

THE FINANCIAL CRISIS: A NEVERENDING STORY

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Abstract:

The global financial shock had symmetrical effects across the Eurozone: the cross-border financial flows decreased in 2008, and the investors repatriated the funds towards home markets and re-evaluated the level of their international exposure. In the banking area, large mergers and acquisitions took place before the crisis and large banking group were created. This concentration process in the banking sector continued in the crisis context, because the banks performance dropped significantly. The Romanian banking system was less affected by the crisis, since it was not exposed to toxic assets, as well as due to the prudential and administrative measures adopted by the National Bank of Romania. Still, for Romania, but also for the entire Europe, the danger didn't disappeared. The Greek situation and the Ukrainian conflict represent a challenge for the achieved stability in the European area.

Key words: *financial crisis, banking system, European measures, Romania.*

JEL Classification: *F26, F36, G34, G38, O47.*

1. Introduction

The contagion issue on the financial markets, an important characteristic of the economic decline periods, poses special importance due to the consequences it may have on the global economy in terms of monetary policy, of risk management and optimum resource allocation. A country facing poor fiscal conditions may trigger this effect in the countries it has economic relations with just because it does not take adequate measures for the tax consolidation, and this phenomenon propagates much faster in the European Union countries where interconnection is much stronger [5].

The effects and causes of the financial contagion were analyzed by Upper and Worms (2004), Degryse and Nguyen (2004), Cifuentes, Ferrucci and Shin (2005). All the studies proved that the financial interaction may represent the cause of the contagion. The countries have to increase their own economic qualities and all the stable financing sources at disposal, to gradually liberalize the financial market and consolidate international cooperation aimed at avoiding crises and their contagion effect [17]-[4]-[1]. Celik (2012) also believes that it is necessary to compare the correlations between two financial markets both in a stable period as well as during the crisis period. The severity of the financial contagion depends on how risk sensitive the market is, on the information asymmetry, because it is believed that these produce ampler fluctuations on the market [3].

But the global financial shock had symmetrical effects across the Eurozone: the cross-border financial flows decreased towards the end of 2008, and the investors repatriated the funds towards home markets and re-evaluated the level of their international exposure. This process affected the countries with the highest trust in the external funds disproportionately. Inside the Eurozone, Ireland was the best example: the high dependency of the banking system on short-term international investments required the government to provide a 2-year liability guarantee for its banks at the end of September 2008. The sovereign debt markets within the Eurozone didn't display major shifts in 2008 and 2009. During this period, the main focus was on the stability of the banking system. Moreover, the weight of the public debts in Ireland and Spain offered a certain comfort because those countries could absorb the fiscal expenses associated with a medium-sized banking crisis. The demand for the sovereign debts of the Eurozone countries was supported by banks which capitalized the government bonds as guarantees in obtaining short-term loans from the European Central Bank [12].

But, in 2009, a number of countries reported an unexpected rise in the budgetary deficit/GDP ratio. For example, the inland revenue in Ireland and Spain decreased faster than the GDP, as a result of the great sensitivity of the inland

revenue related to the decline in the construction activity. Furthermore, the recession and the loss increase estimates within the banking sector in certain countries had a negative impact on the value of the public bonds.

Anyways, the most shocking news came from Greece. After the elections in 2009, the new government announced a budgetary deficit for 2009 estimated at the value of 12.7% of the GDP – higher than the double of the previous estimation, respectively 6%. Moreover, the Greek fiscal accounts for the previous years were reviewed in order to prove the significant deficits. This finding of extreme breach of the euro fiscal regulations with regard to Greece led to the creation of a political influence which laid the blame on the fiscal irresponsibility of the periphery states, even if the underlying financial and macroeconomic imbalances were much more important factors [2].

It is obvious that the developing countries were seriously affected by the global financial crisis caused by the developed countries. The economic crisis is directly and indirectly related, through different channels, to the development processes within the developing countries. A slower increase within the industrialized countries has a major impact on the export prospects of the developing countries.

In UE countries, the crisis strongly affected the national economies and their convergence process. One of the main reasons for which the Eastern European economies showed an increase resistance to the crisis was represented by the existence of strong regulations within the financial system. Although they allowed the massive entry of foreign banks on the local markets, the countries roughened the regulations within the banking sector.

In Central and Eastern Europe, in terms of liabilities, the banks tried to reduce the dependence on external financing and to concomitantly increase the resources attracted from households through classical channels. In terms of assets, the banks reduced the exposure within the client segment represented by individuals and companies which showed an increased credit risk, at the same time increasing the number of government bonds issued by countries with solid fiscal policies [7].

The parent banks started to adopt a "deleveraging" strategy, a gradual process which was not meant to negatively impact on the lending and the real economic growth but had to maintain the exposure in countries within the Central and Eastern Europe non-members of the Eurozone at the level agreed by Vienna Agreement. The lending growth rate turned negative in almost all the countries newly entered in the European Union for the period 2011- 2012. Due to the lending conditions throughout the emerging Europe, the lending contraction was amplified.

Another effect was represented by the slowdown of the lending contraction due to the deposit advances. The banks avoided a greater lending contraction which would have been triggered by the financing restrictions through the increase in deposits within the same period, with certain exceptions such as Latvia, Lithuania and Slovenia.

Then, the interest rates for the attracted deposits increased significantly in the Central and Eastern Europe, compared to the level recorded before the outbreak of the financial crisis. According to the European Bank for Reconstruction and Development, this aspect contributed to the attraction of new depositors in the transition regions, suggesting that the funds accumulated in this manner could partially counteract the decrease in cross-border financing.

A major effect of the sovereign debt crisis was the maintenance of demand for consumer loans and the demand for mortgage loans from individuals in the form of demand for credits originating from companies. Thus, the consumption of the households decreased, and the economic growth rates were below the pre-crisis level. However, the unemployment became a pressing issue to which both the governments and the central banks have to find proper solutions.

2. Measures adopted to fight crisis in Europe

The European governments undertook the task to guarantee the interbank loans and to guarantee new loans with a maximum duration of 5 years, in order to provide the stability of the European financial system. Mortgage guarantee funds started to operate in many states aimed at supporting the individuals who encounter problems in the payment of the mortgage loans. Poland, Hungary, Slovenia and Great Britain launched such funds in 2009, as part of an anti-crisis measures package. Many European countries adopted fiscal measures to combat the crisis effects: income tax reduction in investments (Bulgaria), taxation of the consumption, and not of the income (the Netherlands), investments accelerated amortization measures (Spain and the Netherlands), VAT reduction at the construction of new dwellings (Belgium), profit tax reduction (the Czech Republic), SME stimulating measures (France and Germany), tax exemption for deposit interests earned by the individuals (Romania) (according to the European Commission).

Because of the degree reached by the economic fall and the monetary policy limits, the governments returned to the fiscal policy in order to support the demand. Before allowing the automatic fiscal stabilizers to carry out their tasks, large discretionary incentive packages were introduced in the majority of the advanced economies, especially in Germany, Japan, Korea, Great Britain and the USA, and afterwards in the emerging European countries as well.

Following the 1990s, the European banking sector witnessed a considerable development and diversification. This diversification may be approached from three directions: the first direction is aimed at the range of the banking products and services, the second refers to the geographical expansion and the third may be a mix of the first two [16]. Hungary and the Baltic states were seriously exposed during the crisis and they faced a great deposit deficit.

The European market of the banking services has integrated in the previous years, but the barriers to total integration still exist, especially within the retail activity. The retail banking services, defined as service provision to

consumers and small and medium enterprises (SME), remain the most important banking sector, representing more than 50% of the total activity of the EU in terms of gross domestic product [11].

The characteristics of the European banking systems have changed over the past 20 years. The permanent increase in the demand for loans was the factor which led to the unprecedented development of the banking assets, evolution supported by the deregulation process, the creation of the single market of financial services, as well as by the introduction of the euro. The banks had the opportunity to extend their market share, not only at national level but also throughout Europe. The entry of the foreign banks into the European markets of banking services resulted in a more intense competition in many segments. However, the whole Europe has also implications for the seismic risk and generates different challenges for the current supervision framework.

In response to the increasing competition, the banks have diversified their activities by becoming involved in insurance and mutual funds, private banking and asset management. Many of the largest European banks reacted to the changing competitive environment either by stimulating the domestic demand, or through mergers and acquisitions. By the late 1990s, approximately two-thirds of mergers were performed between two or more banks, while a third was between banks and other financial institutions.

In the past decade more and more large cross-border banks appeared in the EU. In 2005 the largest 14 cross-border banking groups accounted for almost one third of the total EU banking assets [14]-[16]. The year 2007 marked not only the outbreak of the global financial crisis but also the end of a stage of international banking system concentration as a result of the cross-border banking transactions, stage which began almost 10 years ago, as shown by the following table (Table 1). After an intense activity characterized by mergers and acquisitions carried out over a period of nearly a decade, we notice the creation of some real financial giants (Bank of America, Bank of China, JP Morgan Chase, Citigroup, BNP Paribas, Banco Santander, ABN Amro, Unicredit, Sberbank) [16].

Table 1 The largest banking acquisitions during 1998-2007

Year	Transaction	Transaction Value
2007	Banco Bilbao Vizcaya Argentaria (BBVA) bought Compass Bancshares	7,3 bil. USD
2007	Banca Intesa bought Banca SanPaolo	37,62 bil. USD
2007	Barclays, RBS and Santander bought ABN Amro	90,85 bil. USD
2005	Mitsubishi Financial bought UFJ	4104 bil. USD
2004	J. P. Morgan Chase bought Bank One of Chicago	58 bil. USD
2003	Bank of America bought FleetBoston	49,26 m bil. USD
2001	Sumitomo bought Sakura Bank	45,5 bil. USD
1999	Fuji Bank bought Dai-Ichi Kangyo	40,01 bil. USD
1999	RBS bought National Westminster	38,4 bil. USD
1998	Travelers bought Citicorp and resulted Citigroup	72,5 bil. USD
1998	National Bank bought BankAmerica and resulted Bank Of America Corp	61,6 bil. USD

Source: Wall Street, 2007

In the last ten years, the European Union recorded macroeconomic imbalances which deepened the negative effects of the financial and economic crisis which broke out in 2008. The economic imbalances in the Eurozone (caused by the accumulation, in certain member states, of massive deficits and public debts), to which there were added increasing competitiveness differences, made the financial crisis and debt crisis, occurred simultaneously, very difficult to manage for some countries.

In response to these challenges, the European institutions together with the Member States and the European Central Bank first of all agreed on measures to ensure financial stability. Thus, the European Mechanism for Financial Stabilization was created, which allows the European Commission to borrow, on behalf of the EU, up to 60 billion euros from the financial markets and, in turn, to lend this amount to the EU countries confronting with difficulties.

Also, the European Fund for Financial Stability was created – a fund for emergency situations, with a lending capacity of 440 billion Euros, intended for the Eurozone countries facing problems. It collects funds from the financial markets, based on the guarantees offered by the countries in the Eurozone.

A group of experts called the "Troika", formed of representatives of the European Commission, the European Central Bank and the International Monetary Fund (IMF), evaluates the progresses made with regard to the agreed reforms on a regular basis.

Because the two mechanisms designed to provide financial stability (the European Mechanism for Financial Stabilization and the European Fund for Financial Stability) were instituted as temporary measures, in the fall of 2012 the countries in the Eurozone created a new financial mechanism, this time permanent – the European Stability Mechanism (ESM). At present, the lending capacity of ESM is of 500 billion euros. Alongside the contributions from the International Monetary Fund (IMF), this mechanism has nearly 750 billion euros at its disposal, becoming integral part of the EU global strategy meant to guarantee financial stability.

The Stability and Growth Pact (SGP) was consolidated in December 2011 and brought more transparency and a stricter supervision of the national budgets by the Commission. The consolidated SGP introduced provisions and sanctions for the Member States which exceed the limits in terms of public debts and budgetary deficit. When a country does not apply the agreed regulations, the European Commission may initiate procedures to rectify the situation. However, whilst the aspects regarding the supervision and monitoring provided by the consolidated Stability and Growth Pact apply to all the Member States, the financial sanctions may be imposed to the states in the Eurozone only.

In December 2011 also a new mechanism was introduced –the Macroeconomic Imbalances Procedure (MIP) for a closer supervision of the divergences between the economies, especially the differences existing at competitiveness level (the capacity of a country to sell its products and services on the domestic and foreign markets). The MIP analyzes 10 economic indicators, thus identifying the changes occurred with regard to the exports’ market share, the cost of labour, the private sector debt and the price of houses. The imbalances may manifest, for example, through wage rises which do not correspond to the productivity increases or by sudden increases in the prices of houses.

At the same time, in 2011, the countries in the Eurozone agreed to take a number of measures stipulated by the Euro Plus Pact. It reflects their economies’ interdependence and it expresses the intention to provide a better coordination of the national economic policies. The Pact was also signed by six countries outside the Eurozone: Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania.

Moreover, 25 EU member states agreed on a Treaty for Stability, Coordination and Governance which came into force on 1 January 2013 and it consolidates the budgetary discipline and the economic governance between these Member States. The Member States were to unite their strength in order to halve the tax gap by 2020. The Governments have to agree on measures to combat the tax heavens, to rectify the loopholes and to combat the aggressive tax planning.

For the coordination of the economic policies, the European Commission set a strict calendar called the European half-year. Within this calendar, the programmes of the Member States in terms of economic and structural reforms are analyzed in detail and recommendations for the following 12-18 months are set.

From 1 January 2014, the EU banks have become safer. The amendments voted by the Parliament restrict the bankers’ bonuses to limit the speculative risks, increase the capital reserves to help banks cope better with the crises and consolidate the supervision. Measures were taken to reduce bankers’ abuses before the outbreak of the crisis. The debtors will be better informed on the costs and risks of the mortgage loan, will be partially protected against the market fluctuations which determine the rate increase and will be better protected if they cannot reimburse the loan.

From September 2014, the EU banking supervision system brings approximately 150 of the largest European banks under the direct supervision of the European Central Bank (ECB) and the European Banking Authority was requested to develop supervision practices to be complied with by the supervisors within the national banks [6].

3. Challenges for Romania

The prolonged economic and financial crisis was a challenge for the financial institutions, although those in Romania were less affected since they were not exposed to toxic assets, as well as due to the prudential and administrative measures adopted by the National Bank of Romania [15].

Given the economic and financial crisis which broke out in the European Union area after the fall of 2008, the Romanian banking system, similar to its counterparts in the other European countries, confronted with the consequences of the decrease in the standard of living, the worsening buying power (with regard to the retail segment) and with the lags and delays in payment occurred in the area of corporate clients. All these led to the deterioration of the quality of the banking investments, to the increase in the volume of non-performing loans in total banking portfolios determining in the end the accumulation of excessive risks to which the banks were exposed [13].

In this context, a new issue was launched: the exposure of the Romanian banking system to the foreign banks that play an important role in the Romanian banking system.

Having these questions in view, Romania decided to join Basel III Agreement. Basel III started to be elaborated in the context of the international financial crisis, as a consequence of the concerns determined by the proportion, depth and expansion of the crisis. The new standards stipulated by the Basel III agreements impose higher and better quality capital requirements, with a view to improving the risk management system, as well as increasing the transparency and publication requirements of the credit institutions. For some of the credit institutions within the Romanian banking system, the compliance with the requirements imposed by BASEL III is likely to prove difficult. The implementation process of Basel III requirements will be carried out over several years, and during this interval we will probably witness a series of restructuring within the domestic banking system [13].

Therefore, during 2013-2014 we saw many banking acquisitions, mergers or even some banking capital outflows in the Romanian bankig market. In the banking sector a special attention has to be given to the risk level they are exposed to within the business environment. In Romania, the banks’ exposure decreased, thus decreasing the weight of credits denominated in currency as a consequence of the decrease in financing the banks with foreign capital

by the parent bank, the decrease in interest rate for the credits in lei, the increase in minimum currency reserves and of the programme „First Home” which benefits from state guarantees (at present, half of the mortgage credits are state guaranteed).

The crisis triggered in 2008 because of the sovereign debts and the banks' lack of liquidity seems to be endless. Because of the strict measures imposed on Greece by the creditors, it is believed it almost gave up on its sovereignty after tough negotiations with the European representatives.

The stocks of the Athens Stock Market dropped by nearly 4%, reaching close to the lowest level recorded in the summer of 2012. The securities of the National Bank of Greece, one of the largest Greek banks, fell by nearly 8%. The shares of Piraeus Bank, another large Hellenic bank, lost almost 9% of their value. Also, other large European stock markets dropped. The bonds yield issued by Italy, Spain and Portugal, the most vulnerable economies in the Eurozone, represented the actors of one of the most serious contagion episodes following the climax of the debts crisis.

The exist of Greece from the Eurozone might have on the financial markets the magnitude of the collapse of the American Investment Bank Lehman Brothers. The Grexit risk has been cited by many analysts as being the highest risk for the Eurozone economy. The issues faced by Greece proved the vulnerability of the European Monetary Union, which is not an optimum monetary zone. The loss of monetary instruments which allowed the artificial maintenance of external competitiveness for the Greek exports determined a huge imbalance of the Greek trade balance and an excessive indebtedness. In the years to come, the European Monetary Union will show prudence with regard to the entry of new weak Eastern-European economies into the Eurozone, taking into account the problems faced by Greece. Moreover, the Eastern European states no longer seem willing to adopt the euro currency in the near future. Poland has already announced this fact; Romania postponed again the date to adopt the euro, due to a lack of real convergence of the Romanian economy with the ones in the Eurozone.

The result of the negotiations in Greece and the extent to which the Greek banking sector was affected, given the fact that the Greek capital has a weight of 13% of the total assets in Romania, are the main risks with regard to the forecasts for Romania. Another external risk is the geographical proximity to the conflict in Ukraine. Internally, we view the fiscal slippage before the general elections in 2016 as the main threat. The situation in Greece has also left its print on the state bonds market in Romania. Furthermore, the analysts draw the attention to the risk represented by the increase in the budgetary expenses in Romania within this pre-election period.

On the other hand, there is also the conflict in Ukraine and its proximity to Romania. Although our financial sector is not exposed towards Russia and Ukraine, the conflict in Ukraine may have negative consequences on Romania in terms of external commercial flows through the possible negative impact on the demand for Romanian exports from the economies in the Eurozone, as well as financially, through the channel of the joint creditor, because most of the external financial receivables on Ukraine and Russia are held by Austria, Italy and France, and these countries are well represented in Romania, both in the banking and real sectors.

4. Conclusions

The deep cause of the financial crisis was the massive liquidity created by the main central banks throughout the world and by the wish of the petrol and gas exporting countries to limit the currency appreciation. Also, there was a savings glut, generated by the increasing integration into the global economy of certain countries (China, South East Asia mainly), with large accumulation rates, but also by the global redistribution of the wealth and incomes to the petroleum and natural gases exporters. The abundant liquidity and the savings glut created resources available for investments, including sophisticated financial instruments, difficult to handle by some investors on the international market. Against this background, a series of microeconomic factors such as deregulations and different errors of the international rating agencies rose and worsened the situation [10].

The effects on the economy were differently experienced by the countries, depending on the regulations and their development level. The governments adopted anti-crisis measures both individually as well as collectively (at the level of the European Union). Large amounts were invested in the domestic financial structures, a large part of the banks were nationalized and taxed were reduced in order to stimulate the economy.

The integration and globalization provided important opportunities for the economic-financial performances and the achievement of additional earnings in the Romanian economy, however generating high risks. From the perspective of the direct impact, the banking system in Romania was less affected since it was not exposed to toxic assets, also due to the prudential and administrative measures adopted by the National Bank of Romania (NBR). In Romania, the answer to the crisis effects was not similar to the one formulated by some European or American states. The Romanian economy has a high current account deficit, which indicates its dependency on the foreign financing, this representing the main risk. This deficit has to be reduced, otherwise the consequences are dramatic for the exchange rate and for the economic growth [10].

A recent study by Erste Group (2015) shows that the private investment re-launch represents the key factor for the recovery of the growth potential of the Central and Eastern Europe region, once the direct foreign investments dropped sharply in this region, following the outbreak of the crisis. The local economies and the transfers from the EU increasingly compensate for the decrease in the direct foreign investments, which should support the relaunch of

investments on the whole. Year 2014 represented a turning point for the increase in investments and this tendency seems to continue in 2015. Given a favourable economic background in the region, the main pillars of regional growth and convergence will be the local investments, a prosperous SME sector and the EU funds, which should be used entirely [8].

A favourable perception and the increase in domestic demand contributed to the stimulation of investments in nearly all the countries in the region. Poland and Hungary have already attracted investments larger than the 2008 level. Poland is a leader in investments in Europe on the whole, since the Polish economy was stimulated by public investments, whilst other countries were facing the tax consolidation process. In 2015-2016 the investments in the Czech Republic and Slovakia should reach the levels recorded before the crisis. In spite of all these, Croatia, Slovenia, Bulgaria and Romania will need a stronger recovery to be able to return to the pre-crisis investment levels.

The region is likely to receive an instalment of approximately 40 - 60 billion Euros from the Juncker Investment Plan of the European Commission, representing a fifth of the entire investment package, taking into account the fact that many of the projects submitted are related to the energetic infrastructure and digital economy (two top priority domains) in the period 2015-2017. In addition to the Juncker Investment Package, the countries in the region have access to European funds amounting to 185 billion Euros, available for the period 2014 - 2020.

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