputs include reduced incomes to the factors and their owners in general and reduced standard of living and possibility of vulnerability to poverty for labour in particular.

In some countries, migrant workers, (foreign labour) are likely to suffer more by being the first to be laid-off. This will have many and far-reaching implications on the countries and individuals dependent on transfers from migrant workers in form of remittances. The crisis is culminating into a worrisome meltdown in the economies of most developed countries.

The actual extent of impacts of the crisis will depend on a number of issues. The issues include but are not limited to the degree to which a particular country is integrated into the dynamics of global investment flows, expanded trade, information technology and vibrant financial security arrangements. It will also depend on the extent to which a country is marginalized from the dynamic processes above. The kinds of policies that will be put in place by individual governments independently and in collaboration with the global community to solve and mitigate the impacts of the downturn will determine inter alia, the severity and length of the crisis.

The crisis has impacted different countries differently. This is also true for Tanzania. The country has been affected differently by the crisis. However, there are a number of specific impacts of the crisis on Tanzania that have been recorded. These are outlined in what follows. It is to be noted that generally, the impacts of the crisis in Tanzania emanated from the

reduced aggregate demand both at global and local levels. The crisis resulted into liquidity problems and all-times low consumers' and investors' sentiments in the world market. Foreigners' appetite for goods and services produced in and exported from Tanzania declined on account of the crisis, inter alia. Some of the actual impacts of the crisis that have been observed and recorded in Tanzania are presented here. Unless otherwise stated, the facts and figures presented here are from URT (2009).

According to Mtango (2008), the effects of the global financial crisis forced Tanzania to reduce its growth forecast to from 7.8% to 7.5%. More recent figures on the impact of the crisis on economic growth are available in URT (2009). It is documented among other things that the crisis has resulted into reduced growth forecast from 7.4% in 2008 to 5% in 2009 in Tanzania Mainland and from 5.4% in 2008 to 4.5% in Zanzibar.

The reduced growth forecast had a lot of connected impacts through the multiplier process. These include reduced employment, real and nominal incomes and standards of living. On real incomes for example, it was announced by Tanzania's President on 1st May 2009 (Workers' Day) that the government would not be able to increase wages due to the crisis. It is the researcher's interpretation that the crisis has hindered the growth of the national cake, from which increased incomes could have come from. Essentially 2009 was a lost year in economic growth terms.

The crisis has helped in reducing inflationary pressure from 25.3% in October 2008 in Zanzibar to 12.2% in April 2009. In the mainland, inflation had reached 13.3% in February 2009 but the pressure somehow eased due to the crisis. The July 2009 inflation was approximately 10%. Reduced oil prices from about USD140 per barrel before the crisis to figures below USD 50 per barrel after the crisis take some credit for the prospects of reduced inflation.

In the financial markets especially foreign exchange, the Tanzanian shilling declined in value compared to such vehicle currencies as the UD Dollar. Exchange rate between the shilling and USD in September 2008 was about 1 USD to 1,162.9 Tshs. By June 2009 it had moved to about 1 USD to over 1,340 in some bureau de change. On average the Shilling declined by about 13.7% between September 2008 and March 2009. Export earnings were likely to decline by USD 31 million from USD 2,891 million in 2008/09 to USD 2,860 million in 2009/10. This reduction was a result of several processes including reduced export volumes of goods and services and prices of the same.

Although attribution and causality may be difficult to establish and ascertain, statistics show that over 48,000 people had lost jobs directly in Tanzania by April 2009 due to the crisis. A rule of thumb has it that for every one job that is lost directly, there are about three others lost indirectly as a result of a negative multiplier effect. New direct employments to the tunes of 70,000 and 210,000 indirect ones did not materialize. This is due to the crisis which made it impossible for the USD 4 billion Nickel and Aluminum projects to start in Tanzania due to the prospective investors' inability to secure the needed investment capital from the credit-crunched global capital market.

Internal revenue forecasts in Tanzania for the period July 2008 to March 2009 were missed by 9.5% and by 10% by the end of the 2008/09 financial year. About 472.9 billion Shillings that were budgeted could not be realized. This is a direct effect of declining tax revenues and import duties due to decline in economic activities triggered off by the crisis. None tax

revenues by Ministries, Departments and Agencies (MDAs) for the period July 2008 to March 2009 were short of the estimates by 32.4% compared to 24.1% in the same period in the fiscal year 2007/08.

The realized aid and loans for development projects in Tanzania for the period July 2008 to March 2009 were about 56% only of the estimates for 2008/09. This indicates that donors and lenders were unable to deliver as per Tanzania's expectations because they have been negatively affected by the crisis. The 2008/09 budget was negatively affected by the crisis. The expected internal revenue to finance the budget was 4,728,595,000,000 Tshs. This was actualized by 90% only (4,248,858,000,000 Tshs).

Tanzania Investment Centre (TIC) reported that Foreign Direct Investments (FDIs) flow into Tanzania would be less than $675million instead of the $750 predicted earlier in 2008. This is a reduction of 10%.According to URT (2009), the country had a plan to finance infrastructure projects in 2009/10 by funds raised from sovereign bonds. Due to the crisis however, the cost of borrowing from the international financial markets for this purpose was too high and the plan had to stop. Lack of capital made it necessary to either cancel or postpone huge investment projects in mining, energy and industries. Among the projects that have been affected include the USD 300 million electricity joint venture project between Artumas and Barrick Gold and Artumas' USD 7 million Mtwara electricity project.

The crisis has caused Artumas share prices to drop from 55 Kroner to 1.9 Kroner in Oslo Stock Exchange. Other affected projects include a joint venture between the National Development Corporation (NDC) and a foreign investor to revive Kilimanjaro Machine Tools industry. Cement production project in Mtwara stopped because shareholders had been badly affected by the crisis. The nickel project to the tunes of USD 165 million was postponed and mineral exploration investments dropped by 50% from USD 90 million to 40 million annually.

The reduced FDI inflows has a lot of implications due to the benefits of such investments in most developing countries in general and Tanzania in particular. According to Ngowi (2009f), benefits of FDI in the development of host economies is widely acknowledged. See for example, Dunning (1994), Blomstrøm and Kokko (1997), Røvik and Frøyen (1997), Ayiku (1995) and Ngowi (2001a, 2001c). The roles cited by the authors above include but are not limited to capital formation; contribution in gross domestic product (GDP); increased government revenue from, among other things taxation of FDI projects; employment creation; increased output; increased export and therefore foreign exchange earnings; import reduction for market-seeking FDIs; introduction of modern, up to date, advanced and state-of-the art technologies; linkages with the rest of the economy – for example linkage between plantation agriculture and agro-processing, packaging and transport industry; better and superior management, organization, marketing and production skills. When FDIs shy away from Tanzania due to the crisis then it implies that these and other benefits that the country could benefit will not be forthcoming. For detailed Tanzanian-specific impacts of the crisis, see Ngowi (2009). Ngowi (ibid) documnts thta the crisis has affected various sectors of the Tanzanian economy differently. The sectors include but are not limited to tourism, agriculture, mining, industrial, cotton sub-sector, coffee, Nile Perch and food Sub-sectors as well as the financial sector including banks.

Responses to the Crisis

The impacts of the crisis necessarily called for a number of responses at the individual,

household, community, national, sub-regional, regional and global levels. Whereas some responses have aimed at stopping the spread of the crisis and its many negative impacts, others have aimed at reducing possibilities of a future crisis and at best prevent one all together. Other responses have taken the form of exploiting the opportunities that unfolded from the crisis.

At the global level, responses have included several meetings, resolutions and interventions to address the crisis by the United Nations (UN) and its various agencies/organizations, the World Bank (WB), the International Monetary Fund (IMF), the group of eight richest countries (G8) and the group of richest twenty countries (G20). There have also been a number of responses at continental and sub-regional levels. At continental level, inter alia, the Association of African Public Administration and Management (AAPAM) held a round table conference on the crisis in Nairobi Kenya (21st to 25th September 2009). At the East African Community (EAC) level inter alia, the East African Business Council (EABC) held a workshop on the crisis in 2009.

At national level, responses have included various policy measures including use of fiscal and monetary policies and their various instruments such as taxation and subsidies (fiscal policy instruments) and interest rate (monetary policy instrument). Part of policy responses have included issuing of stimulus packages that have aimed at stimulating economic activities through increased aggregate demand. Stimulus packages have aimed at, inter alia, raising aggregate demand through creating and maintaining jobs and incomes. Stimulus packages have been seen both in developed, emerging and developing economies. In the developed economies, stimulus packages have been seen in such countries as USA, Germany and Japan. In the emerging markets the greatest stimulus packages have arguably been those in China. In developing economies, a stimulus package has been seen in inter alia Tanzania where a total of 1.7 trillion Tanzanian Shillings were set aside as stimulus package in the 2009/2010 national budget.

There have also been policy responses in form of bail out plans for specific and strategic sectors, industries and firms. The focus has mainly been on those firms that are too large to fail due to their systemic importance. These are firms that play crucial roles in national and even global economy whose collapse due to the crisis would trigger collapse in many other related and linked economic activities. Bail outs have been mainly seen in the developed world including USA, Japan and in West European countries where the motor industry has been among the targets for bail out plans.

At the firm level, responses have included various cost-reducing measures like reducing and even stopping production, seeking for bankruptcy protection, foreclosures, laying off employees and even taking advantages of the opportunities unfolding from the crisis. At household and individual levels, responses have included change in life style and various cost-reduction measures.

Works that have dwelled on responses to the crisis include those of the ILO (2008) on a global policy package to address the global crisis; ILO (2009a) on tackling the global job crisis and recovery through descent work policies; ILO (2009b) on the financial and economic crisis: a descent work response; AfDB (2009) on response to the economic impact of the financial crisis; and Aryeetey (2009) on the global financial crisis and domestic resource mobilization in Africa.

Other works on responses to the crisis include IMF (2009) on world economic outlook: crisis

and recovery; Krugman (2008) on *b*ad anti-stimulus arguments*;* Ngowi (2010b) on the current global financial crisis: its impacts and solutions in Tanzania; Ngowi (2009d) on whether the 2009/10 Tanzanian budget could offer recovery from the crisis; UN (2008) on calling for decisive action to lessen impacts of the global economic crisis; and Soji-Eze (2009) on six measures identified by the ILO to address crisis.

The work of Fagbohun (2009) dwelt on global financial crisis and corporate environmental governance with a focus on rethinking rationalizations. Barrell et al (2009) worked on fiscal stimulus to address the effects of the global financial crisis on Sub-Sahara Africa while Tumusiime-Mutebire (2009) looked at the global financial crisis and its impact on Uganda and policy response. Walsh (2008) worked on responses to the crisis through going green and asks whether the environment will lose out to the economy or not.

Impacts of and Responses to the Crisis in the Banking Sector

As noted above, the 2008 crisis has affected virtually all sectors of the economy. The financial sector in general and the banking part of it in particular is not an exception. This part of the paper focuses on the impacts of the crisis in the banking sector. The theoretical framework behind the discussions raised here is the business cycle theoretical framework. More particularly it is the recession stage or phase of the business cycle theory that informs the part of the study on the impacts of the 2008 GFEC. As for responses to the 2008 GFEC, the aim is to attain recovery and eventually reach the boom stage or phase of the business cycle theory. For details on business cyce theory see, among others Pass, Lowes and Davies (2000: 50 – 51) on description of the term.

The literature indicates that the 2008 GFEC had a number of impacts in banks across the world. Adei (2010) correctly noted that financial sectors in sub-Saharan Africa are vulnerable to several risks that could still unfold from the crisis. Unlike in developed economies, there has been no systemic banking crisis in sub- Saharan Africa. Commercial banks and other financial institutions in this part of the world remained largely sound. IMF (2009) correctly points out that cross-border banking system linkages are minimal in Africa. There is less exposure to complex financial products. Financial systems in the continent are generally not well integrated with other global financial markets.

According to IMF (ibid), with continuous crisis, risks could grow because a protracted economic slowdown elevates credit risk. Financial sector is vulnerable to a substantial weakening in client incomes and debt servicing capabilities. Banks could also incur losses on other financial assets such as deposits with troubled correspondent banks. Due to declines in the prices of most commodities, major industries, such as timber, mineral and cotton have been hard hit by the crisis as has been the case to tourism and other sectors. Problems in these sectors could quickly affect the banking sector due to interconnectedness, co-movements of sectors and multiplier effects.

Due to the crisis, parent banks investing in Africa could withdraw funds from subsidiaries and local banks and negatively affect the sector in Africa. Besides the possible withdrawal, there can be stopping of investing local profits in local subsidiaries. This calls for among other things, monitoring of the sector vigilantly in order to minimize vulnerabilities and mitigate risks. According to Ssonko (2000), the crisis has affected among other sector, the financial one in Uganda. Citing Ssewanyana et al (2009), he argues that as a result of the crisis, Uganda's financial sector has been affected by the drop in demand for government securities, as investors retreat to safer destinations. For example the Bank of Uganda (BoU) had to suspend a number of Treasury bill auctions in the first quarter of 2009. Citing BoU (2009), the author informs that in order to encourage lending the BoU cut its lending rate to

the commercial banks by 3.4 percentage points, from 19.3% to 15.8%.

The author points out that the structure of Uganda's banking sector raises concern because about 80% of the banking business is foreign owned (mainly by banks from South Africa, the UK, Nigeria and Kenya). This is seen as posing potential risks to the economy since the local banks could face difficulties if due to the crisis their parent companies abroad withdrew funds to support their operations at home as documented in IMF (2009).

According to the BoU (ibid) however, the banking sector was sound and stable. Its capital adequacy ratios were said to be well above the regulatory requirements. BoU admitted that Uganda is a home to subsidiaries in international banks. However, it was of the view that the local subsidiaries have no exposures to the subprime products of other toxic debts. While some banks such as Citi Bank International and Barclays Bank (Uganda) Ltd have their own capital base and no exposure to the toxic assets, the two subsidiaries have a stand-alone capital requirements and are decoupled from the parents. Nevertheless, while solvency is not an issue, the global banking system has not wholly escaped being affected by the global financial crisis.

Soko (ibid) citing BoU (ibid) informs further that the abrupt decline in capital inflows has contributed to the reduction of liquidity in the banking system in Uganda. The author informs further that there is also some anecdotal evidence that some large local companies access to credit abroad was curtailed causing an increase in domestic demand for credit. This is further reflected by the nominal average interest rates which peaked at 23.2% in August 2008, but declined subsequently to 18.9% in January 2009. However, the rates increased to 20.9%. in March 2009. According the MFPED (2009), this increase to the corporate demand for locally loanable funds went up following a switch by companies which were previously borrowing from abroad to the domestic banking system.

According to Nanto (2009:1), due to the crisis, numerous small banks faced huge problems in restoring their balance sheets. On its part, the IMF (2009:1) correctly notes that the global economic and financial crisis is having a significant impact on the Tanzanian economy. It notes further however that the Tanzanian banking system remains sound but is vulnerable to credit risk resulting from the economic slowdown.

The IMF (ibid:2) correctly notes that the Tanzanian financial system was not directly affected by the 2008 GFEC. The banking sector in Tanzania was described by the IMF as sound, but vulnerable in some areas. According to the IMF, despite of the 2008 GFEC, banks in Tanzania are well capitalized and there was no indication that they were directly exposed to the toxic debt that has caused havoc in global financial centers. However, the economic slow-down associated to the crisis could raise banks' credit risks. This can happen through banks' exposure to export crop financing and personal loans.

The second round effects of the 2008 GFEC are likely to increase pressures on banks and other financial institutions. The IMF (ibid) argued further that banks were well-capitalized and not exposed to toxic assets in the global financial centers. Among other things, non-performing loans were reported to have remained at a low level. The fund correctly informed further that due to slowing down of the economy and international commodity prices and demand for traditional exports fall, non-performing loans are likely to increase. It is the researcher's views that the IMF's view is based on among other things, the nature of business cycle and intersectoral linkages.

The IMF (ibid) correctly argues that banks are particularly exposed to personal loans and crop financing. The reason is that the two are likely to suffer during a downturn such as during the 2008 GFEC. It is the researcher's opinion that repayment of personal loans during economic crisis can be difficulty for those who loose jobs, those whose working hours are reduced, and those who have been depending on such transfer payments as remittances from the Diaspora. Banks may also reduce issuing of personal loans if they are perceived to be more risky in times of crisis as was the case in the 2008 GFEC. All these would have impacts on banks' business performance.

The impacts of the 2008 GFEC to banks through crop financing is related to the fact that during the crisis there was reduced demand and prices for most export crops such as cotton, coffee, sisal and horticultural products, inter alia. The reduced demand and price have direct negative impacts on the willingness and ability of those who had borrowed from banks to finance various nodes of the crops commodity chains. These nodes include but are not limited to trade in various crops inputs such as seeds and farm implements, crops cultivation, crops transport, crops storage (godowns), crops processing such as milling and packaging and crops trade. The reduced demand and price have impacts on profit margins and ability to repay crop financing loans in time and amounts agreed with banks. The section on the impacts of the 2008 GFEC in Tanzania in general and the part on the impacts on various agricultural sub-sectors shades light on this discussion by offering actual impacts of the 2008 GFEC on crops and by extension on banks through crop financing.

The IMF (ibid) correctly argues further that large foreign banks experienced financial difficulties. As a result, "... there is a risk that they try to repatriate funds from their Tanzanian subsidiaries or curtail their local operations by selling their assets". Keeping in mind that Tanzania has a substantial number of foreign banks operating in its jurisdiction (foreign bank account for about 51 percent of the banking system's assets in Tanzania – IMF (2009), this risk is very real. In the table below, some possible impacts of the global financial crisis on the financial sector in Tanzania are presented.

Box 1: Impacts of the Global Financial Crisis on the Financial Sector in Tanzania

As the crisis persists there are clear risks of enhanced pressures on the financial system. These include:

• **The likely increase of credit risk for banks.** As Tanzania is hit by the global recession, the economy slows down, and commodity prices and demand for traditional and mining exports collapse, non performing loans (NPLs) are likely to increase. Some cotton, coffee, and gem stones exporters are already experiencing debt servicing difficulties. Banks also appear to be exposed to personal loans, which have grown at a fast pace in recent years and now account for about one fifth of total credit allocation. Bank stress tests results show that, in spite of being well capitalized, banks would be affected by a rapid deterioration in their loan portfolios. O top of that, credit risk is compounded by a large credit concentration.

• **Difficulties experienced by foreign parent banks.** As foreign banks[3] experience financial difficulties, there is a risk that they will repatriate funds from their Tanzanian subsidiaries or curtail local operations by selling their assets. Local depositors could also lose confidence in a foreign bank creating a potentially rapid withdrawal of deposits. This in turn would have many and far-reaching negative implications in the economy in general and in the banking sector in particular

• **Exacerbation of financial weaknesses of nonbank institutions.** The pension sector in Tanzania accounts for over one fifth of financial sector assets. However, it is not effectively supervised. Actuarial studies indicate that there are some financial weaknesses in some pension funds. A number of insurance companies are also experiencing difficulties and require rapid recapitalization. Although these structural underlying weaknesses were not caused by the 2008 financial crisis, the latter could exacerbate them.

Source: IMF (2009)

Responses in the Banking Sector

The impacts of the 2008 GFEC in the banking sector has necessarily triggered responses of various kinds. The available literature indicates that responses have included those undertaken by countries, by some organizations and institutions, by central banks and by individual banks. Nanto (2009:1) correctly informs that "Nearly all industrialized countries and many emerging and developing nations have announced economic stimulus and/or financial sector rescue packages, such as the American Recovery and Reinvestment Act of 2009".

Other responses according to Nanto (ibid), have included to make changes in the financial system in order to reduce risk and prevent future crises. Other responses that have aimed at preventing future crises have been legislative, oversight, and domestic regulatory Functions. In the USA for example there has been a proposal for financial regulatory reform focusing on five areas. These areas include establishing the Federal Reserve as a systemic risk regulator, creating a Council of Regulators, regulating all financial derivatives, creating a Consumer Financial Protection Agency, improving coordination and oversight of international financial markets, and other provisions.

As informed by Nanto (ibid), G-20 leaders' Summit on Financial Markets and the World Economy met on November 15, 2008, in Washington, DC as part of global responses to the 2008 GFEC in the banking sector. The leaders instructed finance ministers to make specific recommendations in the following areas: avoiding regulatory policies that exacerbate the ups and downs of the business cycle; reviewing and aligning global accounting standards, particularly for complex securities in times of stress; strengthening transparency of credit derivatives markets and reducing their systemic risks; reviewing incentives for risk-taking

[3] which account for about 51 percent of the Tanzania's banking system's assets

and innovation reflected in compensation practices; and reviewing the mandates, governance, and resource requirements of the International Financial Institutions.

There have been a number of regulatory reform proposals as part of responses to the 2008 GFECin the banking sector. Nanto (ibid) informs that there are some major regulatory reform proposals that have been proposed by both the U.S. Treasury and the G-20. These include reforms in the following areas:

Systemic Risk
The proposal was that all systemically important financial institutions should be subject to an appropriate degree of regulation. Inter alia, it was proposed that the use of stress testing by financial institutions should be more rigorous.

Capital Standards
It was proposed that large, complex and systemically important financial institutions should be subject to more stringent capital regulation than other firms. Among other things, it has been proposed that capital decisions by regulators and firms should make greater provision against liquidity risk.

Hedge Funds
The proposal in this area include requiring hedge funds to register with a national securities regulator. Systemically important hedge funds should be subject to prudential regulation. Furthermore, hedge funds should provide information on a confidential basis to regulators about their strategies and positions.

Tax Havens
It has been proposed that minimum international standards (a regulatory floor) should apply in all countries, including tax havens and offshore banking centers.

According to the IMF (2009:1), the authorities in Tanzania have taken steps to maintain financial sector stability in Tanzania. These responses have included comprehensive and regular analysis of risks to the sector. The fund argues however that the absence of firm supervision over pension fund activities remains a serious shortcoming, and the rapid establishment of the new regulator is a top priority.

According to the IMF (ibid), there have been responses to the 2008 GFEC impacts in the Tanzanian banking sector. Among other things, the BoT has strengthened its monitoring of the financial sector. IMF (ibid) argues that BoT holds daily meetings to discuss developments in the banking system and has launched a survey to capture banks' potential exposure to vulnerable sectors. The IMF has proposed some additional measures as responses needed to help limit the impact of the crisis in the banking sector in Tanzania. These measures are presented in the box that follows

Box 2: Measures to Limit Impacts of the 2008 GFEC in Banking Sector

• **Pursuing efforts to strengthen monitoring of banks' soundness.** Data collection on Non Performing Loans (NPLs) could be more frequent and data quality enhanced. Commercial banks could be encouraged to improve their oversight of credit risk and to adopt a more conservative approach for collateral valuations.
• **Enhancing contingency plans.** The bank resolution framework could be reviewed to ensure
it is fully operational in times of stress. Arrangements to provide emergency liquidity could also be made more efficient, potentially by broadening the scope of paper accepted as collateral and reducing costs related to it.
• **Improving financial sector supervision.** Take a comprehensive approach to financial sector
stability assessment to include all types of institutions.
• **Enhancing supervision of pension funds**. Put in place a regulator, issue investment guidelines and undertake comprehensive audits as required under the legal framework that became effective in November 2009.
• **Intensifying cross-border coordination between host country and home country supervisors** to avoid transmitting stress from one institution to another.

Steps to strengthen and enhance financial sector supervision
The Bank of Tanzania produced an initial financial stability report for internal discussion and has initiated risk-based assessments of financial institutions and an early warning system to spot signs of weakness. In addition, the authorities recognize the critical importance of having an effective system in place for financial supervision of the rapidly growing pension funds. The new Social Security Act was passed by Parliament in April 2008, providing the legal basis for the creation of a single regulator and giving the BoT the authority to establish investment guidelines.

Source: IMF (2009)

A Model for Studying Impacts of and Responses to the 2008 Crisis in Banking Sector

As indicated in the literature above, there are various causes, impacts and responses to the crisis in the banking sub-sector of the financial sector. Impacts of the crisis in all sectors and areas of the economy including productive sectors (mining, agriculture, FDI, tourism, transport, remittances, ODA, civil society organization (CSO) funding etc are assumed to have affected banks in differing degrees and ways.

This is because, as per the business cycle theory, the crisis caused a decline in economic activities in these sectors. Among the activities that declined are various transactions that would have gone through the banking system. When these transactions decline, automatically there will be decline in banking activities and associated bank incomes and profits.

The other way in which the crisis might have impacted banks is through the inability of affected real sector businesses to borrow more from the banks thereby reducing banks core business of issuing credit. This implies decline in bank incomes and profits that would arise from extending such credits. The incomes include but are not limited to various fees and interest rate incomes.

Due to the crisis, some of the businesses that had borrowed from banks were unable to repay their loans. The inability might have been to pay the whole loan or part of it as well as to adhere to the payment schedule/frequency in terms of time and amounts of capital and

interest repayment. This would lead to defaults, bad and/or doubtful debts. At best it could lead to debt restructuring. These impacts are assumed to have led to reduced profits and reduced bank soundness.

The impacts of the crisis have triggered a number of responses within the banking and other sectors. The responses have aimed at stopping the crisis, reducing the impacts of the crisis and preventing a future crisis. Among the possible responses from the banking sector include freezing of all or some types of lending; reduced lending; increased risk assessment; stress-testing; financial stability measures; erecting financial fire walls; more adherences to regulations (Central banks and Basel regulations in general and Basel III in particular). The responses to the impacts of economic crisis in banking sector however, stand to trigger and fuel further impacts in the sector. There include both positive and negative and well as short-term, medium-term and long-term impacts in the sector. As per the business cycle theoretical framework, these impacts can affect the real sector of the economy thereby impacting the crisis in new rounds accordingly.

Areas for Further Research

Knowledge on the causes, impacts of and responses to the 2008 GFEC is still evolving as is the knowledge on the Euro zone sovereign debt which is closely related to the 2008 GFEC. There is therefore a need to update knowledge in these rather virgin areas of study in general and their impacts and responses to these impacts in particular. The model that has been developed in this paper can be tested in specific banks so as to generate knowledge on impacts, responses and results to such responses in a specific bank setting.

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