

Risk Management Aspects Related to the Current International Financial Crisis

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Abstract

The current international economic crisis, having as the main aspect the liquidity crisis of the financial societies, is fast-growing in a cross-border dimension and also leading to an increase in the intensity of the associated risks due to the development of the economic relationships and integration process.

The differences between the economic standing of the national economies, even if they are members of the same economic community, make impossible and inefficient the identification of the right solutions by the development of unique programs. Starting from this situation, it is considered to be more efficient to develop anti-crisis actions on the national dimension as the international one seems to be very important in the formula of the cooperation between all institutions involved.

The insufficient development and organisation of the governmental activities of macroeconomic analysis and forecasting in direct connection with the coordination and correlation of macroeconomic policies, represents a huge problem for the right management of the international economic crisis.

Key words: *equilibrium, homogeneity, efficacy, risks, sustainability*

JEL Classification: *G01, G32*

General Characterization of the Economic Environment Analysis

At this moment, the international economic system is affected by the economic crisis phenomenon, being in his early stages and characterized through a rapid evolution caused by the complexity of the connecting channels of risks and economic effects.

Theoretical Aspects

As a developing mechanism of the phenomenon, the debut domain of the economic crisis is the financial one, the sub-domain is the investment one, and the type of the crisis corresponds to the liquidity crisis.

The general problem of analysing the appearance and evolution of the phenomenon of liquidity crisis in financial-banking system belongs to the study of the general issue of needs and resources particularly regarding the situation of great capital accumulations which amplified the necessity to identify new investment objectives.

Theoretically speaking, the investors, working most of the time with attracted funds and being thus forced to respect both the prudence principle and the profitability one, have an obligation to select, from the existing investment objectives, those that equally respect both principles, during the entire life of the investment, thus assuring, actually, predictability.

The Facts

Returning to the problem of the beginning and evolution of the actual international economic crisis, it appeared due to a liquidity crisis of the financial-banking system as a result of utilising investment opportunities with a poor grade of predictability in order to prepare the decision process according to which investments have been made. In fact, this is the case of real estate investments.

In the search to identify the management mechanism which leads to this kind of investment, some *aspects* can be highlighted, as follows:

- Real estate investments knew a promising evolution, first because of the growing demand, which, at the level of banking investment strategy is associated with a very good return;
- The methods used to forecast the market evolution, strictly necessary in medium or long term investments had a great minus characterized through the following *coordinates*:
 - it took into consideration a trend of the market by extrapolating statistic data;
 - it ignored the correlation between the evolution of this market with the general macroeconomic frame, for example the correlation between the offer on the real estate market and the concrete demand, having as fundamental index the spending capacity;
- The decisional processes according to which the investments were made had a big minus because they ignored the existence of a maximal percent of investments from all funds for investments, as an internal rule of the investing institution, used in the case of investment opportunities with an insufficient grade of predictability;
- Last but not least, it was important to analyse the way the real estate market has been built; the three *theoretical possibilities* are:
 - the real estate market was built on demand;
 - the real estate market was built on the offer of real estate services;
 - the real estate market was built on the offer of specific financial products and services, most probable the real case being the one specific to the construction, in the early stage, of the real estate market by the real estate service suppliers, the strong evolution of this kind of market is owed to the explosion of the offer of financial-banking products and services.

As an evolving mechanism, the development, intensive or extensive, of the real estate market, attracted investments from the financial-banking companies, the market evolution rhythm and the investment rhythm outpacing the recovery rate of investments by sales to beneficiaries who, in fact, were just theoretically considered real demand. Practically speaking they were, from the beginning, just a potential demand.

The result of this capital direction from the financial-banking companies to the real estate market was the debut of liquidity crisis started from the drastic lowering of sales of real estate objectives.

The fatal error in deciding to invest was the lack of a firm promise to buy the real estate objectives, which should have been applied at a “t” moment after the investments towards the

real estate suppliers. Theoretically speaking, this activity of turning firm promises of acquisition into real facts is likely to be managed by the involved financial-banking companies as well and thus they would have guided the development of real estate market towards efficiency and equilibrium.

The main result of this wrong mechanism is what is happening at this moment at the level of international economy, and that is the drastic crisis of liquidity on the financial-banking market.

The development of economic international relations and the evolution of economy integration amplify the risks of the economic crisis by activating mechanisms and channels to transmit risks and effects.

The Analysis of Solutions to Minimize the Liquidity Crisis Effects

As a measure to minimize the liquidity crisis effects, recently, the states from the Economic and Monetary European Union announced the guarantee of all deposits made in resident banks for a period of two years. The main motivation of this decision was the necessity of the establishment of some macroeconomic policy instruments that will be used in the eventuality of a liquidity crisis of the financial-banking system – risk associated to the evolution of actual international economic crisis most likely to happen.

The followed mechanism is to attract cash economies from the international financial market.

The next question is asked: to what extent this mechanism is correctly directed to the followed goals and to what extent it is risky?

To answer this question the next *scenarios* will be considered:

- In the case of not taking these measures, the imminence of liquidity crisis of the financial-banking system would induce great effort and it would be hard to be sustained by the state to save the financial-banking institutions in crisis from financial collapse; in a case like this, public reserve funds would have been used widely, would become risky for maintaining the macroeconomic equilibrium; more than that, there would be the possibility of insufficient public funds – in this case the financial crash would have great effects on national economy, the first effect being the one of general instability and the impossibility to manage the macroeconomic equilibrium (see Fisher's macroeconomic equilibrium equation);
- In case that such a decision has been taken, there are *two ways*:
 - The optimum instrument, until the moment when using the attracted funds would become a necessity, is to create state reserves, funds that should be attracted by the emission of government bonds;
 - The formula in which the state guarantees open deposits at retail financial-banking companies is risky due to the following reasons:
 - First, the state does not have direct access to use those funds, most probably those will become different components of the monetary mass in circulation, through the retail financial-banking system; following Fisher's macroeconomic equilibrium equation which is:

$$M \times V = P \times T \quad (1)$$

where:

M = money in circulation;

V = the speed of money rotation into the economy;

P = the level of prices in the economy;

T = production level in the economy,
which can be written like:

$$V = \frac{P \times T}{M} \quad (2)$$

and for a developed economy the condition is:

$$V \approx ct \quad (3)$$

we get:

$$\frac{P \times T}{M} \approx ct. \quad (5)$$

We can see that the risk of growth of the circulating monetary mass induces pressures on macroeconomic policies like: as an efficient action and easy to adjust in time, the central bank will be forced to take actions to decrease the circulating monetary mass, eventually through an increased rigor on the usage of loan type financial-banking products and services.

More than that, against the backdrop of the economic crisis whose main forms of expression are the kind of liquidity crisis, it is possible for the level of production in economy to fall, which directs the option to the same type of actions, namely the decrease of circulating monetary mass.

On the medium term, at least in the banking approach, under macroeconomic conditions of crisis will put pressure upon the financial-banking activity which is expected to decrease drastically, primarily due to the decreased demand of products and services and secondly due to decreased possibility to manage the already made investments whose coordinates are strongly influenced by the economic crisis.

Under this kind of conditions the banks become less profitable, the banking management being pointed much more to respect the prudence principles, which constrains the banks to adopt measures to attract funds; however, those inconveniences as regards the efficiency of the deposit investment do not oppose the announced macroeconomic actions, the depositors being guided towards respecting prudence principles rather than efficiency principles.

- Secondly, as a result of the drastic decrease of investment opportunities, it is possible for the attracted monetary mass to be greater than the forecasted one; under these circumstances, we can have in mind the next *two scenarios*:
 - The case in which the financial crisis effects do not continue to affect the financial-banking system, which was the object of investment through deposit builds, it can be considered that the action was right, with the above amendments;
 - The case where the financial crisis continues to affect the financial-banking system which was the investment's objective by attracting deposits and from this perspective it affects the deposits' integrity; the government that guaranteed those deposits can be confronted with major losses of funds.
- Thirdly, one must take into consideration the objective of such actions; attracting funds through deposits, theoretically, must be directed, exclusively, to avoid the possibility of the banks, as subjects of financial support, to be in the position to execute the financial dues of inefficient investments, as stimuli that worsen the financial crisis; here the following question arises: which is the deadline for bank payment possibilities to deponents as compared with the time period for which the government is bound to

guarantee the deposits and also compared with the estimated possibilities of the banks to become profitable while launching new products and services on the market in the context of the financial crisis?

Recommended Solutions

It is certainly the fact that the financial-banking system liquidity crisis imposes the consideration of a solution to attract funds for the adjustment of the liquidity state of crisis affected companies.

Considering the crisis affected companies as an investment objective is both risky because to forecast the company's evolution in a crisis evolution time is difficult and complex as every company has its own situation and its own adjustment, which gives an increased rate of complexity at the level of an eventual centralized forecasting activity.

Under international crisis conditions, it would be easier to work with the issue of creating a government company as a financing fund to ease up risky effects from the international financial crisis. The finance for this fund should be based on government bonds, concurrently with an increased prudence of banking regulation associated to product and service selling operations as well as to the investment ones. Such a solution must be associated to an international cooperation activity with a view to limiting the risks and minimizing the effects. The proposed and identified solutions must be correlated with the main macroeconomic policy actions.

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Aspecte ale managementului riscurilor asociate crizei financiare internaționale actuale

Rezumat

Criza economico-financiară internațională actuală, al cărei principal aspect este criza lichidităților la nivelul societăților ce lucrează pe piața financiar-bancară, se transmite rapid și cu caracter de multiplicare a intensității și profunzimii efectelor în primul rând ca urmare a extinderii relațiilor economice și de integrare internațională.

Diferențele mari de standing economic al statelor afectate de criză, chiar dacă acestea sunt membre ale aceleiași comunități economice, fac aproape imposibilă sau cel puțin ineficientă furnizarea de soluții anticriză prin dezvoltarea unor programe unice. Din această perspectivă, se consideră a fi preferată ideea de acțiune anticriză dezvoltată la nivel național, nivelul internațional de implicare rămânând esențial și indispensabil, dar dezvoltat la nivelul cooperărilor între instituțiile implicate.

Insuficienta dezvoltare și organizare a activităților guvernamentale de analiză și previziune macroeconomică asociată direct aplicării principiilor de corelare și coordonare a politicilor macroeconomice reprezintă un mare impas în gestionarea crizei economice internaționale.