

FINANCIAL GLOBALIZATION - FROM CHALLENGE TO CRISIS

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Globalization – a process or a phenomenon very much discussed, appreciated by some persons, contested by others – represents a reality of those consequences are felt by each one of us. Information circulates faster and faster, the access to information is easier because of the technological evolution and this thing makes that the environment in which we live to modify continuously. The speed with which information circulates, the level of development of the communication means determines the elimination of the temporal and space barriers from the humans' development. Each area is influenced by this process and the financial markets not only are an exception but these can be considered a real engine of the globalization. It is obvious that we can't talk only about a national market but of a financial market which works at a global level.

Financial globalization doesn't represent a new phenomenon, but the size and speed which phenomenon knows it is without any precedent. The connections between states and the interdependence between financial systems are more emphasized than ever.

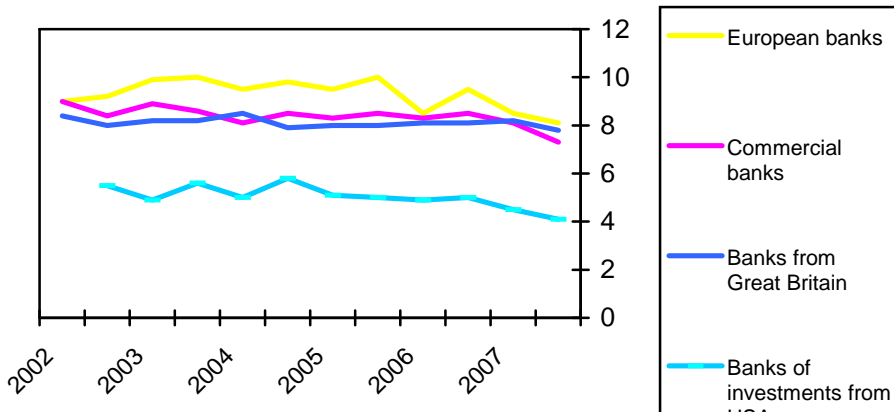
More, the dynamics of the present crisis of the mortgage credits constitutes a proof of the way in which globalization modifies the reaction of the financial system at shocks.

The worse problem created by the underpremium crisis is on the credits' market. The financial crisis spread also into the real economy through the credits for consumers and for enterprises, because the financial institutions are confronted with an acute crisis of liquidities. To avoid an obstruction of the credit market, central authorities, especially those from USA have interfered. In fact, it is very well known the theory of Ben Bernake, according to this the loss of banks¹ followed by the slow down of the credit rhythm will lead to a moderation of the economical activity and to a diminution of the goods' value which constitutes a mortgage for the credits, creating in this way a negative spiral.

In fact, the solvency ratio of the banking institutions diminished as a consequence of the mortgage credits' crisis.

¹ Loss of the banks are according to Bloomberg approximately 400 billion dollars

First graphic. The evolution of the solvency ratio at the banking institutions



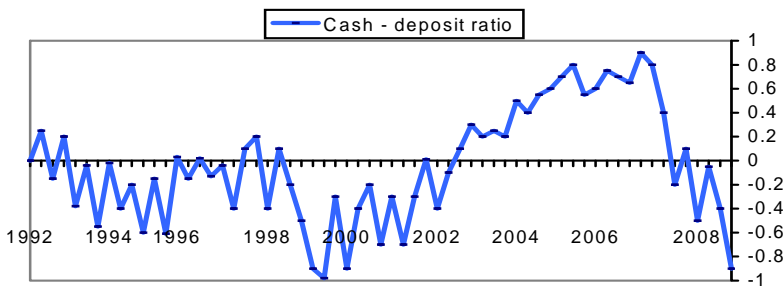
Source: Bloomberg

To stop these negative effects the Federal Reserve dropped the interest from 5,25% to 2% and financed the banking system with liquidities of 400 billion dollars.

Still, what appeared to be an subevaluation of the risk on the mortgage credits market from USA proved to be one of the biggest crisis from the last ten years. The hedging funds watched as a

source of the systemic risk have reacted better than the regulation institutions. The market between banks considered to be one of the most efficient and liquid suffered a series of malfunctions, especially in the aspect concerning liquidity, as it is shown in the next graphic.

Second graphic. The evolution of the liquidity on the financial market



Source: Bank of England, Financial Stability Report, Aprilie 2008.

These deficiencies raised a series of problems to the regulation authorities. First and the most important is the liquidity risk which in the Agreement Basel II is not mentioned.

As a consequence of this fact, The International Bank of Regulations took the decision to publish at the end of the year a set of standards to regulate this risk. Mainly, the liquidity risk with which has confronted the banking

institutions was administrated through facilities offered by the central banks.

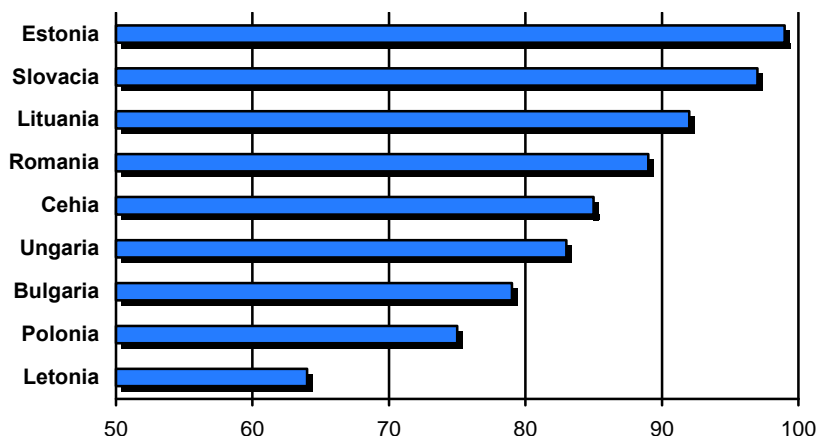
Thus, the present events guide us to another thinking of the features and effects of globalization. The social-economical consequences transmitted by globalization of the economy and advantages or disadvantages of the banking-financial globalization can't be outlined without having a new vision

over the dimension and complexity of this present process which is determined, mainly, by three characteristics.

First of these and probably the most powerful is the financial innovation. The process of innovation which marked the financial markets from the last twenty years lead to the creation with the help of the financial engineering of the derivative products form the stock exchange and outside. These, at their turn, became important instruments for the risk of management are used in an investment purpose by the companies, financial institutions, individual investors. For example, the credits' portofolio of the banks can be transformed into a series of titles with a negociable value. Those are then sold to financial markets, in packets, with a different risk to certain investors, banks can benefit of new resources and investors of important results. Financial institutions can in this way to administrate efficiently the exposure and to transmit the risk to those investors which are capable to control it.

A second characteristic is the fact that economies become more open from the financial point of view, especially the economies in the development process. Through its instruments: international trade, financial international flows, direct foreign investments, the globalization creates favorable conditions to expand this flows; financial transactions occupy on the exchange markets a higher percentage than the international trade; the intensity of the relations between countries was possible thanks to the fast liberation of the commercial system and to the investments in the countries in process of expansion and through the progresses of the technologies and other means of telecommunication. In the economies from Central and Eastern Europe the banking assets are hold, mainly by the foreign institutions.

Third graphic – Banking assets hold by foreign banks (2006)



Source: The Economist, A special report on international banking, Mai 2008.

This fact was determined mainly by internal factors. From those factors we mention the financial freedom and non-regulation which lead to higher investments. The liberation of the capital account, more flexible policies of the exchange rates, the opening of the

capital markets were measures which attracted many foreign investments.

The third characteristic is the fortification of the role and importance of the financial institutions, from those we mention: banks, hedging funds,

funds of “private equity”. These have a few common features:

- ✓ play an important role in the assurance of the efficiency of the market and offer liquidity to the capital market;
- ✓ use complex strategies for investments;
- ✓ use advanced methods for the administration of the management risk.

These features lead to an improvement of the economic area in which the financial institutions act, trend obvious for the emergent economies, but also created and a strong dependence of the health of these economies to the financial conglomerates. These can generate problems regarding the monetary stability thanks to the important role that they have for the equilibrium of the financial markets, they raise certain problems concerning the transparency and their role in sustaining the financial stability. In this context, because many aspects regarding prudence included in the some field directions (which are addresses to banks, investments societies) weren't stipulate at the level of financial groups, the European Union adopted rules in harmony with other concerning the prudential control of financial holdings in order to limit the risk that their activity to be one that makes unstable the European financial markets and these are: the Directive no. 2002/87/CE known under the name of Financial Conglomerate Directive.

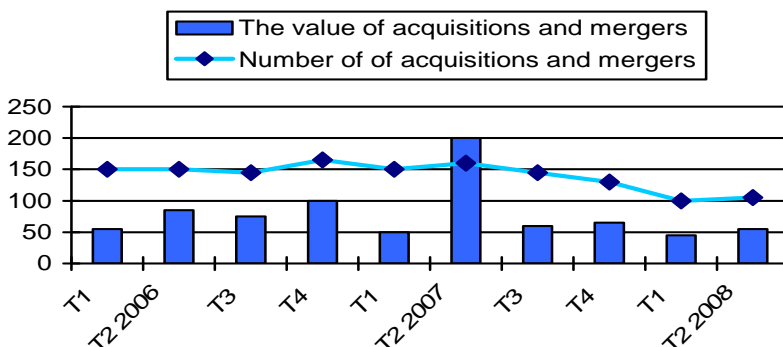
In what concerns the consequences of the financial globalization we will analyze two of the most important.

First of all, the globalization increases the efficiency of the financial markets. Because of this, such as of the technological process and incorporated in the assets' price which leads to a dimension closer to the truth of the risk.

The efficient allocation of the capital represents the ability to place resources in a way that leads to maximum their value. The operational efficiency gained also because of the globalization because the cost of the finance diminished as a consequence of the competition.

The process of allocation of the capital can be outlined also through the trend which manifests at the global level to concentrate the resources. This trend manifested by increasing the number of banking acquisitions and fusions, even if, in the present the economic conditions aren't so favorable as we see in the fourth graphic. Still, in the future, it says that will be a reorganization of the banking system and also an increase of the number of acquisitions and fusions as a consequence of the diminution of the financial power of certain financial groups.

Fourth graphic. The evolution of the banking fusions and acquisitions at global level



Sursa: The Economist, Under the hammer, 10 July 2008

Another consequence of the globalization is made up by the fast maturity of the emergent economies. International Monetary Fund predicts for 2007 and 2008 that half of the economic

growth, at the global level it will be registered by the emergent economies. The same trend is registered and for the financial conditions of this country.

Table no. 1. The evolution of ROE and ROA at the European level

	2003		2004		2005		2006		2007	
	ROE	ROA	ROE	ROA	ROE	ROA	ROE	ROA	ROE	ROA
Austria	7,0	0,3	14,8	0,6	14,8	0,6	16,9	0,7	18,3	0,8
Bulgary	22,7	2,4	20,6	2,1	22,1	2,1	24,4	2,2	25,4	2,5
Czech Republic	23,8	1,2	23,3	1,3	25,2	1,4	22,5	1,2	23,1	1,3
Greece	8,9	0,6	6,4	0,4	15,9	0,9	12,8	0,8	20,1	1,3
Italy	7,4	0,5	9,3	0,6	9,7	0,7	11,5	0,8	-	-
Polland	5,4	0,5	17,1	1,4	21,9	1,6	21,0	1,7	25,6	1,8
Romania	15,6	2,2	18,5	2,4	15,2	1,9	11,7	1,5	11,4	1,3
Serbia	-1,2	-0,3	-5,3	-1,2	6,7	1,1	10,0	1,7	12,8	2,1
Hungary	19,3	1,5	25,3	2,0	24,7	2,0	24,0	1,8	22,9	1,8
European average	11,3	0,5	13,7	0,5	15,0	0,5	16,7	0,6	-	-

Source: International Monetary Fund , Global Stability Report, April 2008

In the next paragraphs we will identify the main challenges of the financial globalization and the way in which this affects economies.

First of them refers to the low impact of the monetary policy generated by the financial globalization. In the last years, the relation between monetary policy and financial stability was analyzed careful. The financial and monetary stability represents the medium purpose of the state policy.

The financial stability affects positive the prices stability. First of all, promotes an offer of credit and capital flow which are stable and essential for a harmonious expansion of economy. Second of all, financial stability sustains the mechanisms of transmission of the monetary policy.

A financial stable system assures the transmission of the modification of the monetary policy instruments over the market rates. That is way, the changes in the monetary policy will affect the consumers and companies behavior and

last of them the inflation and the economic activity.

In addition, the stability of the prices has at its turn a positive influence over the financial stability.

An efficient monetary policy will promote financial stability by eliminating the contradictory signals transmitted by prices which are associated with high and volatile inflation. Low and stabile inflation offers to population and companies clear indications regarding to the modification of the relative prices. As a consequence the allocation of resources will become more efficient. Some specialists have shown that, because of the capital markets integration, the interest rates will become equal in most of the countries which will lead to the diminution of the central banks' abilities by the countries with low interest rates, thing which creates a dilemma for central authorities; attracting a high flow of

foreign investments or the control of inflation.

A second problem is the faster spread of the risks at the global level. Globalization, synonym with economic and financial integration leads to a larger transmutation of the conjunctural exchanges, especially of those produced in USA, taking into consideration the important role of the US economy.

Thus, USA contribution at the world GDP reaches 20,50%. In the financial plan, this percentage has a higher level, the percentage of the US exchanges towards the global exchanges is 25% in 2007 knowing a descending evolution, in the '90 this percentage was

32,8%. Also, the intensification of the financial relations had as a consequence to the growth of the percentage of US assets which are hold by the other states. The percentage of the US assets hold by the countries from European Union increased from 3,1 % from GDP to 14,1% in 2005. Studying the connection between the consequences of the recession from USA and industrial countries we notice a close correlation, the diminution of the US GDP leading also to a limitation of the GDP from these countries as we can see in the following table.

Table no. 2. The correlation between US economy and industrial countries

	1974 -1975	1980	1982	1991	2001
United States of America	-6,1	-3,4	- 4,5	-2,1	-2,9
Industrialized countries	-5,4	-1,5	0,4	-1,3	-2,0

Source: International Monetary Fund

In conclusion, the financial liberation, which manifests for 20 years (faster or less faster in different countries) materialized mainly in: the acceleration of the financial innovations, high non-regulation, financial globalization, expansion of the capital markets reflecting a trend of non-interfering. The financial system

becomes, thus more efficient as a direct result of globalization and innovation, but not necessarily more capable to absorb the shocks. Concerning the regulation authorities these must stay vigilant and flexible, to elaborate, in this purpose models which have to surprise and correct the not favorable dynamic of the economic cycles.

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