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THE EFFECTS OF THE INTERNATIONAL FINANCIAL CRISIS AND THE GOVERNMENT'S INTERVENTIONS

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Abstract

The stock exchanges have a great role in the efficient function of the financial system of the country because they represent the mechanism for properly direction of savings and for stimulating the investment that, in matter of fact, represent the base for the greater economic development. The events on the stock exchange are one of the basic factors for set up the scenes and for transmission of the actual financial crisis all around the world.
The actual financial crisis that escalated as a result of the "mortgage-crisis" in the USA spread very quickly in the countries all over the world and caused problems not only in the financial sector, but in the real sector in different countries.
The aim and the purpose of this paper is to represent the situation of the global financial market at the moment and to analyze to which degree the Macedonian financial market is vulnerable to these external financial shocks.

Key words: *International financial marker, Macedonian stock exchange, financial shocks, banking sector, financial crisis, government intervention, liquidity.*

Introduction

The stability and the efficiency of the financial system in every country, above all, depend on the way that the banking sector and the securities market function. Namely, the banks are the major mediators of the citizens' and companies' savings. In today's conditions of inefficient banks the saving is taken in a wrong way and aridly in the aspect of the entire economic development. The stock markets also, have a great role in the efficient functioning of the financial system of the countries because they represent the mechanism for directing the savings and stimulating the investments that is actually, the basis for achieving bigger economic growth. In the paper's continuance an analysis is made- that is to say- how the irregularities in the functioning of the banking sector in one country can be the reasons for appearance of a major economic crisis that via securities market grew into global financial chaos.

1. Development of the American financial crisis

The experience related to the appearance and influence of the financial crisis shows that the eventual disturbances in the securities market can cause serious consequences on the financial stability in one's country. In the past, the events and the happenings in the world's financial stock markets were the reason of appearing and overthrowing the consequences of the modern financial crisis all over the world. These kinds of events that are happening currently are characteristic for the American financial market and they caused very bad and difficult situation that hasn't been noticed since The World's Economic Crisis in the 30's of the last century.

The American financial crisis began as a mortgage crisis, but it spread in the USA's banking sector and in a short period of time in other countries in the world. Namely, we talk about the credit's crisis which began on 9th of August 2007 when the prices of the credits started to rise severely. The American corporations couldn't withstand the competition in the industrial production because the labor's price was high, and the businesses began to use the cheapest ways of making money. The banks offered loans, not for production investments, but for spending credits using the citizens' estates as a guarantee. In this process of financing, the banks realized the biggest incomes through issuing credit cards and small amount of loans. According to this trend, the western banks and the advertising companies engaged in this process and the result was a boom in the spending credits.

In the period between 2004 and 2006 the prices of the real estate, especially the houses raised quickly which was a serious problem for those who bought a house for the first time. The creditors solved this problem in such a way that they lowered the criteria for loans' guarantees. First, the creditors made a mix of the new loans with bad quality with quality mortgages and bonds, and then they put them in debt packages and were selling them to the investors all over the world. That process is actually turning the mortgage loans into securities.

The credit's policy of the American banks caused a debts' rise in the households so they owed as much as the American economy can produce in a year. The biggest part of the means was used for investments in the real estate market and it resulted in creating a bubble in that market that in the end had to blow.

The blowing of the bubble in the real estate market and the rise of the unpaid mortgage obligations, actually, meant that less and less number of owners of the houses were in a position to pay off their monthly obligations. The institutions on Wall Street couldn't pay off the mortgage securities that were used as a guarantee for the bigger debt to be supplemented with new investments. These institutions were stuck with those securities with suspicious value, so they had to get cash or to sell those stocks. With this kind of action the prices of these securities were reducing much more. Faced with such huge debts and the fall of there assets, the banks rarely gave credits or they fully gave up of issuing them and by doing that the whole financial system was close to destruction.

The fall of the American financial sector is a serious threat that can cause a recession not only in the USA, but in great number of countries all over the world, that actually is happening at the moment.

a. The situation in the American financial system and government interventions

Thankfully to the process of the globalization, which is one of the channels for transferring the crisis effect, the negative consequences of the financial crisis were felt not only by the developing countries but by the developed countries too. That was the case with the American financial crisis, which, almost overnight, the crisis began to affect the other parts of the world. In these kinds of dramatic conditions a question is being asked- What do the responsible people from the developed countries undertake to reduce and eliminate the influence of the financial crisis?

The decision of the Federal Reserve's to leave The Lehman Brothers Bank to bankrupt aroused series of chaotic events. During this period, in only 96 hours, strange things happened on the American market. What happened actually? Lehman Brothers Bank is the fourth biggest investment bank in the USA which because of the debt of 613 billion dollars had the need of capital enlargement. This bank was in such position that the prices of the shares fell continuously and no one was ready to buy it without the government approval and guarantee. This bank hadn't got any other solution than to bankrupt. Also, Merrill Lynch, a bigger investment bank was forced to sell itself to The Bank of America. Table 1 present the major banks that have crumbled or been bought out during the global financial crisis.

Table 1. Banks affected by the global financial crisis - 2008

Bank	Date	Status	Website
Fannie Mae	07 Sep	Nationalized	Fannie Mae
Freddie Mac	07 Sep	Nationalized	Freddie Mac
Lehman Bros	15 Sep	Collapsed	Lehman Bros
Merrill Lynch	15 Sep	Taken over	Merrill Lynch
AIG	16 Sep	Part-nationalized	AIG
HBOS	17 Sep	Taken over	HBOS
WaMu	25 Sep	Collapsed and sold	WaMu
Fortis	28 Sep	Nationalized	Fortis
Bradford & Bingley	29 Sep	Nationalized	Bradford & Bingley
Wachovia	29 Sep	Taken over	Wachovia
Glitnir	29 Sep	Nationalized	Glitnir
Hypo Real Estate	06 Oct	Rescue package	Hypo Real Estate
RBS	13 Oct	Part-nationalized	RBS
Lloyds TSB	13 Oct	Part-nationalized	Lloyds TSB

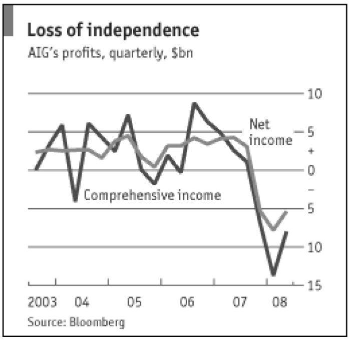
Source: http://news.bbc.co.uk/2/hi/business/7644238.stm, December 2008.

On the other side, the market pressures forced the federal reserves to take over the biggest insurance company (American Investment Group- AIG) in order to avoid its bankruptcy. Although, this insurance company had the largest market value of approximately 239 billion dollars, this wasn't the reason for its rescue. The government approved its rescue giving the reason that if this company collapsed, the financial market would undergo catastrophe, because it secures the biggest part of the commercial and life insurance in the USA. AIG caused systematic risk because of the bad work in working out the insurance deals that led to losing its fortune and wealth and then losing its independence too (Figure 1). The previous events happened just two weeks after Fannie Mae and Freddie Mac were saved by the government as well as after the saving of Bear Steams 1[15].

15) After the taking of Fannie Mae and Freddie Mac by the American government, there was an opinion in the public that the same will happen with the Lehman Brothers. That was exactly the problem. If the government did that, then they would confirm that they created the so called- moral risk and that the government itself was behind all the risky financial activities that were undertaken on the financial market. This decision will not end the credit crisis, but will put an end to a decade of moral risk. (www.economist.com, November 2008).

Figure 1.

The lost of AIG's independence



Source: www.economist.com, November 2008.

But, the AIG rescue didn't calm down the investors because the greatest crash of the American bonds happened the next day, even though they are considered to be the safest investments. The same situation was recorded in 1941, when the world was at war, and the USA was still recovering from the depression. In such circumstances the need for the gold grew up and simultaneously its price increased too. The gold world market tried to please every need, but there were less and less reserves.

The American financial investments that faced the bankruptcy as well as those which were close to that if they weren't saved by the government, had huge problems because of the lack of capital. This problem was the result of the high stockholders' incomes as well as the new banks' debts in order to supplement and fill in the investments.

The world financial market participants were in fear, because the world markets are at crisis, the trading on the world stock market decreases, the investment banks lose their trust and so on.

The American federal reserves and part of the European central banks reacted to these financial disturbances by "injecting" billions of Euros in a form of short term credits in order to stabilize the global financial market and to improve the liquidity. However, this wasn't their final intervention, because they continued to take over numerous measures to bring back the stability of the world financial market. In such a way, The American senate adopted the proposal given by the Bush's administration to save the financial sector. According to this plan, the American government set aside 700 billion dollars to secure the system. With the approved funds, the Ministry of finance will purchase the property that isn't liquid from the banks' balance and from other financial institutions and with such strategy the credit market wouldn't be blocked and the global fall of the stock market would be ended. But, the investors welcomed this decision with great attention because of the uncertain effect of the influence that this President's plan can have on the global finance market.

It is understandable that the government takes measures, but that can't improve the economy overnight. It is also very clear that the American economy needs time to recover its trust in the financial institutions and to escape from the financial crisis.

2. The influence of the American financial crisis on the international financial system

The process of financial globalization encourages the effects of the American financial crisis to spread out side of its borders. Also, the American financial crisis reflected on the shares' prices of the Asian stock market, and huge losses suffered one of the major Japanese and Australian banks that financed Lehman Brothers. Except for Asia, the crash was felt in other European countries.

This financial crisis was felt in Iceland, where in the previous period of time, the three biggest banks were being nationalized and they collapsed because they were not in a position to pay out depositors. The stock market collapsed too and the national currency lost almost half of its value. The losses of the financial sector in Iceland will be greatly felt in England and in Wels, because they invested great deal of funds in the banks that faced crash.

The consequences of the financial chaos weren't felt only in the English municipalities; they were also felt in the English bank sector. Namely, the British bank "Bradford and Bingley" had serious problems as a result of the global financial crisis and that's why the government decided to nationalize it. Before this bank, "Northern rock bank" was nationalized and the powerful bank group HBOS that consists of "Halifax bank" and "The bank of Scotland" had to be immediately saved from a bankruptcy, by being taken over by a smaller bank called "Lloyds TSB Bank".[16]

In the early days of October, in spite of the taken measure, the British government brought a decision to invest approximately 65 billion dollars to recapitalize the eight biggest home banks and apartment's association that, actually is their partly nationalization. This plan is much more different from the American one because the British government buys the banks' shares, while the American financial plan is to ransom the basic funds of the banks that are badly produced.

In addition to that, the bank "Hypo Real Estate" that finances only commercial projects and public construction is the first German victim of the financial crisis. As a first step was that the German government and the banking sector agreed to get 35 billion dollars to save Hypo. But, soon after this plan, the larger number of the banks declared that they withdraw from that action because they confirmed that Hypo's problems were much deeper and elementary.

The German government and the banking sector gave a new plan, that is to say they would give extra 15 billion dollars to the bank, except for those 35 billion dollars and that the state guarantees for those money.

Slovenia wasn't saved from this financial disturbance too. The stock index lost its value almost half of the worth in six months and was driven back to the same position that was two years ago. The consequences were felt in various segments as: the banks' portfolios were weakened, the stock markets, funds, the investors lost over 10 billion dollars, and Slovenians buy houses and cars rarely… The experts in this country suggest that first the banking sector should be stabilized, than the economy in the country.

In regard to the previous data and facts, the next section represents how international financial institutions and governments react to the global financial turmoil that spread in many countries in the world.

2.1. The role of the international financial institutions and government interventions in resolving the problems of international financial crisis

In today's conditions of globalized world, we are witnesses how, apparently, a distant financial crisis can spread very quickly in other countries in the world. For solving such problems that were caused by the actual financial crisis a global, coordinative, flexible and fast reaction is necessary. This must be done by the international financial institutions and the government in the countries affected by the financial crisis.

All these events show us that the European governments cannot stop the so called domino effect of the American financial crisis, but they take over some steps to amortize there consequences. Among those steps, except for injecting fresh money in the banking sector, an agreement for minimal guarantee of the private deposits was agreed. These deposits in the European Union are 50 000 Euros, but some of the members of the European Union are determined to enlarge that sum to 100 000 Euros. Some of the governments, as the Slovenian decided to fully ensure the deposits so they cannot be taken by the other banks in the European Union.[17]

16) www.sfgate.com, November 2008.
17) www.one.org/international, December 2008

The leaders of the most industrious developed countries (G-20), on the common meeting, agreed that the prior thing to do in this moment is to recapitalize the banks that are in crisis. The countries that are members of the Union will guarantee the mutual credits to 2009; every country will decide the amount of funds that will give for these purposes.

The measures that the some governments undertake are not enough for resolving the consequences that were caused by the world's financial crisis and for returning the trust in the financial institutions. To this kind of actions must be added the activities of the international financial institutions. In such contest, will be mentioned the involvement of International Monetary Fund, the World Bank, as well as The Basel's committee for bank supervision[3] of the international financial market.

IMF offered financial help of hundreds of billions dollars to the member countries that can urgently get credit to stabilize their financial systems. World Bank joined to these financial packages that are approved by IMF, and at the same time they were giving the fact that a greater help will be needed by the developing countries. They have bigger problems with the financial crisis and they have to strengthen their financial systems.

The World Bank reacts to such needs through undertaking a wide range of activities that can be grouped in three groups: supplies financial help in the developing countries offers advices and technical help and forms partnerships with other organizations.[3]

In November 2008, the Basel's committee for banking supervision, for surpassing the basic weaknesses that were produced as a result of the crisis in the financial markets, announced a detail strategy that will refer to improvement of the regulation, supervision and controlling the risk in the banks that work in the international capital market. The basic activities of this strategy are the following:[18]

- strengthening of the risk capture of the Basel II framework (in particular for trading book and off-balance sheet exposures);
- establishing extra smoothing of the shocks in the plan for the capital that can be used in the period of crisis periods;
- supplementing the measures for estimation of the risk in order to maintain the strength of the banking system;
- strengthening the supervisory function for estimating the liquidity of the banks that work in the international capital market;
- strengthening the process of controlling the risks;
- promoting the global supervision.

The building of a stabile and efficient financial system is a complex and long-lasting work, and we should into account different institutional structures that exist in some countries.

For realizing this aim in the countries where there is a financial instability a help will be needed: first, they should see the weaknesses of their financial systems; second, to develop a strategy that will handle with the existing financial weaknesses and third to secure a technical help for implementing the chosen strategy.

The global influence of the actual financial crisis, in smaller or bigger degree, is already felt in Republic of Macedonia. Because of that, in the continuance we will briefly review that problem.

3. The influence of the financial crisis on the Macedonian capital market

In the research carried in the area of the financial crisis a conclusion can be made that a common characteristic of the modern financial crisis is its quick transmission out of the borders of the country in which it firstly appeared. Actually, the best example for that is the recent American crisis that reached a global proportion. In its beginnings, there was thinking that the influence from this crisis will be felt by the American

18) www.bis.org, December 2008.

financial market and the bigger European investment banks whose working activities were closely related to this market. But, the real happenings showed that the crisis gained such proportions that grew into a world's crisis whose consequences were felt in many countries in the world, directly or indirectly.

According to the fact that the Republic of Macedonia is European country, the danger of spreading the financial crisis in our country disturbed the Macedonian public. The frequent asked questions were: Can the financial crisis influence on the financial sector and will be taken some preventive measures in order to stop it?

Even though the influence of the global financial impact reflected on the Macedonian capital market, but still, the impact is much smaller than the impact that the other European and Asian countries endured. The experts think that it is the result of the psychological reaction of the investors that is a common thing in case there is no trust in the global financial market. The fear that appeared influenced on the drastic lowering of the shares' prices, because there was bigger offer than request of the capital. After this crash, the leaders of the stock market together with the bond commission took over certain measures to control the stock market's transactions, that is to say, the prices were limited to +/- 5% instead of the present +/-10% of the base price and in that way the crash on the market was lessened. But the following week these limits of the prices were suspended as a reaction to the stability of the stock market.

The current situation on the Macedonian stock market shouldn't be alarming considering the fact that there are not a great number of foreign investors that in a case of bigger disturbances will withdraw their capital out of the country. The Republic of Macedonia is a free market, but financial closed economy and there are no lawful possibilities to invest in the foreign stock markets or to buy real estates in other countries. So, the undeveloped capital market that is considered to be shortage in normal conditions is at the moment an advantage, because the financial sector will be isolated from the current happenings.

According to the experts, the situation in the banking sector in Macedonia isn't alarming yet, basically because the global banks that endured great losses from the current financial crisis aren't present in our banking sector. Also, the bankers calm down the citizens that their bank deposits are safe because they are regulated by the leading European banks where the regulations are stricter than the American ones. Namely, we talk about commercial and not investment banks and on the other hand the deposits are ensured by the saving deposit's fund. Because of this, and because of the fact that the Macedonian banks haven't got loans from the European banks that are in a middle of crisis, the situation in the Macedonian banking sector isn't alarming.

Anyway, we should mention that there are some indirect effects that global financial crisis cause in the banking and real sector in our country. In the banking sector this effects can be felt by the bigger interest rate of the credits on one hand and on the other hand, there is a bigger interest rate of the savings deposits which is an easier way for the banks to get to Euros other than to take credits in a foreign banks where the financial crisis is still up to date. In the real sector the metallurgic and textile organizations are facing the negative effects of the financial crisis. The demand for there products on the European markets are falling and they react by firing there workers so the unemployment in the country is rising.

The current situation of the global financial market draws to important questions and according to the answer the stability of the market depends: Are there any financial holes that we should be careful of and are we on the beginning of a new period of regulation? There is no doubt that there will be greater pressures for a supplementary regulation. What we actually need is a regulation that will really work and function. According to the second question it is necessary a bigger attention to be paid on the use of the credit cards because they aren't ensured, in another words, the clients haven't got an obligation to put in money when they open a new account and the enlargement of the interest rates is a measure that for the creditors will mean bigger problem in returning the debts to the banks. We cannot predict the future with certainty, but one thing is sure that the greed for money is the major guilt, the lost investor's trust will be difficult to bring back, in other words- a longer period of time is needed to stabilize the situations on the world's financial market.

a. Recommendations for keeping the stability of the Macedonian financial market

From the previous research can be concluded that the Republic of Macedonia will feel the negative influences of the global financial crisis. These happenings raise the question, which activities should be undertaken to balance and amortize the influence of this so called "financial virus "?

The preventive measures for protection of the Macedonian financial market and the real economy can be done in the following way:

- Making the conditions for crediting of the public and the business organizations more severe;
- Carefully formulating and efficiently taken strategies for taking and controlling with risks;
- Application of the principles in working of the banks which is especially important for the citizens' trust;
- Application of the measures that will guarantee the deposits of the savers so there wouldn't come to a situation of withdrawing them from the banks;
- Application of the corporative directing in the banks that will define the relationships with the auctioneers and supervising boards;
- Greater supervision of the internal and the external supervisors;
- Bigger role of the National Bank of Republic of Macedonia in naming and election of the manager teams and other organs for which the bank has got authority
- Carefully selected politics for controlling of the interest's and currency's risk;
- Greater cooperation between the government and the business organizations from the business sector in order to find a solution for eventual problems that they face or will face in the future as a result of the financial crisis;
- Taking over the measures for enlarging the employment;
- Measures for lessening the trade deficit and so on.

The focus over the previous structural references by the responsible doers in the state will enable a stabile financial system that will influence on making bigger economic growth, enlargement of the competition in the economy, reduction of the unemployment, bigger living standard for the citizens and creating conditions for faster integrating of the country in Euro Atlantic structures.

Conclusion

In conditions of globalized world, the probability is greater, the disturbances in particular market segment or in one country to spread in other regions or countries and to produce financial crisis. The global financial crisis, that began in the USA, in short period of time spread in the countries all over the world causing painful consequences in their economies. Although, the Republic of Macedonia is a minor participant in the international financial market, yet, the consequences of the global financial crisis is already felt in the financial and real sector in our country. Because of this, the influence of the financial crisis shouldn't be ignored. On the contrary, a careful following of the events is necessary and taking over preventive measures for protection of the Macedonian financial market and the real economy.

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