THE EFFECT OF THE CRISIS ON THE ECONOMY OF ROMANIA

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Abstract. *The economic situation of the various countries has been an important subject for anyone but especially for economists. Nowadays, economic phenomena are carried out in a very rapid and profound manner, evolution taking into account various factors such as social, political, cultural, and last but not least, those in the field of information technology and technology. Thus, when the first signs of the current crisis began to be observed, the whole world was alert in only a few hours. In the opinion of economists and monetary, financial crises appear as a manifestation of banking crises, with an impact on financial stability and collapse of financial infrastructure in the absence of central bank intervention. The economic crisis that hit the world economy in the summer of 2007 is unprecedented in the post-war economic history. Although the current crisis has many features in common with past similar recession episodes. The crisis has been preoccupied with a long period of rapid credit growth, low risk premiums, abundance of liquidity, a strong leverage, rising asset prices and bubble development in the real estate sector. Economic activity is characterized by cyclicality, with periods of decline being a normal component of an economic cycle. Crises are not a new phenomenon, but over the last 100 years, due to the acceleration of the pace of economic development and the enormous advances in technology and communications, the frequency of such phenomena has increased. Such happenings have taken place in the past (e.g. in Japan and the Nordic countries in the early 1990s, the Asian crisis in the late 1990s). However, this time is different. The current crises are global and resemble the events that led to the Great Depression of the 1930s. But only two crises remain in history due to the size of the negative impact on people's lives and the international economic system: the 1929 Great Depression and the 2008-2010 Real Estate Crisis. Although there have been more than eighty years between the two, many similarities in origin, causes and propagation can be identified. The most recent one has taken on a much stronger character, because it is now too little time since its start and the effects cannot be fully analyzed. In addition, due to technological changes and recent financial innovations, the effects were much stronger and major interventions were needed to control them. To date, the most important effect is the bankruptcy of some banking and credit institutions in the United States and the European Union, as a consequence of defaulting, especially in the real estate sector, and the recovery of claims.*

Keywords: *crisis; banks; cyclicality; risk.*

Introduction

The increasing connection of the Romanian economy to the international, real and capital economic flows favored the recent catching-up process, evolved in the growth rates of 2000-2008. But an emerging economy, still marked by structural rigidities, open to the external market, can be deeply affected by such unfavorable economic conditions. As we can see, the spread of the economic and financial crisis in the United States and the UK has also hit the Romanian economy, which, from a 7.9% increase in real GDP in 2008 (true, artificial), is seeing a reduction meaning rhythm, and it is possible to reach even a negative rate in the years to come.

The analysis of the effects on our economy targets several plans: the evolution of the volume of production, orders in industry, the labor market situation and the evolution of unemployment, as well as the analysis of the investment rate in the economy. The data underlying this analysis are provided by the NBR through the March 2009 Contingency Report.

In Romania, the conjectural oscillations in the evolution of the volume of production in industry and construction are present even in the period before September-October 2008. However, after October - January, there was a decrease in production in these fields, the industrial one being the most affected (Berca, 2010).

The forecasts contained in the National Bank of Romania Context Bulletin illustrate a rebound in the growth rate of production since March. In the industrial sector, the revival is generated by the automotive industry (whose domestic demand is supplemented by an increase in external demand, especially in the German market). A positive development is also expected from the construction materials and oil processing industry. The metallurgical and related industries (metallic constructions etc.), which faced a reduction in production and orders in four to five months, seem to interrupt the negative trend and have a slight increase over the next period. Industrial branches such as textiles, footwear, clothing, leather will continue to decline in production volume, being directly influenced by the decline in aggregate demand (especially end-user goods) and in revenue cuts (Armeanu, 2005).

Developments in European countries during economic crisis

The World Bank estimates on the impact of the economic crisis, which began in 2008, predicted the largest decline in GDP for the European area. In developed economies, this period brought the first decreases in key macroeconomic indicators after years of consecutive increases. Emerging economies in Europe have been hit harder by the sudden halt in foreign capital inflows and the lack of adequate monetary and fiscal policies.

The latest crisis began in the United States by breaking the "bubble" of the property sector. The structure of the financial system has made it possible to spread the effects globally. To make the most of the leverage available, financial and banking institutions had to reduce their credit risk. Thus, these institutions have recourse to the development of packages involving several instruments with different risks, the calculation of a risk per package and their sale to third-party financial institutions.

Such packages also included many unprofitable assets or very high risks. If the ultimate consumer becomes incapacitated, responsibility lies with the financial institution that bought the package and not with the issuing bank.

Thus, dangerous banking assets have become the property of international banks, including European banks. When more and more people became incapacitated in the US, European banks were also drawn into this dangerous liquidity mechanism. Many banks were overexposed due to bad loans.

The main result of the crisis from this point of view was the increase in risk aversion to these banks, which led to a major contraction of loans with negative effects on the real economy.

Emerging economies in Central and Eastern Europe have been heavily affected by this credit shake because both investors and financial institutions, in the desire to protect their financial resources, have resorted to measures such as:
- blocking investment projects
- tightening credit conditions
- stopping activities
- Withdrawal from certain countries
- reversing capital flows (from the emerging country to the mother country)

Investment stagnation has destabilized these economies, whose system is largely based on foreign capital contributions.

One of the effects of these measures is to increase the degree of regulation in the financial and banking sector. This measure comes after a long period of relaxation of fiscal policies, which has contributed to the spread of the crisis.

Many prestigious economists have expressed their dissatisfaction with the market deregulation movements before the financial crisis. Nouriel Roubini, in his book Crisis Economics, explains in detail how these movements for market deregulation have contributed to the 2008-2009 disaster. In its view, the unprecedented diversification of financial instruments, made possible by the fall in the regulation of the financial and stock market, fueled the risk appetite of investors and hid the risks to which certain financial assets were subject. The specific risks of certain assets were concealed by grouping these tools into packages and offering the possibility to buy such packages with very few additional guarantees. Thus, investors added to their portfolios and traded many so-called "toxic assets" on stock exchanges. The financial crisis that started in 2008 has highlighted these issues and has severely destabilized the financial markets. European financial institutions have played an important role in distributing and securing toxic assets. This is one of the reasons why the crisis has been felt more strongly in Europe than in other areas. Many European banks held a large volume of toxic assets. At the same time, these institutions also represented important sources of financial resources for emerging economies, such as Romania. In order to recover from the effects of toxic assets, banks were forced to use important financial resources, reducing their exposure to other markets.

Major European banks were more exposed than US ones due to the use of larger levers. They offset the risks associated with large leverage by holding less risky assets and securing them. The size of banks transforms them into dangers for the economic system, which is why the government is obliged to keep them from failure (which would affect the country's macroeconomic situation much more strongly). Thus, the exercise of the role of a last resort creditor has become a tool used extensively during this period. If the role of the US in the US lies with the Federal Bank, there is no such institution in the European Union. The European Central Bank is not authorized to do so. Under these circumstances, national governments intervened to save banks in countries such as Belgium, Germany, Iceland, and the United Kingdom.

In emerging countries, foreign capital dependence strongly affected their ability to relaunch the growth process. When capital markets jammed, by the end of 2008, these economies had no reserves to which they could call for continued economic growth.

The fall in domestic economies was only one of the factors that led to the disastrous results in these countries. Other important factors were:
- the share of non-performing loans in bank assets, which in some cases exceeded 25%.
- similar to the US real estate bubble existed in these economies.

The result was the narrowing of the main indicators of economic growth, together with worsening indicators of living standards.

Global trade has also experienced a sharp contraction, including in the developed countries of the European Community whose export structure is heavily diversified. Decreasing consumption affects production and, indirectly, unemployment. Decreasing consumption leads to a general reduction in demand for most product categories. For this reason, companies are forced to reduce their production and make redundancies or other similar measures to reduce their spending. If before the crisis of dependence on external financial resources brought advantages to the countries, it has now turned into an important risk.

Although the effects of the shock were generally lower in the European Union than in the US, the fall in GDP is similar. Prior to the crisis, the annual GDP growth of the European Community was 3.2%. In 2008, this figure dropped by half. For 2009, Europe's most drastic decline was registered by Finland (- 7.8%) and Slovenia (-7.8%) followed by Ireland.

For the same period, the unemployment rate reaches the highest in Spain, 18%, followed by Ireland and Slovenia by 11%.

Another reason why the impact of the crisis was so strong in Europe is the low savings rates of the population. Basically, this was largely based on credit for consumer growth, with the saving rate being negative for the most affected countries:

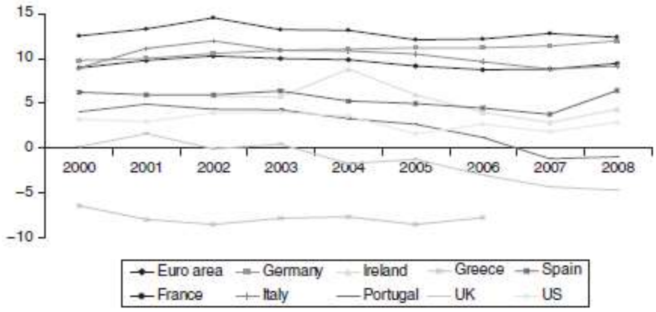

Figure 1. Population saving rate
(Source: Arestis, An assessment of the Global Impact of the financial Crisis, 2011)

However, the situation is not as dramatic as in the US, especially due to European policies on:
- less involvement of European banks in the creation of new financial instruments that include both promotional and hide actions
- less expansive monetary policy
- the low value of the external deficit calculated on the whole European block

Although the European economic system as a whole has been saved by measures taken at EU and national level, the economic crisis has revealed the many existing weaknesses. One of the most important is the lack of anti-cyclical policies and control measures that can be implemented in case of destabilization of the financial market.

The impact of the crisis on the evolution of FDIs in the European Union

Between 2005 and 2010, the total value of intra-European trade increased by 19.1%. In 2010, trade in services in the EU-27 accounted for 56.1% of total exports and 58.4% of imports. Most foreign direct investment made by EU Member States was directed to 56% of other EU Member States.

In terms of value, commodity trade has gradually increased since 2005 and total exports have increased by about 18.9%. Since 2009, as a result of the crisis, trade in goods and services has fallen by 19.1% for goods and 9% for services. The increase has resumed since 2010 with higher values than previously recorded. Data published by Eurostat presents the situation as follows:

It can be noticed that the most drastic decrease was recorded in the FDIs at the inter-European level. For 2009, values of up to 60% are lower for this indicator. 2010 saw a return of all indicators to values similar to those in 2007. Statistical data is presented for the EU-27 as a whole, but the situation in each country is different.

Most FDI flows in the EU Member States are heading for other states in the Union. Luxembourg, France and Germany made the largest contributions to intra-European FDIs in 2010.

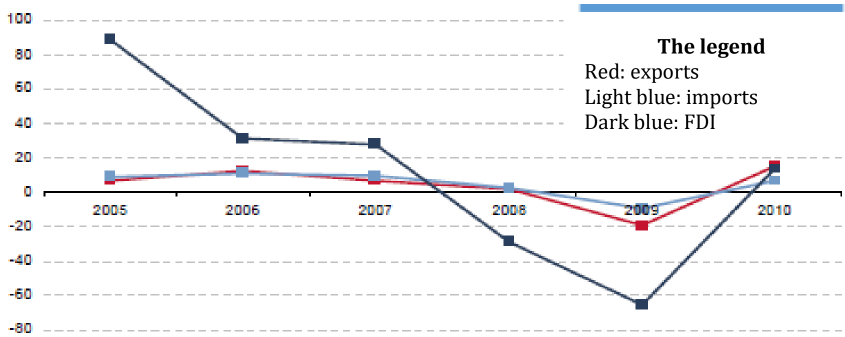

Figure 2. Development of imports, exports and FDI between 2005 and 2010 (Source: Eurostat External Trade Report, No 3/2012)

In the foreign direct investment sector, the economic crisis had a major impact, resulting in a sharp drop in the volume invested. The rapid resumption of investment is largely due to the encouragement policies adopted by the institutions as well as to the growing need for firms to remain competitive on the international market. A side effect of the economic crisis was the need to reduce costs from multinational firms. of the methods used was the relocation of production capacity to EU regions with lower costs, especially for labor. The effects are multiple. On the one hand, moving production to another country involves investment in that country, which has led to an overall increase in the volume of FDI. On the other hand, products made in less developed countries are exported, as evidenced by increased trade between EU countries.

The evolution of the production volume

However, the resumption of the demand for building materials should not be attributed to the development of new real estate projects, but rather to the need to continue and complete the already contracted works (Popescu, 2007). In fact, the strong reduction in demand for housing due to the cessation of lending and, on the other hand, to expectations of price reductions will very likely lead to a stagnation or even reduction of entrepreneurial interest in this medium-term domain. The optimistic expectations for the resumption of production are supported by another specific indicator such as the degree of utilization of production capacities in industry. It rises from 67% in February 2009 to 73% in March, indicating a relative revival of production.

Estimates on the use of production capacities

It should be noted, however, that in the context of the crisis, an asymmetric evolution of the analyzed branches is observed. This leads inevitably to a restructuring of the economy, to a repayment of the contribution of various branches to GDP. It remains to be seen whether the economic policies to be implemented in the next period will contribute to this structural adjustment process or will rather seek to "rescue" the sectors most affected by the crisis. Improvement of the economic outlook can also be corroborated by the positive trend of orders in these industries, whose production has a growing trend (the automotive industry, construction materials, oil production and derivatives).

The evolution of orders in industry and construction

In contrast, orders in the construction sector are slightly negative (the short term balance illustrated by the National Bank of Romania Draft March 2009 Bulletin is close to zero). Private entrepreneurs in the textiles, clothing, footwear, leather goods, transport services, energy infrastructure have reduced their production due to reduced demand for specific goods (both domestic and foreign).

Labor Market - According to the records of ANOFM, the number of redundancies increased in September-November 2008 by about one third compared to the same period of the previous year (with a maximum of 16.8 thousand people reached in November). The most frequent announcements to close down production capacities came from the industrial sector and especially from export-oriented branches (as a result of external demand contracting). These include: the petrochemical industry, metallurgy and metallic constructions, means of road transport and automotive components, machinery, electrical equipment and apparatus. Given the relatively high degree of specialization of these industrial segments, the re-employment or retraining of the redundant is difficult, which accentuates the size of cyclical unemployment.

The evolution of the labor force and unemployment rate

Unemployment rose by 0.1 percentage points from September to November, rising to 4.4% in January and 4.9% in January respectively. The deterioration of the labor market conditions is obvious and the forecasts also anticipate adjustments of the hired personnel in the following period. Also a factor that is meant to amplify the unemployment dimension in the coming period is the flow of labor migration back to other European countries, generated by worsening employment and social conditions in recipient countries.

The general tendency on the labor market is to reduce employment and, implicitly, to increase unemployment (in particular, cyclical) (Totir & Dragotă, 2011). A worsening of the employment situation will be felt in industry, especially in those branches that are forced to reduce their production of goods and services. There are, however, industries that, due to relative revival, have slowed the pace of layoffs.

In terms of wage growth, 2009 starts with a reversal of the trend. In September 2008, the gross average earnings were set at 1751 lei, increasing constantly until December to 2023 lei. The percentage increase reported in December / September is almost 16%. In January, however, there is a reduction in the salary of approx. 10% over the previous month, reaching an absolute level of 1839 lei. The explanations of a relatively late adjustment of wages in relation to economic activity should take into account the existence of rigidities of nominal wages (even in the private environment), keeping the contractual terms on wages that were negotiated at the beginning of 2008.

Analysis of labor market developments allows important conclusions to be drawn. The first shows a worsening of the unemployment situation in the economy, even if the unemployment rate is around what economic theory called natural rate. The second concerns the increasing pressure on the social security budget as a result of the increase in the volume of transfer payments (unemployment aid, etc.) committed from the budget (Mărginean, Stanef & Crețu, 2011). Or, given the existence of an already large budget deficit, there is a need for a rethink of economic policies in the field. A third conclusion shows that the evolution of wage earnings, especially from the private sector, correlates with the economic situation and the expectations regarding future developments. We cannot say the same thing about the public sector. Except for certain staff reductions invoked by the government (or, rather, the freezing of vacancies in the flowcharts of central and local) blocking certain bonuses they were not taken real reform so as to achieve a reduction the weight and role of the state in the economy.

The level of investments (gross capital formation) registered a pronounced negative evolution starting with September 2008, the month in which the signs of the global crisis have become more and more acutely felt in the Romanian economy.

Estimates of investments

During this period, it can be noticed that the reduction of investments in construction will continue in the next period. A similar development will also be recorded in the manufacturing industries, electrical and electronic equipment. The downward trend will be present mainly in industries such as metallurgy, metal, construction, chemical, and energy transport, methane gas.

Inflation rate - The annual inflation rate has a downward trend, but remains at levels above the variation range.

Inflationary pressures remain strong - mainly as a result of rising food prices and lax wage policies adopted by politicians in the run-up to elections. In the second quarter, Romania ranks first among the 27 EU Member States, with a growth rate of 9.3% rate projected for 2008 - 9.1%).

In 2008, the current account deficit (main vulnerability) increased significantly; it is forecast that by the end of the year it will reach 18.6 mild. EURO (13.4% of GDP).

In the first 8 months of 2009, Romania attracted foreign direct investment of 6.5m. EURO; they will likely reach 8-10 mild. EURO at the end of the year (Păun, 2010).

Conclusions

The banking system is particularly complex because of the multiple ways in which it acts on the overall economic system. The main role of banks is to attract financial resources in the form of deposits and to capitalize them in order to obtain profit.

At the level of activities, however, there is a strong diversification of the operations executed by banks (Mărginean & Orăştean, 2011). Diversifying the work of these institutions changes how they affect the economic system as a whole. The latest economic crisis highlights this. Due to the large number of financial instruments and the increasing complexity of transactions between the various financial institutions, major system failures have prompted the international crisis to spread the crisis.

Romania was less directly affected by these factors because the domestic banking system still relies heavily on traditional financial instruments. The lack of so-called toxic assets has diminished the contagion effect on Romania (Mărginean, 2011). However, the country has been indirectly affected by the overall fall in international consumption and foreign direct investment. These two factors led to a strong economic contraction in 2009-2010. 2011 marked the beginning of a stabilization period, with the main economic growth indicators reporting its upward trend. Favorable outcomes have been achieved through sustained efforts by the authorities and the NBR to manage fiscal and monetary policy. The main threat currently present for Romania is the cessation of the economic growth process. This can happen either due to the misalignment of control over the economic system or due to the decrease in international consumption (Băcescu, 2004).

For the other countries in the European Union, the impact of the crisis has been strongly felt due to the links between European and American banks. The share of toxic assets and bad loans in the portfolio of these banks has led to important problems and, in many cases, to the need for state intervention as a last resort creditor. Each state has implemented its own anti-crisis package and, although there has been a correlation at European level, the results are very different in the case of national economies (Aglietta, 2001).

For the whole of the European Union, the crisis has revealed some errors in the international financial system and has destabilized the classic conceptions that some institutions are too big to fail. The dependence of the European economic sector on the functioning of the financial and banking system has led national governments to intervene in order to avoid stronger adverse effects in the future.

Economic cycling is a known and proven phenomenon on many occasions. The lack of a set of anti-cyclical measures that can be implemented in similar situations is a major weakness of the European economic system.

One of the most important factors in the propagation of the crisis was the circulation of banking assets between institutions. The possibility of reselling risky assets as part of low-risk packages is a relatively recent practice, which has been favored by some leaks in the US and European regulatory system. At present a considerable effort is being made to strengthen control over financial institutions, but their increasing negotiating power could lead to similar effects in the future.

The 2008-2010 crisis is not the first of its kind in the last century. There have been many similar periods in recent history, but the seriousness of the current situation is largely due to the increase in trading speed and the diversification of financial instruments. In the future, none of these intensifying factors will disappear and will not diminish its importance. For this reason, it is all the more important to exercise good control over the system while avoiding choking it. Finding this balance is one of the greatest challenges of the present century (Haralambie, 2011).

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