The Impact Of The International Economic Crisis On The Monetary Policy

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Abstract: - As the present economic crisis has its origin as well as its manifestation in financial components it may deeply affect the behavior of many economic agents. The financial component of the crisis is intensified by the fact that many companies are facing a decreasing demand, the sell less, the risk of not being paid is also very high and the risk of insolvency has never been such close. If at the end of last year the first signs of crisis could be hardly felt in Romania, at present, after a semester, the crisis seems to be more deeply felt, while the signs that were merely seen now represent more than daily realities.

Key-Words: - policies; fiscal integration; monetary integration; economic crisis, macroeconomics modelling, cybernetic systems.

1 Introduction

The crisis started as a sub-prime lending problem in the U.S., later extending throughout the world. The first signs of a deepening financial crisis were drawn by the collapse of the investment bank Bear Stearns in the spring of 2008, saved from bankruptcy by the intervention of FED which backed up the acquisition of the investment bank by J.P. Morgan with 30 billion dollars. Next step was the nationalization of the British Bank Northern Rock and FED intervention in the case of the two giants Freddie Mac and Fannie Mae. In Europe, the major French lenders, Credit Agricole, BNP Paribas and Societe Generale said they have a satisfactory level of capitalization and that they don’t need other sources of capital. The banks claim that they have not asked for this recapitalization from the state and that this occurred after the states have agreed to inject more than 1900 billion euros in the banking sector to guarantee bank loans. Bank of America has strengthened its status as the largest retail bank in the U.S. by concluding the agreement for the acquisition of Merrill Lynch, the largest brokerage firm in the world, in exchange of 50 billion dollars.

2 Economic Crisis vs. New Challenges.

If we take a look at the macroeconomic indicators of the European economy, we can ascertain the fact that in 2008 a 2% economic growth has been expected, and the foresights for 2009 show a 1.8% growth, considering the fact that there was a 2, 8% economic growth in 2007. This data represent, of course, an average of the economies of the 27 member states, considering the fact that in the euro zone the economic growth represented 1.7% in 2008, while in 2007 the economic growth represented 2.6%, and the prospect for 2009 for the euro zone is
approximately 1.5% according to the foresights contained in the reports of the European Commission. The main disturbance is represented by the exacerbated disorders on the financial markets, caused on the one hand by the slowing of the U.S economic growth, and on the other hand by the strong increase of raw material prices, which cumulated lead directly to negative influences in the global economy. Taking into consideration these negative aspects, it appears that in the economy of the European Union, based on solid foundations, for the immediately following period 2 million new working places will be created, considering the fact that in the period 2006-2007 7.5 million employments have been made. This aspect reflects the fact that the slowing of the economic growth is also affected by the substantial reduction of working places in the European Union. We can ascertain the fact that in the European Union, in 2008, inflation has increased to approximately 3.6%, but it is expected that this growth in inflation for consumer prices in 2009 to be 2.4%. The cause of this increase in energy and food prices was the main factor that has determined, in fact, this increase in inflation. The deep cause of the financial crisis has been the abundant liquidity created by the major central banks around the world (EDF, BOJ) and by the desire of the countries that export oil and gas to limit currency appreciation. In addition, the reduced volatility existent in the market has created a tendency to underestimate risk and led to a real lack of vigilance of investors. Risk margins have also been very low and nondiscriminatory. Together, the low rates of interest, the appetite for assets with high gains, and the diminishing vigilance towards risk and low margins have covered the price signals on financial markets and led to the insufficient understanding of the risks involved. The main risks are related to the persistent disturbances that are in the financial markets that could exacerbate the slowing of the American economy. The uncertainty regarding the impact of the crisis in the real economy is still at a high level. Risks related to imbalances in certain countries, with a current account deficit and/or a high external debt could be supplied by changes in risk preferences due to the deepening and/or extending the financial crisis. Risks related to imbalances in certain countries, with a current account deficit and/or a high external debt could be supplied by changes in risk preferences due to the deepening and/or extending the financial crisis. Other risks refer to a disorderedly correction of global imbalances in general, even if current prospects seem to notice an improvement in the current account deficit of the United States. The price evolution of raw materials could involve other surprises, both negative and positive. European banks found themselves suddenly deprived of liquidities, because the money was transferred for the payment of guarantees and mortgages for the buildings in the United States. In this case European banks have to confront with uncommon problems when they have to credit firms in Europe. In these circumstances the European economy has been quite affected and European banks had to reconsider their crediting policies and their attitude towards their clients. The most affected have been the companies depending directly from liquidities or from a continuous cash flow. The fact that the effects had not such a powerful influence could mean that contamination is either slower or the EU resistance has improved more than expected. EU economy has still a relatively good position in order to withstand global turbulences because of its fundamental improvements. On average, both public deficit and current account position have been, in 2007 less than 1% of GDP, although the differences between Member States remain significant. It must however be noted the fact that for 2009 budget deficits of the European Union countries will exceed 1%, and for countries belonging to non-euro area this deficit will be even greater. After recording the best result since 2000, namely 0.9% of GDP (0.6% in the euro area), in 2008 a new growth of the medium public deficit has been recorded, representing 1.2% of GDP in the EU (1.0% in the euro area) due to a more moderate activity as a whole, and some tax reductions in certain countries. In 2009, considering the maintenance of the existing policies, the deficit should stabilize at a global level. In structural terms, fiscal consolidation should also stagnate. The financial situations of households and the country’s balance sheets have improved dramatically in recent years, and the unemployment rate in the EU and euro area is at its lowest level in the past 15 years.


The fiscal policy as being part of the economic one of the state comprises the whole of the regulations regarding the establishment and tax collection characterizing the state options regarding taxes. The fiscal policy always has in view the accomplishment of the objectives by using methods, means, and specific instruments to get public financial resources. In accomplishing such objectives the fiscal policy must tally to each stage of economic development by taking into consideration the basic
principles of fiscality. The fiscal policy is being accomplished by the decisions of fiscal policy. The working of them entails the adhering to the basic principles and the evolution of the economic variables as well as the option of the tax payers whose effort must be taken into account. Such elements must tune through the fiscal decision at the macroeconomic level in order to ensure the working, efficiency of the fiscal system to avoid disturbances. The effort to stand the international economic crisis, the evolution of the budgetary process during the next period, the effort to back the economic growth and cut down inflation, the tallying within a budgetary deficit correlated with the macroeconomic objectives established, the keeping to the European Commission recommendations and the international financial bodies made possible a first amendment of the budget this year. The impact in the Romanian society entailed fiscality growth on the business environment.

4. Romanian’s Fiscal and monetary Policies in Time of Crisis

The budget is a key test for the five-week old government, providing an important signal to investors of its commitment to prudent fiscal policy. The draft budget is austere, and includes significant cut backs in government spending. In particular, public sector wages will only increase by 5% in 2009 well below the nominal net wage growth of 21.4% y-o-y in November (for the public and private sectors), no bonuses will be paid, and overtime will be rewarded with time in lieu instead of pay. In addition, the government plans to reduce spending on state salaries by 20% through a reduction in overtime and cutting fringe benefits. Improvements to infrastructure will account for 20% of the government’s total expenditure in 2009, and will be topped up by structural funds from the EU. In the short term, this will help to create jobs though unto it is unlikely to prevent either a marked slowdown in growth or a spike in unemployment. Over the longer term, improvements to the country’s infrastructure are essential for securing sustainable growth. The Romanian government is targeting a budget deficit of 2.0% of GDP in 2009, from a projected 4.8% deficit in 2008. We believe that there are a number of risks to the government’s forecast and instead expect a 2.9% deficit in 2009. In particular, since 2005, Romania has adopted a pro-cyclical fiscal policy and tends to backload spending into the final quarter of the year. A further factor which may weigh on the government’s fiscal policy is the trade unions interpretation of the government’s plans. Indeed, trade unions have traditionally managed to have a powerful influence in Romania, membership totals 2mn (9.3% of the population in 2008). We believe that further depreciation lies ahead for the leu with a move to support at RON4.000/EUR expected in the short term. A breach of this level would signal further moves towards the all time low of RON 4.1650/EUR. The risks to the macroeconomic stability of the Romanian economy are expected to rise substantially in the medium term, which will weigh on the outlook for the leu. We forecast real GDP growth to slow substantially in 2009 to 3.1% (from an estimated 7.8% in 2008), and to average 3.9% over our five-year forecast period, a significant reduction from the average (estimated) 6.9% seen in the previous five-year period. Concurrently, we expect the leu to come in at RON 4.1650/EUR by end-2009, with risks for further depreciation beyond this level. In addition to overall growth dynamics, Romania’s poor balance of payments situation will similarly be a negative factor on the currency. We believe the risks to our forecast for the Romanian leu are predominantly to the downside, with a worsening of key macroeconomic indicators by more than our current projections having a much more negative impact on the unit than anticipated. Furthermore, on the political front, should the formation of a new government following the parliamentary election prove to be protracted, this will exacerbate the risk associated with the country. Not only will this heighten the instability that investors associate with Romania but it will also make a co-ordinated response to the problems facing the country protracted and complex, at a time when an organised and swift response is needed.

5 Conclusions

It is notable that the majority of central banks in developed and emerging markets in the region have already embarked on an aggressive rate cutting cycle and we see little reason for the NBR not to follow suit.

The factors which are negatively impacting Romania’s economic outlook: collapsing external demand and a shortage of capital inflows due to tight credit markets and heightened investor risk aversion— are a regional phenomenon. That said, given the bank’s cautionary approach to adjusting monetary policy, we believe that the NBR could remain hawkish for a few months longer, although we reiterate that our core view is for further rate cuts to occur in the coming months.
References:


