IMPACT OF SYSTEMIC BANKING CRISES ON MACROECONOMIC POLICY

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Abstract

Application of provisions of macroeconomic policy in order to ensure the stability of the banking system, especially, of the financial system as a whole is one of the strengths point of the concept of sustainable development. From one side, management of systemic risk requires orientation of supervisors bodies in monitoring of the situation and to follow the evolution of national banking systems, as a whole, combined with monitoring of monetary policy and microprudential supervision of banks. From another side, real system interacts strongly with the banking system, which generates consequences for banks and financial stability. Motivation for choosing this research topic arising from its novelty and, also, uncertainty of the concept of systemic crisis and involving macroeconomic policy provisions in the banking sector.

Key words: banking sector, economic crisis, banking systemic crisis.

JEL Classification: G15, E01, G01.

Introduction

Conceptual aspect of the notion of systemic banking crisis has been studied and analyzed by many economists, like Lestano J. J. [11], G.E. Hodachnik, E.M. [8] Korotkova, G. Soros [13], *Pranee T.* [12], *Glick R*[7]*,* among them we can meet and *Kovzanadze P.*, that think that "systemic banking crisis - the rapid and large-scale deterioration of the quality of bank assets under the influence of unfavorable factors of macroeconomic, institutional and regulatory nature" [6].

Of course this definition may be completed on forever, because the levels where can be caused a banking crisis are different, involving not only commercial banks but also central banks, having a big influence on the whole economy.

Description of the problem

From information presented in the specialized literature is observed that the most telling is the liquidity crisis which has a considerable impact on the entire banking system, as does Sweden in 1991 when Central Bank invest significant funds in the banking system. Following this, the insolvent commercial banks were nationalized and highly profitable investments were restructured through the issuance of long-term debt obligations. As a result, despite the huge financial resources mobilized to overcome the crisis, it did not have a destabilizing effect on either inflation or the budget sector. Its impact has been limited on the microeconomic level. The banking crises can be divided into three groups presented in the figure 1.

The concept of "system" requires us to find answers for questions like: why systemic crises are dangerous? or that are their impact on the economy and macroeconomic policy?

The crisis concerns only one of the banking sectors of the national economy (ex. banking crises in Spain 1978-1984, in Argentina 1995-1996) or even a single category of credit institutions (for example, the crisis of storage banks in the United States at the finish of 80th years) [6]. Other sectors of the national economy at this moment show the necessary stability.

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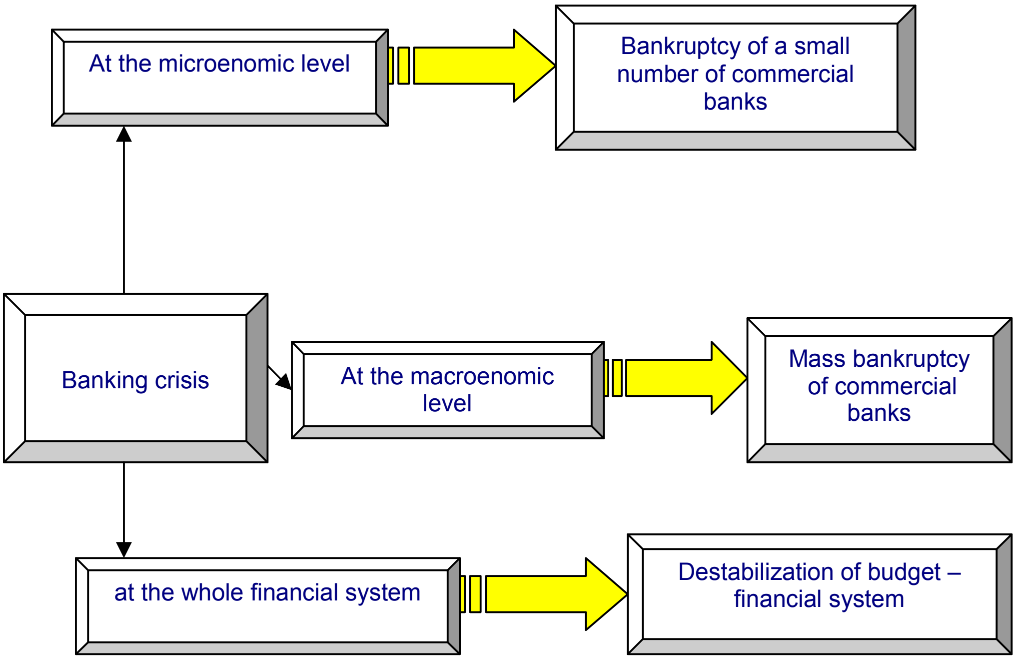

Figure 1. Types of banking crises

In countries with transition economies, on the contrary, increased systemic crisis in the banking sector has led to an immediate aggravation of the political crisis, which causes a permanent financial crisis. The problems of overcoming banking crises in transition countries is that they coexist and simultaneously aggravated with crises taking place in nearly or in all sectors of the national economy, except, perhaps, the informal sector, including shadow and criminal business that best uses the crisis with maximum benefit for themselves. Crisis even more covered sphere of social relations. In other words, in transition countries, there is something more than a banking crisis, which should be considered as separate, but a very important part of the general crisis of the political-economic system. That's why, the western technology of banking restructuring sometimes get not only a strong inhibition, but negative results.

If in countries with market economies in the moment of banking crisis in the credit sphere along with critical structures continue to function healthy, sustainable, competitive lending institutions that consist the most significant part of the system, then in countries with economies in transition all credit institutions have difficulty, including the lender of last resort and the public finances. New commercial banks in transition countries are usually problematic organization which commits difficult transition from total state protectionism in the credit system to banking autonomy.

Obtaining autonomy, new banking structures, in the initial stage of this transition is too closely associated with the state budget, has a chronic deficit and is therefore they a universal source of infection. Banking structure of market countries is completely independent of the state budget, and their situation does not directly affect their financial stability.

We can agree with the experts of the International Monetary Fund that the forms of manifestations of the banking crisis in all countries, without exception, are universal. These are indicators of bank failure.

So, at the macroeconomic level the difficulties may be related to the following aspects:

- increase in crediting, which in some degree is caused by the increasing investment or changes in tax laws;

- rapid development of so-called "soap bubble" in real estate and/or securities spheres, which terminate their activity;

- slowing down the economic growth and/or reduction of export transactions, or loss of export markets;

- excess in productive capacity/ decrease in profitability in the real economy;

- the growth of the budget deficit and/or of the current balance of payments, reduction of public debt service capabilities;

- sudden changes in exchange rates and interest rates, etc.

The question of what factors caused the development of the modern global financial crisis, is still debatable. Most analysts tend to believe that is caused by a combination of number of micro and macroeconomic factors.

Methodology and data sources

Characteristic for macroeconomic conditions is a long period of excess liquidity, partly due of low interest rates, which has been established after the recession in 2001. Excess liquidity fueled internal demand and initiated the growth in property prices, which almost doubled in the period from 2000 to middle of 2006.

Macroeconomic factors resulting from financial regulation (or its disadvantages) and policies of credit institutions have also played an important role in inflating the “financial bubble”.

According to this approach, banks gave loans for sale to other financial institutions, which from them formed pools and issue securities insured by assets. These tools were the basis for the new structured products.

From 1970 to 2011 alone, Laeven and Valencia counted 147 systemic banking crises. They identified a systemic banking crisis when signs of market financial distress, such as losses, liquidations and/or bank runs occur and when policy intervention measures to deal with significant losses are introduced. The authors identified a systemic banking crisis if two conditions:

- significant signs of financial distress in the banking system;

- significant banking policy intervention measures in response to significant losses in the banking system, are met.

Based on these criteria, 147 crises were identified. For these various crises, the authors gave information on policy responses (deposit freeze, guarantees on bank liabilities, liquidity support, nationalizations, recapitalization, expansionary monetary policy, expansionary fiscal policy) and on the outcomes of banking crises (fiscal costs, output losses, increase in public debt and peak in non-performing loans).

Laeven and Valencia noted that monetary and fiscal policies are used more extensively during banking crises in advanced economies than in emerging and developing countries, possibly because advanced economies have better financing options to use countercyclical fiscal policy and generally more space to use monetary policy.

However, the same authors also noted that such countercyclical policies, while used to avoid a sharp contraction in economic activity, risk slowing down actual bank restructuring that would allow banks to recover more quickly and renew lending to the real economy [9].

There is therefore a risk of prolonging crises by depressing growth for a longer period of time. In addition, increase in public debt may in turn lead to slower growth and further depress the economy. Finally, Laeven and Valencia found that more targeted interventions, such as bank recapitalisations, were associated with more positive outcomes than less targeted actions [10, p. 147 – 177].

World experience shows that choosing the best way out of the financial crisis may be different. Among experts there is no consensus on the question of what should be the structure of anti-crisis actions. Some emphasize the need to reduce budget expenditures to overcome the crisis, others - minimizing the loss of national income and to accelerate economic recovery, and others - to achieve long-term structural reforms. As rule, governments have a certain choice of measures to overcome financial crises. Determining factor in the development of appropriate policies is to understand the role of redistribution of taxpayers in favor of banks and creditors, accepting the major consequences of the crisis.

Such redistribution is capable of restoring productive investment, but it is associated with high costs for financial support and indirect costs, associated with inefficient allocation of capital and the reduction of economic incentives, that may appear after the crisis.

In order to prevent the development of the banking crisis and its becoming into a systemic crisis are important rapid adoption and implementation of government actions. For this it is necessary to determine the magnitude of potential bank losses and develop ways of adequate banks recapitalization.

Recapitalization program must be selective, to establish clear rules for banks' access to refinancing. These long-term studies shows that for recovering the financial health of the indebted firms are most effective restructuring program clearly defined, even if their implementation also requires public funding. Graphically stages of appearance and development of the banking crisis are shown in figure 2.

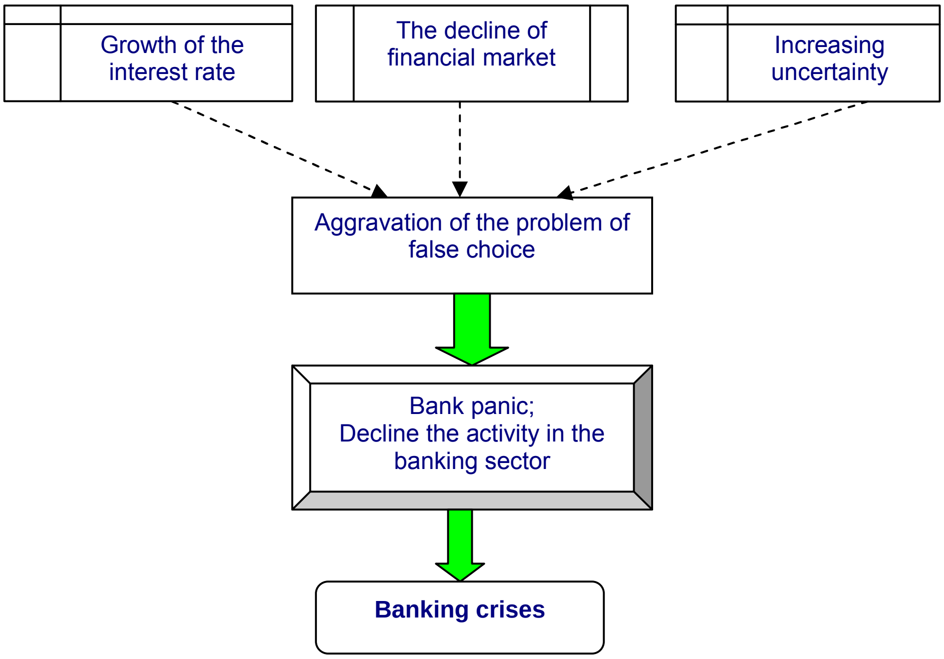

Figure 2. Stages of development of a banking crisis

Therefore, the countries in transition need most recognition of the special status of their system of crisis of the banking sector. Rapid political and economic decisions directed at restructuring commercial lenders are required not only to consolidate the banking system, but also to restore the stability of credit and cash-payment sphere. From this, we can say that another important feature for overcoming the banking crisis in the transition countries is to ahead the overcoming of unresolved problems in the organization of settlement and payment sphere, covering the banking sector, along with the real economy and public finances.

Results obtained

We can formulate few lessons of the last crisis, most clearly manifested in our country and in many foreign countries.

First, financial crisis, as a rule, being a consequence of the economic crisis, in the modern world can become the first cause of it. That’s why, for maintaining a sustainable economic development (or to prevent its decline) is extremely important to be a stable and effective functioning of the banking system, of the financial markets, providing its liquidity, and the continuity of the performance of their functions;

Second, to the systemic banking crisis, as well as to appearance of problems at individual banks, it is necessary to prepare in advance, giving to the supervisor organs and to other members of the system to maintain financial stability with necessary powers, wide tools, instruments and sufficient resources, including mechanisms for early detection of banks problem (such called early warning systems), immediate supervisory action (such as prompt corrective actions), the orderly liquidation insolvent credit institutions;

What we observed in the first phase of crisis development - it was in most cases forced actions, in the conditions of absence of prepared instruments for solving arising problems. A such situation was in the U.S.A. and in the UK.

Third – it is necessary a complex regulatory and supervisory system, providing early detection and adequate regulation to systemic risks and threats that arise due to the emergence of financial innovation, the distribution of new financial products, changes in business processes and practices of activities of financial institutions;

The result of this need, in particular, was the creation of the Council for Supervision of the Financial Stability in the United States, the European Council for Systemic Risk, the Council for Financial Regulation and Systemic Risks in France;

Fourth - large, systemically important banks and financial groups require special regime of prudential regulation and supervision, and failure regulation. However, non financial institution should not be considered “too big and too complex to fail”.

Insufficient efficiency of the consolidated supervision in the conditions of lack of transparency of property structure and intra-group relationships can increase systemic risks, threatening the stability of the financial system as a whole.

Of the need for special attention to systemically important financial institutions is confirmed by the work, provided in this area by the Council of Financial Stability, published in November 2010, recommendations to strengthen the supervision of such institutions and the solutions of “Big Twenty”, where, at its summit in Seoul has adopted these recommendations, noting that for reducing of moral risk, created by systemically important financial institutions, and the solving of problem of “too big to fail” requires a complex system, combining the “mechanism of bankruptcy procedures and other measures, ensuring a safety and quickly elimination of all financial institutions, without destabilizing the financial system, without putting taxpayers at risk of loss; requirement that systemically important financial institutions ... must have a wide set of instruments to cover losses in order to calculate a greater risk that the bankruptcy of these firms creates for the global financial system; a solid base of infrastructure for financial market for risk reducing associated reactions, related to bankruptcy of individual firms; and other additional prudential and other requirements, set by national authorities, which in some cases may include additional liquidity deductions, tighter restrictions for large open positions, accumulations and structural measures”.

It should be mentioned that in this sphere must be done much things and in Republic of Moldova. It would be useful to define the concept of “systemically important financial institutions (groups)”; it needs to be better elaborated the state policy related to such organizations;

Fifth - for visible liquidity problems, which worsened during the crisis period and determined governments and central banks to provide unprecedented support for a large number of banks, often hidden real internal problems, namely excessively risky banks policy;

And finally, the sixth - the effective functioning of the system of deposit insurance is capable of exerting a significant stabilizing effect on the banking system and social stability in society. This is confirmed by the experience of national and international practice in general.

Macro prudential policy is called to identify and mitigate risks for systemic stability, reducing costs of the economy in case of failures in provision of financial services, representing the base for work of the financial markets (such as the credit provision, as well as insurance and payment services [4].

Concept of macro prudential approach – is not a novelty [1], but only after the global financial crisis, governing authorities are fully aware of the probability and costs of system failure in modern financial markets and the need for controlling systemic risk. As a result, this approach is still in the development stage [3].

Taking in consideration fact that macro prudential policy is at an early stage of implementation, it must solve three important tasks before it can become effective:

- construction – or improvement – its institutional basis;

- development of an analytical basis for the effective monitoring and assessment of systemic risks for direction of corresponding policies measures;

- realization of international cooperation.

Creating an analytical basis that would early detect systemic crises and would involve instruments of macro-prudential policy on time, is one of the priority problems that should be solved not only at national level but also at global level.

Have been made attempts to develop a single indicator of the general systemic risk, which could activate the macro prudential intruments. But in spite of attractiveness of such statistics - because it would be easy to explain and use for assessing the effectiveness of measures of this policies – has not found yet such an indicator.

Instead of this, governing authorities tend to use a set of indicators [5]. This approach recognizes that systemic risk is not limited to one aspect.

Additional information can also help governing authorities to determine which tool or combination of tools most effectively decided potential problems. For example, for measuring the overall risk, macro prudential authority should monitor the overall credit risk, liquidity risk and market risk, and the concentrations of any of these risks in a particular sector, such as housing or consumer credit. Then he has to analyze these risks, in order to decide witch is the most effective policy instruments for their overcoming.

Even the best of macro prudential policy is not able to prevent all financial crises. This means that its need a reliable and flexible creditor of last resort - usually the central bank - to solve the temporary liquidity shortages. More, macro prudential policy does not operate in a vacuum. Prudent monetary and credit policy, fiscal policy and expenditure policy are necessary for creating sustainable conditions, able to develop a health financial system.

Conclusions

Finally those reported suggests us the idea that the systemic banking crisis is a negative phenomenon that have consequences on the global level, being closely correlated with macroeconomic policy promoted by the state.

Those analyzed in this study allow to note that the impact of systemic banking crises on macroeconomic policy is one considerable, being affected the banking sector and generating expansion of "speculative" business.

Degree of impact of the crisis on the banking system depends on many factors, such as micro -and macro. But the main reason - the situation of the economic system of the country at the beginning of the crisis. Countries with market economies have certain measures to prevent the banking crisis. Countries with economies in transition also need to develop their own economic strategies, taking into account international experience already existing.

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