EFFECTS INDUCED BY THE GLOBAL ECONOMIC AND FINANCIAL CRISIS IN THE NEW EU MEMBER STATES

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Rezumat

Criza financiară globală a transmis o serie de factori care au agravat situaţia economiilor noilor state membre ale Uniunii Europene, pe fondul existenţei unor relaţii financiare şi comerciale puternice cu ţările europene dezvoltate. În acest articol facem o scurtă prezentare a unor vulnerabilităţi induse de această situaţie, subliniind faptul că acolo unde investiţiile străine au dezvoltat oferta internă (pe segmentul *tradable*), vulnerabilităţile sunt mai mult temporare, cel mai grav afectate fiind acele ţări care au avut în ultimii ani creşteri economice pe baza consumului şi investiţii orientate cu precădere în domeniul imobiliar.

Abstract

The global financial crisis transmitted several factors which have aggravated the economic situation of the new members of the European Union on the background of their strong financial and trading relations with the developed European countries. This article is a brief presentation of some vulnerabilities induced by this situation, highlighting that in the cases in which the foreign investments have developed the domestic market (through the

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tradable segment), the vulnerabilities are more of a temporary nature, the worst affected being those states which based their economic growth on the consumption and on investments mainly in the real estate sector.

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From mid September 2008, when the crash of the American giant Lehman Brothers was announced, the financial crisis which had manifested until then only in the developed countries, entered a new period by its direct effect on the new member states (NMS) of the European Union[1]. In fact, the bankruptcy of this institution was a *shock on the trust*, to which the firms and households reacted, among other, by postponing the investments and expenditure. The financial crisis The financial crisis which manifested by the lack of liquidity on the global markets and by risk revaluation by the international investors, also reduced the availability of credits for the real economy, for the firms and households, which sped up the decline of the demand. This decline put its print on the productive and commercial activity which shrank considerably not just in the developed countries, but also in the emerging states. The governments announced fiscal actions intended to alleviate the effects of the crisis on the real economy, but these failed to induce a rapid review of the forecasts for the economic activity. The macroeconomic data show a worldwide dramatic decrease of the industrial activity, which shows that the world economy is in recession (European Commission, 2009).

The increasing concerns for the recession and the deterioration of the financial stability by the increased risk aversion were the main characteristics of this new period. The mistrust towards some emerging countries caused the interbanking liquidity to decrease which, in turn, increased the interbanking interest rates to record levels in most NMS. Besides the lower financing in foreign currencies and the jamming of the interbanking monetary markets, the bonds

[1] *Until then, these countries didn't suffer serious turbulences on their financial markets because the banks from these states have a very low proportion or even no toxic assets, and the financial innovations are very poor. Only Latvia experienced financial problems starting even in early 2007.*

spreads and the CDS on the governmental debt deteriorated suddenly[2], putting pressure on the national currencies. The feeling of pessimism induced by recession in the NMS and implicitly, the even stronger reduction of the appetite for risk maintained in early 2009 and reflected in the depreciation of the national currencies in the countries with flexible currency regime (particularly in the countries depending very much on the global economic cycle) and in the increased mistrust in the political environment in general.

This financial crisis also involves a political risk. Twenty years ago, the former communist countries embraced enthusiastically the market capitalism and the democracy. By setting as general goal the adhesion to the European structures, the NMS have chosen to be under a supra-national umbrella, and this entails numerous political, economic and social risks. The national values are replaced by the so-called "community values"; these are abstract notions at their origin, and interpretable in usage, many times non viable in the long run[3].

The global financial crisis conveyed several factors which aggravated the economic evolution of the new member states[4].

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[2] CDS (credit default swap) level reflects the perception of the investors on the macroeconomic environment of a particular country.

[3] Although not the object of this paper, we must mention here those "community" trends which encourage behaviours in conflict with the Christian principles, regarded as the fundament of the existence of the European continent, and in contradiction with the liberty and life itself: the excessive claim of the citizen rights and less of citizen duties, assertion of the rights of some minorities to the detriment of the majority, non-acknowledgement of the fact that some behaviours of the minorities are pathologic, the attempt to control the population through technical means, the electronic recording of the population etc.

[4] There also are factors considered to have alleviated the impact of the global financial crisis, among which: 1) the status of EU member (it contributed to the achievement of a stronger political institution) which bestows a higher credibility to the NMS; 2) The presence of the foreign banks in the NMS, which means that they too are interested to assist their branches, because without western capital the local banks would have been deprived of liquidity in euro; 3) EU participation to the management of the multilateral crisis of the credit to control the phenomenon of contagion from one country to another (Hungary was assisted promptly); 4) Conventions of Repo reacquisition between ECB and the central banks. This facility provided by ECB has been introduced in October 2008 – for Hungary and in November 2008 – for Poland, and it helped the commercial banks from the two

Thus, the NMS suffer from vulnerabilities induced by the opening of their economies towards the exterior through the capital inflows which “invaded” them lately. During the normal periods, of stability, these inflows are beneficial because they contribute to the economic development, but during the periods of turbulences produced in the exterior, the contagion can cancel these effects. One of the vulnerabilities is induced by the *foreign commercial activity and by the foreign direct investments*. NMS economies depend very much commercially and financially on the EU, therefore with the euro zone. The recession in the euro zone determined the drastic reduction of exports from the NMS towards this region. Another vulnerable element resulting from the current conjecture of crisis is the *dependence of the banking sector from the NMS from the banking sector from the western countries*, the domestic banking system being affected by the international financial trends, of the fourth quarter of 2008, by the sudden slowing or even stopping of the banking crediting for firms and households. On the other hand, the slowing economic activity and the higher uncertainty regarding the incomes put a brake to the intentions of the firms and households to take credits, while the decreased appetite of the banks to assume risks hardened the crediting conditions and increased the price of the credits.

The bonding of the NMS to the conditions from the euro zone, to the importance of the euro for their national economies, under the conditions of a financial-banking domination of these states by the European financial institutions (mother banks, European Central Bank), is a particular case of the vulnerabilities induced by the opening of these economies towards the exterior and a conveying channel for the effects of the crisis towards the new member states. Thus, under the conditions in which the interbank monetary market from the euro zone was almost paralyzed in late 2008, the commercial banks from the NMS (particularly the local ones) started to be confronted with shortage of euro liquidity because they had *restricted access to euro liquidity*. The national central banks could offer liquidity in euro from their own reserves, but during the crisis periods this action doesn’t seem sensible. Another element of

countries to make swap operations through their central banks, operations which they have made previously with the commercial banks from the euro zone.

vulnerability is the *denomination of the governmental bonds in the local currency* because the list of the securities eligible for ECB refinancing doesn't include the bonds issued by NMS governments denominated in the local currency, while the lack of liquidity made unattractive for the financial institutions from the euro zone to buy such stock. Therefore, the price of these bonds decreased very much. Also within the context of linking NSM economies to the euro, appeared the problem of a *asymmetric management of the liquidity and credit by the mother banks from Western Europe*. During the periods of strong stress the priority of some mother banks was to draw liquidity in their country of origin. Thus, the attempt of this bank to remedy the lack of liquidity from the euro zone by drawing euro from NMS markets affected mainly the banks which didn't have access to liquidity from the mother banks. The banks could also reduce asymmetrically crediting in the future, either as a natural reaction to the phenomenon of worsening economic conditions within the NMS, or as effect of the engagement to maintain or increase crediting in their country of origin, as a compensation for the public recapitalization. On the other hand, having in view that NMS economies developed on the basis of foreign investments, particularly from the countries of origin of the subsidiary banks, there is a risk that such an attitude of putting these banks on the second place may also affect in the future the mother banks through driving effects, because of the links existing between the branches of large companies (origin in the same country with the mother banks) and the branches of banks (case of Austria, with large banks which had opened branches in Romania and in other East European countries and with companies which invested a lot in NMS economies).

The crisis revealed the fact that the differences between the emerging countries and the developed ones are primarily qualitative. The crisis of trust generated a reorientation of the investors towards those countries which enjoyed economic stability for a longer period; in stead of the countries with spectacular growth, the investors prefer countries with a slower growth but with a longer economic stability and with a better institutional maturity – the case of Germany. Thus, the investors changed rapidly their preferences for risky assets, the demand for low risk instruments increasing significantly, although their yield is poorer. Looking for low risk investment opportunities, the capital migrated towards the governmental bonds – considered to be the most sure – particularly for the state bonds and bank deposits from the USA and Germany and affected most of the emerging countries, but also countries from the euro zone. The specific vulnerabilities of each country played an important role, as shown by the correlation between the costs of the credit default swap (CDS) and the current account deficit of the balance of foreign payments. While this correlation was valid before the onset of the crisis in this region, the relation became more rigid lately, meaning that the foreign deficits didn’t change dramatically, while CDS cost increased substantially. Although a decline of the interest rate of the German bonds (German Bund) was noticed compared to the previous years, in the euro zone (taken as a whole), the payment of interests related to the GDP will remain at stable levels. This is determined by an increase of the yield differential compared to the German bonds, because the investors changed attitude, making differences between the issuers of sovereign bonds, increasing thus the costs of financing the governmental debt is some countries (European Commission, 2009).

Much of the credit towards the private sector (households and companies) in many NMS is in foreign currency, particularly in euro (except for Hungary where there also are credits in Swiss francs and Japanese yens). The loans in foreign currency have been rather encouraged by the interest rates differential than by the expectations regarding the exchange rate evolution on the medium term. As a consequence of the depreciation of the flexible exchange rates, combined with a decrease of the economic activity and a higher unemployment rate, the level of non-performing credits increased. The banks react by increasing the provisions for losses and by reducing the crediting, which exacerbates the decline of the economic activity. Furthermore, since the mother banks started to have difficulties in their countries, they cut from the funds for the NMS branches. While the mother banks had access to ECB financing, thus facility is not available for the banks outside the euro zone. The simultaneous action will probably maintain the credit low and high interest rates in the NMS, during the coming period.

The countries from Central and Eastern Europe have been strongly affected by the global crisis because of the high risk perceived by the investors regarding the emerging countries, including the countries from this region. On the short term, the global crisis reduced very much the foreign direct investments. Currently, the countries with majority foreign capital within their banking system and with massive inflows of capital are perceived in disadvantage, under the conditions in which until now this was a strong point of them[5]. Otherwise, the global financial crisis revealed maybe faster than expected the risks of developing the economy on the basis of foreign capital directed towards sectors which do not improve the capacity of that economy to pay its debts. The reversal of the capital inflows is even more dramatic, particularly for the Baltic States, because the capital was directed mainly towards real estate which developed very much in these states. A long-term sustainable development requires directing the capital inflows towards the *tradable* production in order to increase the productivity of this sector, which will thus generate future incomes. The advantages of the inflows of foreign capital were obvious in those states which developed their domestic offer for foreign investments (Czechia), but which are affected by the lower foreign orders for their products during this period.

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[5] *The risk of exposure to the crisis through the foreign capital can be evaluated as proportion of the net debt within the GDP, under the conditions in which it is very high and can be withdrawn rapidly. The high proportion of the credit in foreign currency generates the risk of non-payment of the debt.*

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