BANKING INTERMEDIATION AND CONSEQUENCES OF FINANCIAL CRISIS

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Abstract

The financial intermediation of bank institutions, has an essential role in mobilising of the available funds and their distribution in various products and services, for economic growth. The extent that banking system is in distress or passing through a period of crisis, then, everything turns into a general crisis, especially that, in some states, natural and legal persons have been learned ,,to live'' on the credits.The effectiveness of banking intermediation activity in Romania depends on how fast the market is enabled under the influence of the new European regulations. The Romanian market in all its forms is the second largest in the EU, and the banking system is almost entirely made up of banks with foreign capital. The romanian banking market has not suffered so much because of the financial crisis. To the extent that banking institutions provide the necessary funds, Romania has important resources for the transition to a new economic cycle based on sustainable development

Keywords: *regulating markets, integrated system of free markets, bank intermediation, Bank risk, financial crisis*

1. Banking intermediation

The big investors in assets with excessive profit or sophisticated financial instruments, could not achieve "financial plans" without help of U.S., Japan and China banks. And, the major central banks of the world (FED, BOJ) turned out to be closely related to the interests of "great financiers" of those countries.

In this time of great economic and financial turmoil, one thing is certain, the governments involved have proven that need banks. And, in turn, banks have appealed to governments, and requested them public money to get out of a situation of distress and to promote products and services.

The current financial crisis has shown the whole world that the role of banks and their interests are closely linked to the role of the state in a capitalist economy in which markets had badly wrong. A new *regulating of the markets* in an integrated system is necessary like reforming financial system. In the financial relationships, *banking intermediation* must be just a basic of the services carried out by strong capitalized banks and which do not constitute, however, an essential requirement for exit from the crisis.

The role of central banks which oversees the speculative activities of credit institutions and the role of governments in countries affected by the crisis is to updating rigorously the relationship between price stability and financial stability.

,,Only an *integrated system of free markets*, which will operate as a clockwise, it could put in motion locomotives of European economy . Only such a system might be capable of transmitting to companies warning signals about consumptions, staff, using resources, prices, with a view to maintaining technological competitiveness.''[1]

Most states of *,, financial crisis area''* have spent more than have collected. By consuming without sources, those states have registered budget deficits, current account deficits and debts sovereign Most countries with emerging economy in crisis, for survival, have borrowed heavily from international financial institutions.

Financial crisis is given by situation where is located an financial institution, a banking system, or a whole financial system which is no longer able to and honor payments at a time. Understanding that the bankers did it with State to exit the crisis, whether we speak of the american Government and the te biggest banks on Wall Sreet or other financial institutions of Europe and EU members, it had an unexpectedly profitable result in banks favor. The biggest financial institutions being aware that *banking intermediation* is a prerequisite to the existence of any economy, were strengthened as much as needed to record, and this time, substantial profits on american or european taxpayer money.

But what is the banking intermediation?

All economic theories about banking intermediation refers to the major role that banking institutions have to capital allocation in the economy.

On the one hand, relying on credit relationships, *banking intermediation* represent all banking operations of mobilization various forms of money from those who save and their placement in the form of bank credit (or other products) to different beneficiaries, investing in economic development. On the other hand, banking intermediation represents those *banking services with derivative financial instruments, or regulated*

[1] Adrian Vasilescu- Ticket of crisis exit, Curtea veche Publisher, Bucureşi, 2011

financial tools, and a number of activities, with specific banking assets, recorded in off-balance sheet.

In essence, banking service is a intangible and irreversible activity performed to a customer and may be made either before or after, or while he has access banking products. For all intermediary operations, banks receive a price that is highlighted in the daily revenue thus increasing month by month, bank profits.

,,Into an era when triumphs capitalism of free market, an industry that generates so much money, sure is beneficial, and people who earn so much know what they are doing.''[2]

,,Serving customers , care for the quality of this process, adapting for his needs of entire banking organizations and all processes that are carried out in its interior, is the main platform for survival in the competitive environment in all countries in the world''[3].

Banking services are directly related to the opening of bank accounts (current accounts in lei and in foreign currency and deposit accounts), the granting of loans and the transfer of funds. In general, the credit institutions offers two different types of service:

- *simple* what is operative transactions **„today with today''**. For example, foreign exchange, or purchasing of foreign currency for transfer at the third person. Person will come to a banking branch, will purchasing foreign currency, and then he would go, this it in fact the end of transaction.
- *complex*, operative **„of relationship''** which are determined by several banking operations and customer will using repeatedly the service. For example, *the department for current account*: The customer will open the account and it will use to deposit and withdraw money, for foreign exchange, money orders a.q. At the time of sale a service may be indicated and other requirements, which could be useful to the customer. This type of service is one that ensures the perpetuation of relations between the bank and its customers.As a rule, the first banking service which a person requires at a bank, is the filing of capital necessary lodging companies or other entities. Continuing the example above, for corporate customers, credit institutions open and other types of accounts, such as:
- *blocked accounts*, in which are deposited the amounts representing capital required the establishment of an entity. After the customer submits to the bank proof of registration of the company in the commercial register, the account is unlocked, and the amounts are transferred to the client's current account;
- *blocked accounts with special destination*, are accounts in which te amounts are temporarily blocked, in relation to a particular operation, as a measure of protection for the bank and for the proper deployment of the payment obligations abroad. For the amounts secured clients in blocked accounts with special-purpose credit institutions do not pay interest, but but collect certain negotiated commissions related to the administration of these amounts. These amounts are also called *collateral deposits* that customers submitted to a credit institution for the proper conduct of an obligation of payment (guarantees, letters of credit and the like).
- *accounts for loans*, intended to highlight the credits (in lei or in foreign currency) granted by the Bank to clients from which follows to ordinance payments;
- *accounts with the amount gained by participation in the currency auctions*, which highlights the amount in lei or foreign currency arising from sales or purchase transactions of the money in the interbank market, the customer ordered and carried out by the bank on his behalf;

A large part of the banking services does not involve a balance sheet commitment,they not contributes to the increase in resources (revenue) and does not affect the assets of the bank. These services through which undertakes *banking risk* are highlighted in *off-balance sheet* being determined by the group of operations called off operations.

Those operations on *bank bonds anticipated* arising from a cambial circuit are known as *services for loans with guarantees of signatures*.Through his signature credit institution guarantees the commitments of the client to third parties. This banking service not advancing funds but maintains through its own commitment to the client trust (bank is subject to a risk).

Other investment activities include banking services with the same features as the previous ones. Among these activities are: anticipated commitments to grant credits (forward commitements), anticipated commitments to sell or buy securities, banking operations named options (financial futures or options), the anticipated commitments over interest (interest rate swaps), or operations on exchange rates (currency swaps). In another words, by banking services credit institutions performed operations of buying and selling of securities (acquisition, investment, investment) for their customers. In the same banking market segment are services of mandate, operations carried out in the name of the bank, but for the account of clients, which generally refers to the management of securities portfolios.

As intangible assets, banking services are offered in various forms, through innovations of credit institutions, based on the newest achievements in the field of IT, that are mentioned in banking regulations. It is a real art in banking, for the effective promotion of the products and services of credit institutions.

[2] Simon Johnson, James Kwak- 13 Bankers, Wall Sreet's domination and next financial meltdown, POLIROM Publisher, Bucureşi, 2012

[3] Emanuel Odobescu, Dr. Dorina Poanta – *Elements of Banking Marketing*, IBR, Bucuresti, 2006

2. The consequences of the current financial crisis

In the euro area or beyond, the countries affected by the financial crisis registered new bankruptcies or restructurings activity among banks or large companies, that led to the rise in unemployment. Will pass away several years before these countries will create facilities for investment and therefore to create new jobs.

There is no crisis, one like another. Differ due to social conditions in which they appear and the economic relations of the moment. But we can say that they have a common denominator, appetite for assets with high returns or financial engineering or unjustified profits rush, or "rich overnight".

At present, although the financial crisis, credit institutions in Europe continues to record profits pretty good, even if they are smaller than five years ago. The same we can say about the large[4] u.s. banks, although some credit institutions poorly capitalized went bankrupt. In the US, at the beginning of the year 2012 and to date they have going into liquidation 43 of credit institutions, according to the information provided by Market Watch[5].

With all of the risks assumed, placing money in the form of banking products bring substantial income to the credit institutions from interest and bank charges. But with banking intermediation, banking risk arises in its various forms determined by specific banking operations. The main risk is related to the conversion of short-term liabilities in long-term assets.

In this year, some credit institutions in Romania faced with *liquidity risk* had secured some operational payments through loans from the National Bank of Romania. Under present conditions, NBR has never limited operations at repo auctions. The most recent such operation eight credit institutions have lent 12,621 billion lei (2,793 billion euros) from the Central Bank of Romania.

It is very hard to delimited services from banking products in the sense that they have been innovat new forms of lending in addition to the traditional ones. The main characteristic of banking products is the fact that are not covered by physical wear and moral and are free of interest. In fact, banking services for customers of credit institutions shall pay different commissions and fees differ from the banking products exactly by this form of pricing.

Operative units of credit institutions delivering directly to customers *products reversible* and there is not possibility of lessee, redistribution or resale of these intangible assets, only their repayment. To obtain banking products, their beneficiary (borrower) must prepare special documentation, proper to be carried out by a conceptual working, money creation and a certain guarantee, controlled by the bank.

Here must intervene the banks, to provide in addition to money, and *solutions of competitiveness*, with constant checking the loan guarantees. Entrepreneurs come with the labor force and ideas of innovation and development, and banks must come with proposals for a management efficiency

As can be observed in the activities of credit institutions, credit is still "*the engine of economic growth"* being the most requested product, offered by the banks from all traditional products. But, the credit in all its forms, if is not carefully managed, as happened with *mortgage credit*, can trigger a banking crisis which then can turn into a crisis of the system, or a general financially crisis.

So, loans represent claims clients recorded on Bank, legal entities and individuals, for their financing and typically underlie the operations ordered by them of payment of debts, through the banking intermediation. In this activity must have handled a multitude of *assumed risks* related to banking strategy.To not reach in banking crisis situation banks must coordinate their deposits with bank investments. As we mentioned, should not be given long-term loans made short-term sources.

„Development of the financial innovations and a risky speculations, expansion loans, asset pricing without a unreliable economic, sudden and unexpected drop prices of financial assets and quick orientation by cash or high quality investments are inevitable as long as investors seek to obtain higher profits. Under these conditions, the occurrence of financial crises is not a novelty but as a defining feature of its global financial environment enhances the possibility of transmission of crises in the whole system, and their contagion."[6]

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[4] JPMorgan Chase,Citigrop, American Expres, Bank of America, Goldman Sachs, Northern Trust, US Bank

[5] Market Watch, 01.10.2012 , - operates the financial information website that provides business news, analysis and stock market date.

"First United Bank has been closed by the Department of Financial Regulators and professional of Illinois. Old Plank Trail Community Bank, a subsidiary of Wintrust Financial, has agreed to take over First United, through an agreement with the authority to regulate federal deposits. The bank is the seventh credit institution had collapsed in Illinois this year". (Market Watch)

[6] Alin-Marius Andrieș, Performance and efficiency of banking activity, University Alexandru Ioan Cuza Publishing House ,Iași, 2010

Macroeconomic instability, economic recession and weak monitoring of instituțiilor of credit,inadequate bank management have led to a unprecedented banking crisis, known as "mortgage credit crisis", which in fact has been a crisis of liquidity.

Responsible for the banking crisis that began by lossing the confidence by U.S. investors in *securitized mortgages* and then transformed into a financial crisis was the Federal Housing Administration (U.S.). This crisis started in December 2007 included then throughout Europe.After they have provided mortgages for housing construction with low interest credit institutions in Europe have raised the interest rate thus stifling investment.

Factors that may cause the emergence of a financial crisis are[7]: deterioration of the balance sheet of financial institutions; increasing interest rates; increasing uncertainty in the economy; damage the balance of non-financial institutions due to asset price volatility.

Analysts and monetarists analyzed other factors that led to the outbreak of various financial crises shows that some situations are repeated. From *the great economic crisis* due to *overproduction*, between 1929-1933, characterized by a dramatic decrease in global activity and now we see almost the same social convulsions.

Surely it is the question that gave and still gives the " headaches" for responsible States, hit by the economic crisis.The measures that have been taken by Governments and central banks of the u.s. and the EU to lessen the effects of the crisis were materialized through leverage, the recapitalization of financial institutions to improve liquidity, coordinated reductions of interest rates, granting of government guarantees for loans, guaranting or purchasing new issues of shares of some banks. In addition they have interfered with public money for capitalisation of large enterprise interconnected and saving of work places.If by 2011 governments around the world have provided cash of over $ 1 trillion, financial crisis of 2012 no longer depends on the lack of cash but lack of trust of key players in the real economy.

In the states of euro area, financial crisis has caused the disappearance of 3 million jobs, but there are major differences between countries, on a slight recovery in economic growth in 2011.In some industrialized countries, with a stable economy, such as Germany, Luxembourg and Belgium, the number of jobs dropped less than 1%.

In the case of Romania, on the background pecuniary crisis and structural reforms has been the greatest reduction of almost 15 %. front in number of jobs exitente in 2007. Measures taken by central bank and the romanian government against a decrease of the crisis, under the conditions of state reform, have not been similar to those made by some other European countries or those in the United States, recorded thus disappearance of 700,000 jobs in the economy.

Also Romanian economy record at the end of the year 2011 a current account deficit of balance payments of 5,682 billion euros, which shows the dependence of external financing. One thing is clear, the maintenance pecuniary stability under conditions of economic downturn, leads to an increase in inflation and unemployment.Rising inflation can benefit companies that producing competitive goods and have provided both undoing internal especially for export.

What should be done?

For Romania, the second largest market in the EU, of the first measures to be taken urgently by the state is that the allocation of the funds for the exploitation of the resources that have urgent selling market. Romania has lent enough for consumption and now must learn to consume as much as occurs. There have been small steps for example has developed automotive, but Romania can become competitive in the food industry, the energy industry, in agriculture correlated with infrastructure development. A special area is the development of tourism services concomident along with development of a Romanian-owned specialized banks in this area.

Factors that influence the current financially crisis differ from those that triggered the crisis in 2007. This time, credit institutions and markets are those that caused the crisis. They are which supports consequences, real causes of the crisis as an amount of failures who went from the top down. Expenditure and investments of the private sector have been reduced drastically, causing a vicious circle which led to high unemployment and slow economic growth. And this is due to Governments that are not as able to stimulate their economies and to put things in order.

Related to this, credit institutions have lost credibility big companies although recorded in their accounts huge amounts do not invest them, in order to preserve their wealth, and the customer has no trust in any institution of the state.

Romania and in particular Europe have been left behind from the rest of the civilized world in chapter *research and technology innovation*. We live in an information society and for Romania, 2013 have to mean a new economic cycle. From five years ago, Romania is no longer single but in a *permanent cooperation* with satatele in the EU and the NATO bloc.

[7] Mishkin, F,Financial Policies and the prevention of financial crises in Emerging Market Countries, NBER Working Paper , 2001

In Romania, an emerging country with good potential for economic develop invasion of money coming from the outside it has stopped. But the banking system is solid and Romania can move from a "firemen development" at a sustainable development with *new leadership* who have vision and proves by excellence, working with European partners on different areas. One thing is sure. Restructuring and reforms in all spheres of activity must be carried to the end and to permanently break old mindsets to start the engines of the economy with a new culture about products and services quality and productivity.

Fiscal policies and regaining lost confidence, to attract foreign investors, to facilitate *national initiative* for the development investment and growth of labor productivity are chapters as imporatnte, in order to get out of this economic crisis.

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