

A NEW INTERNATIONAL ECONOMIC AND FINANCIAL ORDER

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Rezumat. *Lumea de astăzi caută soluții la problemele legate de recesiunea globală, care este acompaniată de o criză financiară adâncă. Încercăm o analiză dinamică asupra cauzelor care au dus la actuala criză fără precedent și a factorilor care au determinat răspândirea ei la nivel global. Am insistat și în zona setului de soluții viabile puse în practică de guvernele unor țări pentru a diminua efectele negative ale acestui fenomen complex.*

Abstract. *Today's world is looking for solutions to the problems of the global economic recession, accompanied by the acute financial crisis. We are attempting a dynamic analysis of the causes that led to this unprecedented crisis and of the factors that caused its global expansion. We emphasized the set of viable solutions enacted by the governments of some states to diminish the negative effects of this complex phenomenon.*

Keywords: global recession, financial crisis, inflation, monetary policy, growth, fiscal facilities, economic and financial order

Starting with the 80's the global economy has undergone a stage which might be characterized by the following general elements (which have influenced all economic and financial areas, and have brought us to the current, without precedent, crisis):

The long-term downtrend in inflation, greater macroeconomic stability, more confidence in fiscal and monetary policy have encouraged a reduction in both nominal and inflation-adjusted interest rates. As the real returns on governmental bonds have enjoyed a downtrend, many investors have shifted to higher risk asset categories (equities, hedge funds, private equity). The current account surplus of China and the petrodollars have been deposited in financial institutions from USA, Europe or Asia and have been immediately recycled into debt markets, private equity, hedge funds or other instruments. Such surpluses accumulated at the level of several countries (supplying the sovereign funds) have been matched by the willingness of households and companies to borrow and spend more and more. The result was a long period of time of a synchronized but non-inflationary growth between 2003 and 2007, with an inflationary pressure towards the end of the period. Smaller cyclical variations and the financial system's ability to restore the normal situation relatively quick after Asian and Latin American crisis, after some large bankruptcies (see Enron), or 9/11 events, have made investors more

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confident and increased their appetite for taking higher risks, in exchange of a greater return. More than that, the investors have shown more tolerance for short-term volatility, as their focus was mainly towards higher return from long-term capital growth.

The result of these trends and events was a long period (2003-2008) of sustained growth, with low inflation and low long-term interest rates. Former Fed Chairman Alan Greenspan described the failure of long-term rates to rise as a “conundrum”.

Once the current crisis has started to send its first signals we have entered a reverse trend, characterized by a more hostile environment:

- The forthcoming volume of US Treasury debt issues is inviting the investors to consider higher long-term interest rates. It is well known by now that in October 2008 the estimated borrowing needs of US Treasury for the next 12 months reached more than USD 3 trillion, and this just for the time being.
- The expected fall in commodities prices and the downtrend of the exports will diminish the expected increases of the FX reserves of several countries and therefore investing part of such excesses in USA will not reach the desired levels.
- Higher and harder to predict volatility will diminish investors’ appetite towards new transactions or will push them to look after higher return. All these will bring the financing costs to higher levels and will impact negatively the world production, the investments and households spending.

The global economic growth will definitely suffer. I estimate that the 2009 global GDP real growth will be around 1.7%, similar to the one experienced during 1991 recession. Probably the emerging world will have a real GDP growth of around 4%. I would like to mention some of the recent developments and events:

a) The emerging economies are going to suffer a shock. This will be brought by a downtrend in the imports of the developed nations and diminished FDI. Therefore the economic growth of such countries will be much lower compared with last years' trend. Only China will benefit from a higher GDP growth of 6-7% (but below the average of last years).

b) The deepening of the financial crisis and the difficulties the emerging nations are facing has brought an economic contraction in USA, Europe and Japan.

c) The programmes and the facilities implemented by several countries will bring visible results not earlier than the second half of 2009.

There are several opinions that the world economy might enter into a depression after the current recession period. I consider that there are still sufficient ingredients in the world economy to make us more optimistic and to say that most probably the world economy will enter a recovery era, in stages, due to the programmes launched by several governments and central banks, which have been materialized by the following:

- the state intervention in the financial sector by capital injections (in several cases the state becoming main shareholder in some financial institutions) or a system of guarantees covering current and forthcoming engagements of the most important banks (national champions);
- decisions and programmes meant to bring a better and easier access to financial liquidities, accompanied by an important reduction of the official interest rates (having final target the reduction in the cost of borrowing by the companies and households);
- fiscal facilities.

In the current environment the market value of shares and real estate have reached extremely low levels. This is diminishing the value of collateral in case the companies or households intend to use same for obtaining any credit from banks.

We estimate an insignificant increase or in most cases a decline of the households' income. These will bring down the spending. The situation may further deteriorate within the context of more macroeconomic imbalances and increasing public debt, pushing the households to save more because their trust in the ability of the governments to materialize their promises concerning health and pensions will be reduced.

I estimate that in most of the countries the governments will reassess the current situation of the tax regime and will probably decide to increase several tax levels. The short and medium term spending will be negatively impacted.

The current downtrend in the market value of equities will push back the investors from considering new capital investments. In January and March last year I have anticipated the current situation in which all banks have become more selective in financing the private sector and the raising cost of financing. Most probably such banks' policy will be imposed by a more severe supervision activity (from central banks and shareholders; not to forget that the state has become or will become in many instances main shareholder), requiring additional capital and a reduction of the current risk exposure. Therefore private sector access to financing will be restricted and much costly. I have mentioned a downtrend in inflation during next years as a result of a reduction of the commodities prices, a contraction of the production and of the labor market (the unemployment level will rise). The analysts estimate a global inflation level of around 4%. I cannot agree with the analysts which predict a deflation, and my conclusions are based on the following:

- The decline in inflation is a temporary reverse trend;
- The companies will bring down their excess production capacities to match the demand;
- It is possible that the inflation expectations will be influenced by the policies implemented by FED and other central banks.

We estimate an increase of the inflation level in 2010 to 2.3% from 1% in 2009 as a result of increased oil and commodities prices, and as a result of the first recovery signals of the developed nations.

The investors are concerned because of the increased macroeconomic imbalances and public debt in several countries. They are questioning the ability of several countries to meet the debt service agenda. Generally speaking we might agree with them, but we disagree in the case of state capital infusions in the banks, as this action is not spending, but it is meant to be a temporary financing of a capital eroded by defaults. A concern might be in relation with governments' protectionist policy which may be seen more and more.

What about CEE countries, Romania included? We estimate a downtrend in FDIs. Such situation will bring to the table and will exacerbate the imbalances experienced by the respective countries:

- The average current account deficit in CEE is 9% (from only 2% in 2000);
- The intermediation and loans have gone through a huge increase;
- F/X risk which might be materialized by the increase in FX Loans (especially in the cases of borrowers having local currency income only) and the foreigners' current exposure to local currencies (equities and local bonds).

The FX storm, once it starts, will be bigger than the one taking place few years ago in Asia or Latin America, because the fundamentals are much more deteriorated in CEE.

The unsustainable increase of the current account deficit coupled with an increase in loans, especially the ones in FX, may produce an extremely dangerous combination during today's world crisis, when the aversion to risk is more visible. The FX vulnerability will put much pressure on the local currency.

We may reach the conclusion that a boomerang effect against the European banks might take place, because this group of banks (not including UK banks) are sitting on a large portfolio of loans granted to CEE, estimated volume being USD 1.5 trillion. Same type of portfolio maintained by the banks in USA, UK and Japan reaches only USD 120 billion.

The exposure by countries is showing the following levels: Austria – USD 297 billion, Germany – USD 214 billion, Italy – USD 212 billion, France – USD 176 billion. Under the circumstances, we question the programs against the crisis put in place by the respective countries, which include the recommendations of financing just the activity of domestic companies, and the policies imposed to the banks to reduce the exposure against CEE countries. This will reduce or stop any cross border financing to CEE, and any financing of the local banks controlled by the UE developed countries or their national “champion” banks.

I would like to mention few details included in their programs against the crisis by different countries:

USA

We have realized that the Obama administration is very pragmatic and understands the urgency of a national consensus for bringing to work a explicit and implicit plan, everybody being eager to see early birds out of such implementations. The facts and the early results will reinforce the confidence in the new administration. The plan is targeting the increase of the budget revenues and a large increase of the macroeconomic deficits (estimated levels exceeding the ones reached within the last 50 years in USA). We are expecting a new cut in interest rates by the FED, such new level to be kept over the entire year 2009. The plan is meant to have the economy enter a recovery stage. Realizing that the monetary policy alone is insufficient to restore the domestic financing, the plan includes a fiscal relaxation. On the long run the Administration will be focusing on infrastructure projects, the reforms of the health system, of financial legislation, education, energy and trade.

CHINA

Will continue to enjoy an important GDP growth, but less than the one of last years due to a diminished contribution of the net exports and a lower investment in real estate. The authorities will concentrate on increasing the financing towards large infrastructure projects. China has formalized a program against the crisis, which will be “fiscally proactive and moderately restrictive concerning the monetary policy”. It will sustain a “reasonable” increase of the bank loans.

Generally speaking the Chinese program is including the following:

- a downtrend in the level of interest rates coupled with a steady reduction of the minimum reserves;
- public bond issues in order to secure proper financing for the infrastructure projects;
- an increase in the tax levels;
- additional decisions in order to sustain the real estate sector development;
- bringing the energy prices to acceptable levels;
- important financial facilities and financing extended to the farmers.

The launching of such programme has been made by high level officials through explicit commitments and undertakings, increasing the confidence that such plan will be finalized.

Similar plans have been put in place by the governments and central banks in CEE countries. They were meant to freeing and better utilization of the liquidities, capital injection, sustaining the recovery of the capital markets, especially the bond markets, the restoration of trust in the market players.

RUSSIA

Has been very proactive, already employing 60% of the USD 200 billion allocated to the plan against crisis. The main beneficiaries of the utilized amount have been the two national champion banks, i.e. Sberbank and VTB (together enjoying more than 50% of the amount used). The government has intensified the banking sector supervision and has imposed to the banks a restart of the financing activity, allocating important amounts to the strategic sectors of the economy.

UKRAINE

Has launched a “REPO” program for the banks using USD 5.5 billion. The country has signed a financing agreement with IMF for USD 16.5 billion.

KAZAKHSTAN

Is managing an USD 18.5 billion plan for the financial sector.

HUNGARY

Has signed a financing agreement with IMF, having as co-financing partners EU and ECB. The country is allocating USD 2.25 billion for assisting OTP (the national champion bank)

POLAND

Has launched a plan for freeing the financial liquidities in foreign currency. The country has signed a SWAP agreement with Swiss National Bank for supplying the market with Swiss francs. Recently the country has signed with ECB a financing agreement for EUR 10 billion, to assist the liquidity needs of the banking sector.

On 29th of October this year IMF has launched a new short term financing facility. The countries proving good track record concerning the macroeconomic policy, the countries still eligible for the international capital markets financing (showing eligible ratings) and having a sustainable debt level, may borrow under such facility up to 500% of the national quota maintained with IM, for a maximum period of 3 months, not more than 3 times within a 12 months period.

It is more and more clear to everybody that the world is characterized by various and dangerous imbalances, every one of them a potential source of crisis. It is also clear that some emerging nations, after accumulating huge FX reserves, want to play an equal role to the developed nations in fixing the trend of global economy and finance.

The recent international summits meant to find solutions to the current global crisis have proved the fact that the world has entered into a new economic and financial order, requiring its own rules and players. Reaching international agreement is not an easy mission, but the earliest finalization is a must.