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The International Financial and Macro-Economic Frame of the Current Economic Crisis

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Abstract
The international financial and macro-economic frame of the current economic crisis is subjected to certain tensions yet remains relatively robust, even if there is a visible deceleration of economic growth in certain countries, the correlation between the price of actives due to the adjustment of the perception of risk is materialized, and the characteristics of the financial markets are significantly changed.

Key words: crisis, recession, world economics, financial markets, economic deficit.

1. The international context of the current crisis

The United States and the rest of the world have fallen prey to the deepest and longest recession in post-World War history. There have been successful investors, public servants, economic analysts who have tried to make previsions on the trend of this crisis, at the end of 2007 or the beginning of 2008, when the credit collapse was already amply described in the press and the governments tried to adopt extraordinary measures for dampening the effects.

The Wall Street Journal presented a hierarchy of American economic forecast experts, classifying them based on the accuracy of their predictions for 2008, based on two key elements: the real growth of GDP in the fourth trimester of 2008 compared to the same period of 2007 and the rate of unemployment at the end of 2008.

The classification numbered 51 economists, most of them giving positive predictions over the real growth with a medium estimate of 2%, the most optimistic of which being 5%. The only one who predicted correctly is Jan Hatzius from Goldman Sachs who had advanced the value of -0.4%, the real modification of GDP between the two periods considered being -0.8%. Considering unemployment, all of the experts have predicted a much better result than the real value which is 6.9%. Of all the estimates, 6.2% was closest to the truth, while the medium estimate reached 5.2% and the most optimistic 4.3%.

At that point, these economists did not understand what was going on and neither did they have any idea of the global effects of the phenomenon. The raising of interest rates in the United States from 2003 to 2006 has created more and more difficulties for some debtors to honor their debt to the banks. These problems have been felt most acutely on the American high risk mortgage guaranteed deed markets. The investors could no longer identify and reasonably evaluate the risks of their investments due to the low transparency of the innovative financial instruments markets. The level of the risk per ensemble was reevaluated and the liquidity deteriorated due to the negative perceptions of risk, which have extended over other categories of financial instruments. The modification of the characteristics of international financial systems beginning with the second half of 2007 was not a surprise, numerous supranational institutions (IMF, BIS, BCE) pointing towards the fact that the risk is under-evaluated and that an inverse evolution is more and more likely.

The main identified causes which lay at the base of the problems within the financial systems of developed countries were:

- the development of financial innovations undergone without an adequate understanding of risks taken and without the implementation of adequate methods of risk management;
- the significant excess of liquidities in the context of low interest rates which promoted the taking of high risks in order to obtain higher productivity;
- the transparency of the placing in innovative products as well as the respective degree of implementation were insufficient.

The central banks reacted promptly through the immediate measures which comprised the urgent supply of liquidity, the use of new financial facilities over the ones offered through the current monetary policy operations and, in some situations, the reduction (aggressive within the FED) of monetary policy rates.

The world economy slowed its growth rate in 2008, in the context of the extensions of the effects of the financial crisis and the transformation of the latter into an economic crisis. World production has grown by only 2.0% compared to the 3.8% in 2007.

On the backdrop of the decreasing consumer trust, the lowering of housing prices and stocks values but also due to restrictions regarding the conditions for crediting at the world level, the global economic conditions have rapidly deteriorated starting with the middle of September. Due to the financial crisis, on the real activity a diminishing effect on world trade has been observed in 2008 over 2007. If in 2008 there has been a raise in foreign commerce of 4.4% as compared to 6.3% in 2007. Regarding international financial markets, dominated by people who invest other people's money, often in a context in which a destructive behavior gives birth to great fortunes, the evolution of these is marred by volatility and pronounced decrease of stock price.

On the background of the demand in economies of emergent countries and the reduction of the oil production of countries outside OPEC, in the first half of 2008, the price of oil continued to rise until it reached a peak of 147.5 USD per barrel (reached in July 2008), following a sharp decrease until the end of 2008 and reaching a minimum of 39.5 USD/barrel. This came as an effect of the consolidation of US oil stocks and. of the impact of the financial crisis on the perspective of global economies. However, over the whole year, the medium price was 3.5% over the average of 2007, with a value of 98.3 USD/barrel.

Referring to the prices of raw materials (exclusively energy resources), these have been very volatile over the course of 2008, registering a significant rise in the first trimester, determined by the prices of agricultural products and followed by a sharp decrease in the second half of the year, on the background of the reduction of the prices of energy resources and the prices of the non-energy wares have risen by 14% in 2008 as compared to the preceding year.

At the global level, inflation was strongly affected by global economic evolutions and by sharp movement of wares prices. Due to the rising of the prices for foodstuffs and energy resources in the first half of 2008, inflationary pressures were bigger, the average annual rate of inflation reaching 4.8% in July (this data is for the countries belonging to the OECD). In the second half of the year, inflationary pressures had relaxed, the average annual inflation rate for OECD countries dropping all the way to 1.5% in December.

2. Aspects of the crisis in countries within Zone 0

With regards to Zone 0 (here we have the 15 member states of the EU which are within the euro-zone at the end of 2008: Australia, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxemburg, Malta, The Netherlands, Portugal, Spain and Slovenia), these have seen a significant economic slowdown from 2.7% in 2007 to 0.8% in 2008, due to the worsening of economic conditions starting with September, along with the accentuation of tensions on the financial market.

In the first half of 2008, the internal demand has been considerably dampened due to the reduction of real income values of the households of the populace, on the backdrop of the international rise of wares prices. At the same time the decline of residential investments started (affected by the collapse of housing markets) and of productive investments (due to the harshening of the financing conditions). The external demand was limited by the slowdown of the economic growth both in advanced as well as developing economies. If in 2007 exports of goods and services of the euro zone would rise by 5.9%, in 2008 these have been diminished to a 1% increase and imports of goods and services from 5.8% in 2007 to just 1% in 2008, due to the reaction to the evolution of the internal demand.

The slowdown of economic activity, from a sector-based perspective, was reflected in all fields, but more prominently in the manufacturing industry – determined by the reduction in external demand, the rapid diminishing of the order stock and the reduction of activities in the automobile industry.

A reduced activity has been registered in construction as well, on the background of the continuous deterioration of the residential sector. The lowest growth rate of after 2004 was registered in the services field, this being affected by the narrowing of private consumption and production activities. The average yearly rate of inflation, measures through the harmonized index of consumption prices rose from 2.1% in 2007 to 3.3% in 2008, being the highest level from the introduction of the euro and over the level that defines the stability of the prices in the euro zone, an increase determined by the raising of international wares prices, especially of energy resources and foodstuffs.

Starting with 2006, the conditions on the work market had known a significant improvement up to the middle of 2008 when the unemployment rate, which starting with 2005 was following a descendent trend, started rising with the second trimester of 2008, reaching 8.2% at the end of 2008, from 7.3% at the end of the previous year. Also on the background of the evolution of the financial crisis and the deterioration of the macro-economic environment, the budgetary deficit of the Euro zone rose to 1.9% of GDP in 2008 as opposed to 0.7% in 2007.

As an effect of the governmental interventions for the stabilization of the financial system, the rate of public debt of the euro zone rose by 3.3% in 2008 as compared to 2007, up to 69.3% of GDP.

The current aggregated account of the euro zone closed at a deficit of 100.3 billion Euros (1.1% of GDP), as opposed to a surplus of 13.5 billion Euros in 2007, due to the transformation of the surplus of the commercial scales and that of deficit incomes.

Considering the strong increase of imports in the first three trimesters and the decrease of exports in the last trimester and on the backdrop of the contracting global demand and the deterioration of the financing conditions, the commercial scales of the euro zone registered a deficit of 4.9 billion Euros at the end of 2008, compared to an surplus of 46.4 billion Euros in 2007.

The Euro zone has known a descending trend starting with 2001 and has partially inverted in the second half of 2008, due to the depreciation of the Euro. Regarding direct and portfolio investments these have registered net entrances adding up to 200 billion Euros in 2008, compared to 67.2 billion Euros in 2007, most reflecting the rising of net influxes such as debt (on the background of the increase of the aversion towards high risk instruments, the need for liquidity and the differences of interest in the short term) and participative nature (due to the attempt of global investors to modify their investment portfolio favoring resident countries).

This evolution has been partially limited by the increase of net exits of direct investments, and the reserve actives of the Euro zone have risen marginally in 2008, mostly from the reevaluation of actives and the evolution of the exchange rate.

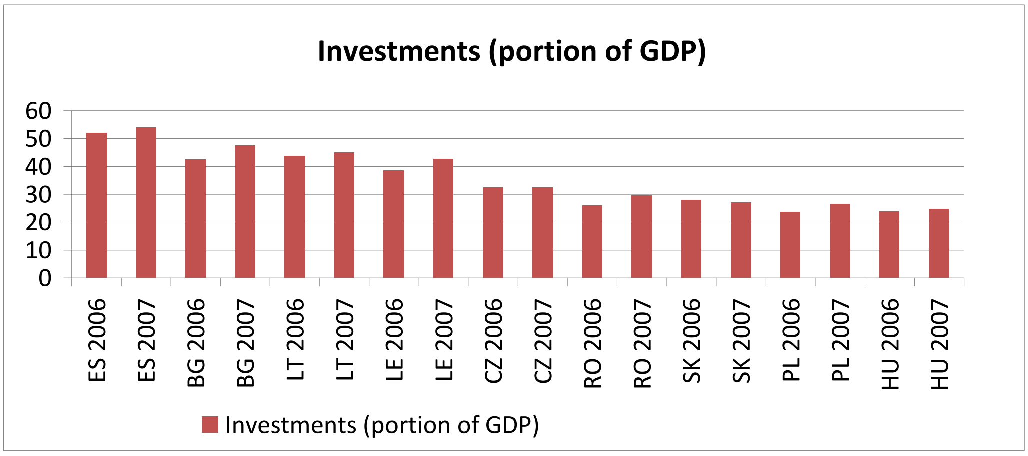
3. The presence of the recession in the Central and Eastern European countries

If up to now we have been referring to the countries in the Euro zone, painting a general picture of the economic evolution or involution in this area, the EU countries outside of the Euro zone need to be taken into account as well. In this category we have to 12 EU states outside of the Euro zone at the end of 2008: Bulgaria, the Czech Republic, Denmark, Estonia, Latvia, Lithuania, Great Britain, Poland, Romania, Slovakia, Sweden and Hungary. These countries have known a decrease of economic growth of up to 1.3% in 2008, as opposed to the 3.6% average economic growth in 2007. The internal demand of these countries has been affected by the deterioration of the external environment and the intensifying of the financial crisis, which have weakened the trust of the business environment and of consumers as well.

In this area we find three states (Romania, Bulgaria and Slovakia) where the highest rates of growth have been registered, of over 6%, while in Latvia, Estonia, Denmark and Sweden a negative rate can be identified. The yearly average rate of inflation registered in the EU countries outside of the Euro zone has been of 4.7% in 2008, as compared to 2.9% in 2007, the highest inflation rates (between 10.6% and 15.3%) being registered in the Baltic states and Bulgaria, followed by the Czech Republic, Hungary and Romania (with values between 6% and 7.9%) and Denmark, Poland, Slovenia, Sweden and Great Britain (with values between 3.3% and 4.2%). As is well known, the main cause of the increase of inflation is the rise of global prices for foodstuffs and energy, but aside from this cause other factors can be identified with a different action from one country to another, among these being the depreciation of the national currencies, the increase of administered prices and the increase of direct taxes.

Regarding fiscal evolutions, we may mention the fact that three of the EU states outside of the Euro zone (Bulgaria, Denmark and Sweden), registered budgetary surplus and the other nine have closed the fiscal year at a deficit, on the whole region an average of GDP deficit of 3.3% being registered in 2008, as compared to 1.5% in 2007.
The level of the GDP fiscal deficit had surpassed 3% in Latvia, Romania and Great Britain, and the public debt portion of the GDP was well under 60% in most EU countries outside of the Euro zone, with the exception of Hungary. The public debt portion of the GDP rose in Denmark, Estonia, Latvia, Hungary, Poland, Romania and Great Britain, reflecting both the slowdown of the economic growth as well as the deterioration of the budgetary balance, while in the other countries it either dropped or stayed at the level registered in 2007, as can be observed from graph 3.1 and graph 3.2.

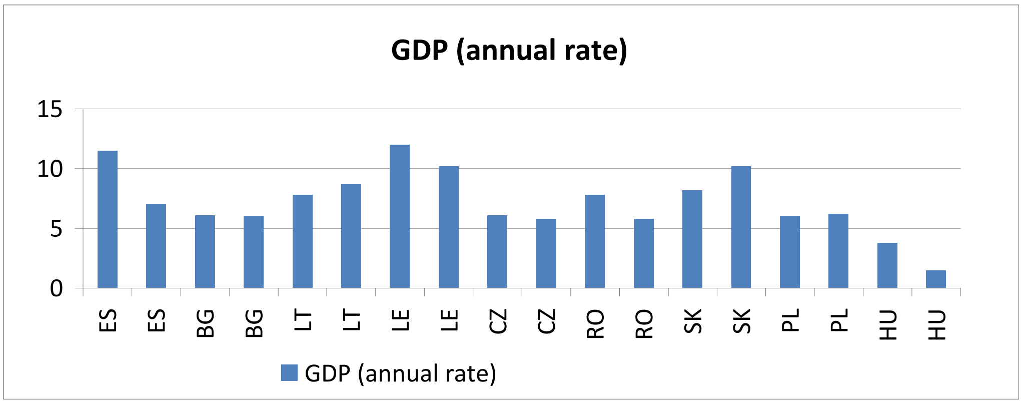
Graph 3.1. The dynamics of the rate of investments in certain countries of Central and Eastern Europe



Source: Eurostat

Taken en ensemble, the countries in the zone under study, the total balance of the current account and of the capital account has improved as compared to 2007 but continued to register different evolution from one country to the next, only Denmark and Sweden closing 2008 with surplus, the other countries registering deficits.

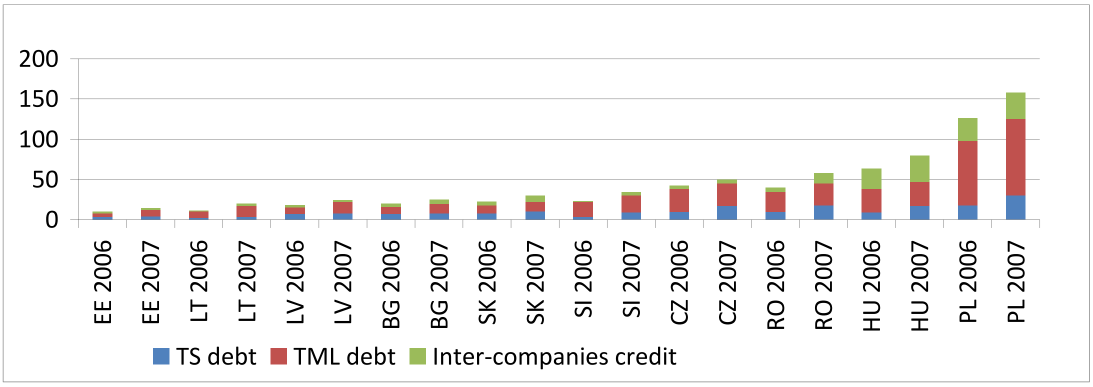
Graph 3.2. The GDP dynamics in certain countries of Central and Eastern Europe



Source: Eurostat

As can be observed in graph 3.1 the external debt in emergent European countries registers developments calling for attention.

Graph 3.3. The structure of the external debt in emergent European countries (bil. EUR)



Source: World Bank, websites of commercial banks

Compared to 2007, these deficits have dropped as a portion of GDP, following the contraction of internal demand in the majority of the countries outside of the Euro zone, with the exception of Poland, Hungary and Slovakia.

The combined deficit of the current and capital account surpassed 20% of GDP in Bulgaria and 10% of GDP in Romania and Latvia, and the external imbalance in most of the countries was generated by the commercial deficit, with the exception of the Czech Republic, Hungary and Slovakia, where the determining factor was the deficit of the income scale, most often linked to the reinvested profit of the foreign companies.

On the whole of 2008, compared to 2007, the net influxes of direct foreign investments have diminished as a portion of the GDP in most EU countries outside of the Euro zone, with the exception of Romania.

Base scale deficits have been registered (current and capital accounts balance plus influxes given by direct investments) in the majority of EU countries, and in Bulgaria, Latvia, Lithuania, Romania and Hungary, they have surpassed 4% of GDP. Net portfolio investment influxes have stayed negative or neutral in many EU member countries outside of the Euro zone, with the exception of Great Britain, Estonia, Slovakia and Denmark.

In the European Union, mid and long term measures which have been or will be implemented are:
- the improvement in the transparency of bank exposures;
- the development of evaluation standards by including liquidity risk;
- the strengthening of prudent regulation, especially regarding large exposures, with the liquidity risk and security being incorporated into the new modifications of the European directive regarding the process of making the capital adequate;
- the structural improvement of the workings of financial markets, with an analysis of the role if rating agencies and the "originate and distribute" model used by banks.

4. The economic and financial context of the crisis outside Europe

Since we analyzed the EU countries, a short presentation of the main economic effects that this crisis has generated outside of Europe should be made. In the US for example, the annual rate of GDP increase in 2008 was 1.1% compared to 2% in 2007, private consumption being negatively affected by the deterioration of consumer perception and the conditions on the work market, but also the decline of the real estate market which led to the decrease of the wealth of population households. On the backdrop of the worsening of crediting conditions and perspectives for demand, private sector investments have decreased considerably

The main engine of economic growth was external commerce, which in most of 2008 had a favorable evolution, leading, along with the increase of surplus of services and incomes, to the reduction of the current account deficit of the GDP from 5.2% in 2007 to 4.9% in 2008. The average annual inflation rate for 2008 was 3.8%, compared to 2.9% in 2007, inflationist pressures being much stronger in the middle part of the year, on the backdrop of the increase in the price of energy resources and decreasing towards the end of the year, along with the prices of raw materials. With regards to the deficit in the federal budget of the US in 2008, this rose up to 5.9% of GDP, compared to 2.9% in 2007, and fiscal revenues were substantially reduced on the background of economic stagnation and budget spending rose following the implementation of economic stimulation measures. The United States were happy to hold a sick economic system on the morphine drip, without tackling the underlying condition. Today, the public debt is substituted by the failure of private agents, which means that this crisis will be a long one and the risk of a "global collapse" exists[1].

With regards to the economies of Asian emergent countries, these have seen a gradual decline of activity, marked especially by the decline registered in the exports of small economies in the region, in states such as Singapore, Taiwan or Hong Kong in the latter half of 2008, to which the reduction of internal demand has been added, determined by the decrease of consumer trust and the business environment as well as the decline of real estate investments. Due to the reduction of oil and foodstuffs prices, the rate of inflation followed the global trend of growth in the first half of the year and decrease in the second half. The validity of financial markets has affected the countries in the region with a certain degree of difference, the impact being more reduced in China due to the relatively closed financial system, but more strongly in Korea and Indonesia due to the high level of internal debt, as an effect of the decrease in wares prices.

China's economy continued to grow in 2008 by 9% compared to the 2007 growth of 13%, the slowdown being caused by internal as well as external factors. The commercial surplus and strong capital influxes determined by the anticipation of the appreciation of the national currency as well as the positive interest difference, have led to the increase of China's foreign currency reserves.

[1] Joseph Stiglitz – Jewish-American economist, Nobel Prize winner for Economics in 200.

The Japanese economy reversed its trend, registering in 2008 a decrease of 0.7%, after an increase of 2.3% the year before, considering the decline of the net export of goods and services, of investments and also of consumption. The average annual inflation rate, measure through the index of consumption goods was 1.4% in 2008 as opposed to 0.1% in 2007. The countries in South America have registered an increase in GDP of 4.2% in 2008 as opposed to 5.8% in 2007, this marking the sixth consecutive year of economic expansion. On the backdrop of improving macro-economic conditions, of the rise of wares prices and of the consolidation of internal demand, the economic growth was considerably stronger in the first half of 2008. In countries such as Argentina, Brazil, Bolivia, Peru, Panama, Ecuador, growths over the average have been registered.

The global context has fueled inflationist pressures in this zone as well, in such a way that the average inflation rate rose from 6.1% in 2007 to 8.7% in 2008.
Starting with September 2008, the external financing conditions have deteriorated, leading to the worsening of the situation of public debt, to the depreciation of national currencies as compared to the US dollar and to the significant decrease in stock exchange lists.

The current aggregate account for Latin America registered a reduced deficit, being influenced favorably by the increase in exports, especially energy-based, as well as the rising level of international prices, as well as the volume of exported wares. For the first time in history, the economic growth was interwoven with current account surplus in a series of countries such as Bolivia, Argentina, Ecuador or Venezuela.

5. New tendencies of payment infrastructure – financial stability means

The stability of the global financial system is dependent on the good running of the payment and deduction systems, this being conditioned, in turn by the liquidity of the financial market. The international financial system presently goes through a period of important structural modifications[2], due, in part, to the rising of credit risk, which influences both the systems of payments as well as the financial stability[3].

Ensuring liquidity is critical for the execution of current transactions and becomes difficult to realize in periods of crisis, when the actors in the market halt the credit lines and/or raise the margin requirements in order to protect themselves from counterpart risks. The payment systems can transform into transmission channel for financial shocks and problems from initial sources towards other parts of the financial systems, not being simply a potential source of turbulence at a systemic level[4]. The accentuation and expansion of the deterioration of liquidity conditions have determined the central banks to act both by providing additional liquidity, but also by expanding the set of eligible collaterals (in order to ensure liquidity *intraday* and *overnight*). To the central banks and supervising authorities comes the task of evaluating that the following of existent standards is respected by the systems of deduction of the financial instruments, the central counterparts and systems of payment of systemic importance, from the point of view of their correct application, as a measure of risk management.

By the designing of the Single Zone of Payments in Euro, the creation of a geographical space comprising 31 countries (27 EU member states, of which 13 Euro countries and 14 non-Euro countries, plus Island, Liechtenstein, Norway and Switzerland), is being intended, in which the consumers, companies and other participants to the economic activity may initiate and receive payments in Euros, under the same conditions, with the same rights and obligations, whether or not they are on the national territory or the territory of another country of this single space.

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[2] Gertrude Tumpel – Gugerell (2007), *Payments and Monetary and Financial Stability*

[3] Banca Națională a României (2008), *Raport asupra stabilității financiare*, pag. 92

[4] Maxwell J. Fry at all (1999), *Payment Systems in Global Perspectives*

The impact of globalization on the financial infrastructure in conditions of turbulence is manifested through the fast extension of negative phenomena as a natural consequence of the multiple interconnections established between the participants, markets and infrastructures. The events on the financial market and the structural modifications coming as an effect of complexity and globalization may have a strong impact on financial stability. An important role is played by international cooperation in the field of *oversight* (*cooperative oversight*) for risk evaluation and the perfecting of surveillance commitments, as well as access to information and efficient coordination between regulating and supervising authorities of financial institutions and authorities responsible for the *oversight* activity of payment systems in accordance with the principles established in 2005 by the International Regulation Bank.

Joseph Stiglitz believes that the current crisis which hit the world economy will be long lasting and, along with it, the financial markets have proven that they have their own limitations and "stupidity". For imperfect markets, with asymmetric information, the official statistics are no longer a reflection of reality.

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