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Liviu-George, Maha and Dragos-Florentin, Mariciuc

“Alexandru Ioan Cuza” University of Iasi, Romania, “Alexandru
Ioan Cuza” University of Iasi, Romania

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Characteristics of the financial crisis in 2008 and its implications on Romanian economy

Liviu-George Maha, “Al. I. Cuza” University of Iași
Dragoș Florentin Mariciuc, “Al. I. Cuza” University of Iași
Bd. Carol I, Nr. 22, FEAA, B334, 700506, IAȘI

Abstract: *The paper tries to underline the most important aspects of the financial crisis in Romania. Taking into account the information speed, the full integration of the capital markets and the commercial integration, the economic crisis of 2008 is certainly a global one and it has repercussions not only on the Western economies, but it also affects the economy of other states, resulting in major consequences.*

Keywords: *globalization, financial crisis, emerging economies, European integration, competitiveness*

Over the last period of time, the financial crisis was the most common topic of discussion maybe overshadowing the debates on terrorism. The lines below will try to touch on the most important aspects of the financial crisis in Romania and to help the readers form an idea about it and reflect on it too.

No matters of what type are, all the crises generate sets of problems which are difficult to solve. Among these, bank financial crises generate the greatest difficulties for the economies. Nowadays, because of the total integration of capital market and because of the communication and information, it can be stated that banking and financial shocks can generate in real time this type of crisis at the global level. Economic crises are interpreted according to the cycle theory and the fundamental breaks.

The interpretation of crisis phenomena has generated many debates, no matter the period of manifestation, concerning the typology of crisis, the channel of transmission, the management and solving modality, as well as the prevention and treatment of crisis. Although the previous crises develop an expectation, a precaution and an avoidance behavior, they still take place. The explanations are many: either the crisis thwarted the precaution measures, or the precaution measures have been minimized, not to speak of the conspiracy theories. It can be observed that most crises come with new essential features the moment they take place. This is also evident in the context of the present crisis in 2008. But if it is about a crisis, what type is it and in what context has it occurred?

We can find the economic crises in the specialty literature interpreted from the view of the cycle theory and of the fundamental breaks. In the first approach the theory of crises is an aspect of the cycle theory (Haberler G, 1937). Thus, the crisis is a moment of the cycle, where the growth stage is compressed, more or less dramatic phenomena taking place: inflation, recession, unemployment or worse, depression. If these phenomena take place at the same time, the crisis is a deep one.

In the latter approach, the crisis represents a major break caused by an unexpected shock of different types: political, economic or social. The economic shocks can be exogenous when they cannot be explained by an economic model and endogenous when they are generated by externalities. In fact, newer theories and instruments, such as nonlinear dynamics, allow the emphasis of the endogenous shock, not necessary by means of externalities, but by the economy's functioning itself.

Another common point is the economy qualitative leap from the normal growth stage to another one, more or less critical. This discontinuity can be practically analyzed by means of mathematic models, from the theory of catastrophes, of chaos etc.

There is not a certain typology of crises. They can be regrouped according to their causes, to their impact, but also to the way they are approached by specialists. An example is represented by the banking and financial crises which generate the greatest problems that need to be solved. Nowadays, due to globalization and deregulation, to the total integration of the capital market but also to communication and information, it can be stated that banking and financial shocks can generate this type of crisis at the global level, in real time. Not always the bankruptcy of a great credit institution generates banking and financial crises, even at a national level. These phenomena generate considerable crises if they are accompanied by certain structural causes but also by important circumstantial factors. In this context, there will be enumerated the main banking financial crises with powerful effects on the collective memory.

The 1929 global crisis is the most important one in the history of mankind. Galbraith interprets the financial crash in 1929 according to a speculative phenomenon, by the explosion of a "financial bubble" which occurred in March 1929. The behavior of the investors was to get into debt, to place more money in eligible investments, believing in a permanent growth of stock exchanges. This fact overcharged the market, which collapsed in October 1929. Friedman and Schwartz indict the Federal Reserve responsibility, not for the release of crisis but for its worsening. The banking support was belated and useless. The sharp financial crisis has spread to all real economy bringing about a dramatic recession.

The financial market had known in 1987 a spectacular collapse similar to that in 1929 only by share index. The crisis result concerning real economy was reduced by the banking support. The 1997 global crisis took place in Asia, affecting Russia, but also countries from Latin America. It manifested itself by collapsing the monetary system from the countries with emergent economy. Certain results had influenced the macroeconomic indicators of convergent economies one year after the crisis release. At all these it can be added the crises of the monetary systems from Scandinavian countries at the end of '80, of American saving banks from the same period, of the Mexican crises from 1994 to 1995.

Every crisis has a combination of structural causes with essential circumstantial elements. The external deficit, the overproduction, the under consumption, the industrial innovation rate, the impact of technical progress, over accumulation, dynamic indebtedness are among the structural causes. Of course, these phenomena can be favorable each by one, but by the combination of these ones with one or more circumstantial factors an amplitude crisis can take place. The commentaries of the public authority, announcing a low yield, the bankruptcy of a bank can constitute a circumstantial factor.

Taking into account the information speed, the full integration of capital markets, the commercial opening, the economic crisis of 2008 is certainly a global one. The deep crisis in the U.S. banking system and then in the stocks exchange in the whole world lead us to state that the crisis which started in 2008 is definitely a banking-financial one. It is difficult to determine what has generated the crisis. Even a set of anticipation is hard to find. Probably,

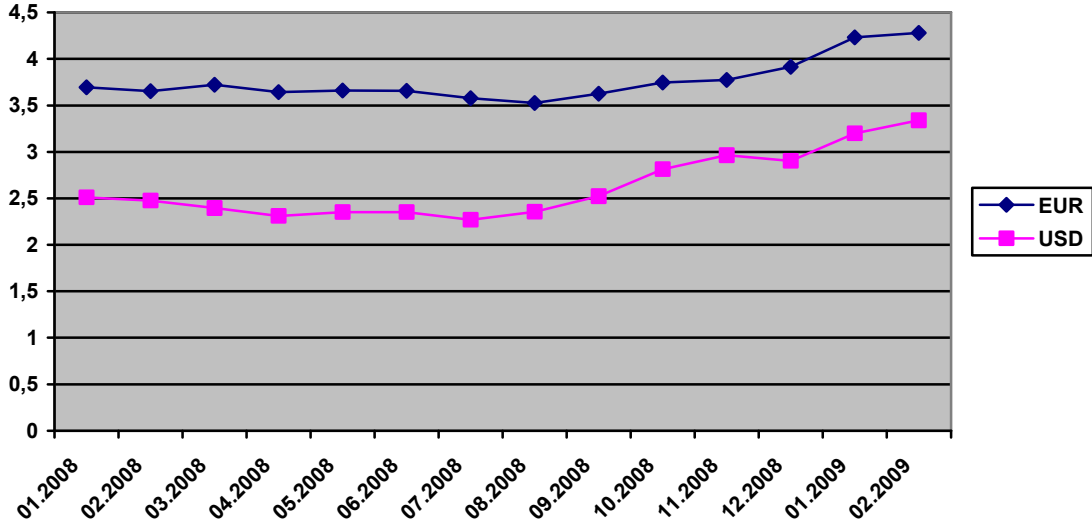
overproduction phenomena combined with under consumption phenomena but also the extremely high budget deficit led the banks to stimulate the indebtedness of the state, population and even on itself. But excessive indebtedness of the population, as well as the banks, led to the emergence of the speculative gaps.

Romanian banking segment is affected by the financial crisis in the U.S., due to increase in the price interbank funding, over assessment of the real estate segment and the suspicion which is manifested between banks, even if their exposition on the market is tiny substandard. This distrust makes them reluctant about lending each other. Local banks are not suspected to have major exposure on the U.S. market, however, the impossibility to separate the banks exposed to the unexposed, raise the price of liquidity.

The Romanian economy has been able to cope significantly well with the multiple external shocks: 8-9% economic growth is by far the strongest in the EU, while inflation has started on a downward trend, the foreign deficit appears to be stabilized, the banking system continues to grow at a fast rate, and the exchange rate appears to fluctuate within normal limits on a free market, according to Mugur Isărescu, Governor of the NBR (National Bank of Romania). The head of the central bank said that even though some of the parent banks had reported losses as a result of their exposure to the American banks that had filed for bankruptcy, these losses had not affected the operations of Romanian subsidiaries. Overall, Isărescu even talked about an above-expectations performance of the Romanian economy, backed by the solid domestic growth. However, he warned that it would be a mistake to be euphoric because Romania had not suffered as a result of the crisis.

The following chart reflects the evolution of the exchange rate between the Romanian currency and the two important currencies: the euro and the American dollar, including the rapid depreciation process of the late months:

Figure 1 – The evolution of exchange rate between the Romania currency (LEU) and the most important valutes (EUR and USD)



Source: The Romanian National Bank

A worsening of the situation on the international financial markets could affect the adoption of the single currency in 2014, but the local banking system will not be directly affected. "It is too early to look into all the details of the financial crisis and its impact on

Romania until 2014. The crisis has a great potential, and a large part of the elements that make up the current world picture could change by then. I am not a fortune-teller, but it is possible." (Isărescu). He added that this crisis had not directly affected Romania, not because the financial system is primitive, but because Romanian banks have stayed away from "toxic" lending products, and that happened because of the severe lending requirements of the NBR.

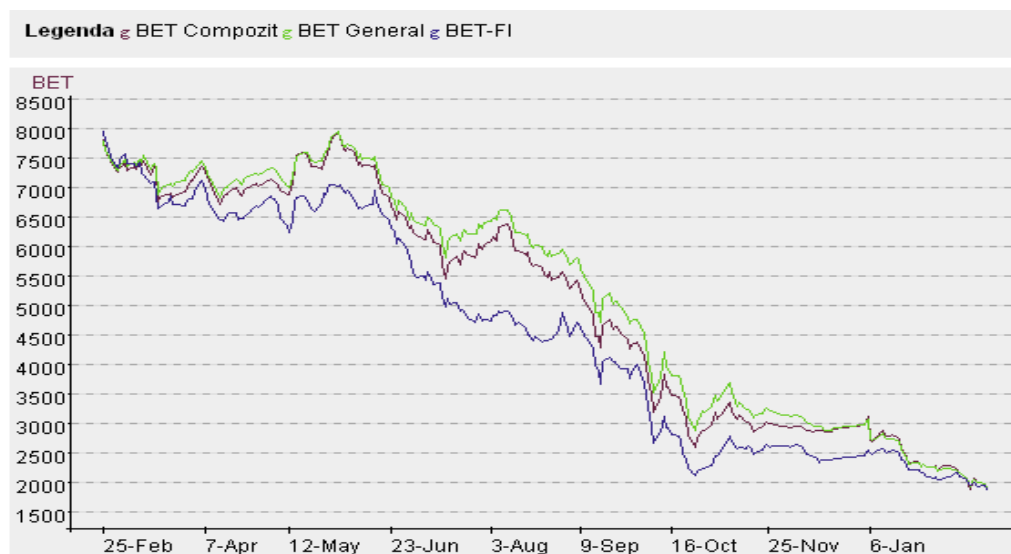
Lenders say that, while certain banks in the Romanian system will opt for mergers and survival techniques, the would-be 2009 banker won't give up when it comes of searching for opportunities, in spite of a worsening of international crisis effects.

"I think this is not a propitious moment to lay the foundation for a new bank. A bank requires sufficient resources, loyal clients, and above all trust. The current crisis demands sometimes a dramatic adjustment in every bank's strategy, converging towards a "core business," to ensure its sustainability," Nicolae Dănilă, the former head of Romanian banking market leader, Banca Comercială Română (BCR). Matei Păun, Managing Partner of BAC Investment Bank, said that 2009 could be subject to mergers and acquisitions on the local banking market. "These are times of preservation and survival. Banca Carpatica and Banca Transilvania are the main targets for acquisitions, but rumors also include names such as RBS Romania and OTP Bank Romania," he added.

The top four players in this sector, in terms of assets, are BCR (Romanian Commercial Bank), Banca Română de Dezvoltare (Romanian Bank for Development), whose majority shareholder is Societe Generale, Volksbank, and Raiffeisen Bank. Banks with majority share packages owned by foreign institutions control 87.9 percent of the banking assets.

During the crisis, nothing affects the economy more than panic. The emergence of a rumor or a fear of instability of the financial institutions triggered an avalanche that can not only crush the institutions, but the whole system. Hysteria covered the Romanian financial market, the signal being the collapse of the stock exchange, although the size of the disaster is not only justified by the international crisis. They followed the depreciation of the exchange rate and the adoption of a prudent loan policy of banks.

Figure 2 – The evolution of the most important stock market index of the Romanian stock market

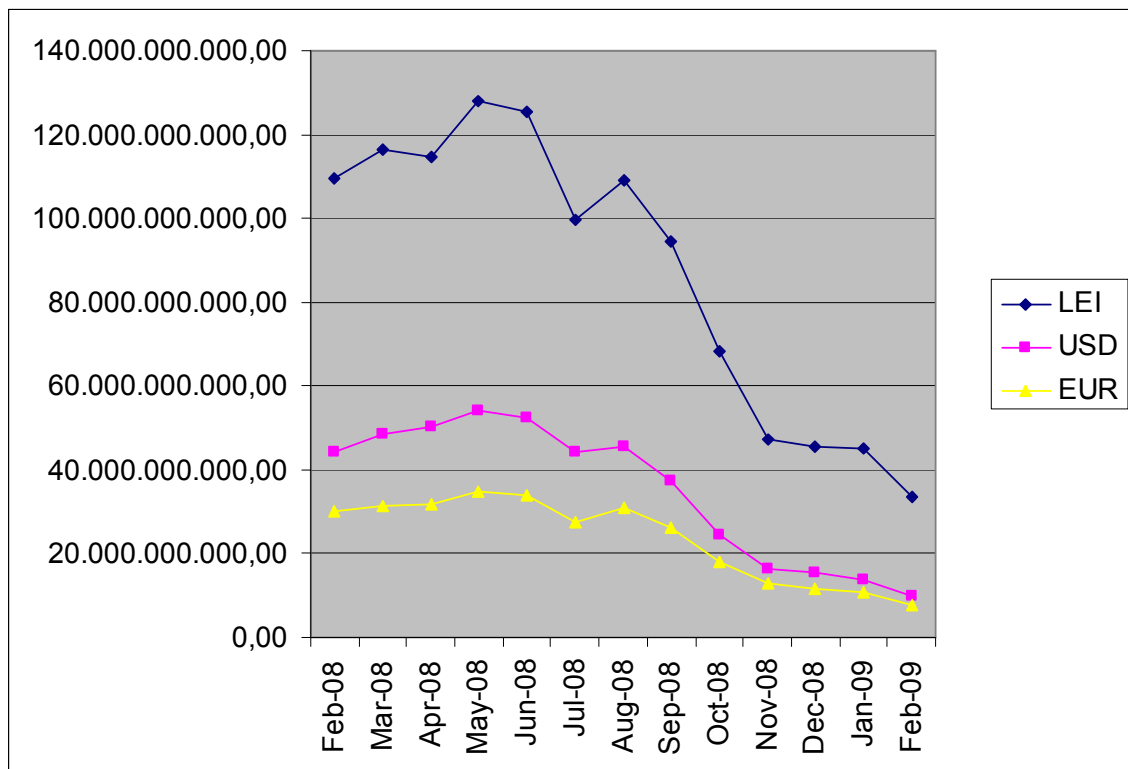


Source: The Bucharest Stock Exchange

The local capital market has followed the general trend of the international financial markets. London index FTSE 100 fell by about 38%, the U.S. DJIA over 35% and the Japanese Nikkei dropped by almost 46%. In the euro area, pan-European index DJ STOXX 50 lost 45.5% in 2008. Exchange losses are motivated by the withdrawal of investors and their reorientation towards precious metals and public bonds.

As the following figures show, the Romanian main index dropped during the last year with more than 75% (Fig. 1), and value of the companies listed on the Bucharest Stock Exchange reduced from 30 billion EUR at the beginning of 2008 to 7,7 billion in February 2009:

Figure 3 – The evolution of the market capitalization of the Bucarest Stock Exchange



Source: The Bucharest Stock Exchange

Romania could also be easily affected by the problems of unemployment whereas situation our country is different, knowing that the unemployment rate is currently low and can even talk about a deficit of labor. Some economists think that if foreign investment is reduced, it is possible to attend a mild increase in unemployment. However, they believe, the economy is developing with a strong pace, which means that there is a need for labor force. For areas which recorded a deficit of staff, the economic crisis may have beneficial effects, because a part of those over 2 million Romanian people working abroad will return, because of restructuring process caused by the crisis in those countries.

Union leaders maintain that unemployment might reach 8%, or about 1.2 million people, as the most affected industries will be textiles, construction, agriculture, automobiles and finance. Figures vary, depending on the source. The president of the SME (Small and Medium Enterprises) Council, Ovidiu Nicolescu, said that the private firms in 30 counties have shed around 50,000 employees, raising unemployment in the private sector to 150,000. The Romanian Association of Construction Entrepreneurs (ARCO) announced in mid-

November that around 70,000 employees will be temporarily laid off until February, and another 35,000 could lose their jobs permanently starting from April. According to ARCO, 32% of Romania's construction companies are affected by the crisis. In turn, the Agrostar Federation asked the minister of agriculture to approve the dismissal of 50,000 employees - almost 75% of its combined payrolls - until April, as most agricultural firms cannot continue production. Several companies announced they would either reduce production or suspend activity. The chemical plant Oltchim Râmnicu Vâlcea said it would reduce production by 20% to 40% after suffering a 50% drop in demand. Five hundred of the company's 4,800 employees will lose their jobs, mainly those approaching retirement, announced plant management.

The fertilizer plant Azomureș temporarily dismissed 250 employees for lack of orders. Krafts Food Romania will close its production unit in Brasov with 400 employees and will partially relocate the jobs to Bulgaria, but Coca-Cola dismissed speculation about closing its units in Iasi and Oradea.

In February, there will be dismissals at Rolem SA – 1,000 people, Belart SRL - 37 people, Romradiatoare SA - 95 people, Viromet SA - 296 people, Electroprecizia SA - 229 people, Marub Industry - 70 people and Fabrica de Scule Râșnov - 12 people. The employees dismissed will receive unemployment aid, in accordance with the Law 76/2002 on the welfare system and the stimulation of employment.

Tourism will also suffer in the next years because of the global economic crisis, as the prices will increase, and people will be more careful when they spend their money. This will happen, because everything will be more expensive and people will have to take care how they spend money. There will be financial and economic limitations, and certainly there will be a decrease in tourism.

Romania's tourism minister Elena Udrea said, within the International Tourism Fair in Madrid, that she disagrees with selling, during this period, the participations owned by the ministry in several hotel companies, arguing that the ministry would obtain low prices in the fallout of the economic crisis. Udrea highlighted that, when the ministry decides to sell its participations in hotel companies, the sale process would be transparent, arguing the sale will not be unfolded on secondary markets. Sources close to the matter said in October 2008 that the former leader of the Tourism Ministry initiated the sale procedure on the capital market of its stakes in several hotel companies, among which, Athenee Palace, Lido, Robinson Predeal, through the law firm "Boștină și Asociații".

The ministry owns majority stakes in four hotel companies, namely, a 90% stake in Predeal, 82.27% in Litoral Constanta, 96.57% in Mamaia and 52.22% in Neptun-Olimp, as well as minority stakes in Athenee Palace - 33.98%, Lido - 42.87% and Robinson - 21.59%.

Even though most economic sectors have been affected by the economic crisis, there are exceptions. One of the exceptions is the media business who had to win from the crisis, especially in view of the audience.

In Romania, articles related to the crisis have kept the first page of most publications business. In the case of financial newspaper, last weeks brought at least an article about this subject on the first page. Capital weekly was targeted by articles about the effects of the crisis on the final consumer, following at the same time projection on various fields, from the capital market in auto sector.

In addition to the print media, the evolution of the business sites shows a major interest in this subject too. According to www.traffic.ro, the number of people who accessed the Business Standard site www.standard.ro in September is higher with 19.9% compared to

August, while www.ZF.ro recorded an increase of 10.8%, www.wall-street.com increased with 17.6%, and www.dailybusiness.ro with 9.7%.

The fall of the banking system has led to the downfall of the financial system in U.S. From this moment the crisis has become global. The American stock exchange fall has led, in real time, to other major stock exchange falls in the world. The global crisis has been generalized by reinforcing regional crisis. What is worse is that the domino effect of the crisis has also affected the well-balanced entrepreneurs.

In these circumstances it is logical to assert that a slow down of the U.S. economy will lead the world into a global crisis. And why an economy with such spectacular growth in the past eighty years, slows down when there are so many emerging economies in the world? It is possible to have significant influences on the part of the Chinese economy?

The answers to these questions may be all questions. But with much precaution, responsibility, in a few words, safe knowledge, episteme and less opinion and conjectural knowledge can give answers to these questions. A certain risk must also be assumed, that of incomplete interpretation, the remoteness of certainty because the human nature is unable to hold unlimited net information. It is very possible that, besides the economic causes of a crisis, there is also a special type of cases, among which the most important appear to be cultural.

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