

The relationship between the current world crisis and global imbalances

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Abstract: The world economy currently experiencing the largest decline in the postwar period, dominated by a financial crisis that swept in a record time around the world. Many developed economies have entered into recession, the rest of slowing economies, and significant growth. International trade and global monetary and financial flows show a significant contraction, while unemployment has increased considerably. Nature of the current crisis events can be reported in a precedent - in particular, the current situation of financial crisis combines the most advanced economies in the world with a time of global economic contraction. But financial crises or periods of global economic contraction are not a novelty. Therefore, the past can be a useful way of understanding this.

Key words: economic crisis, recession, global economy, financial market

Jel Code: E 44, E 63, F 21, G 15

1. Introduction

The paper aims to establish a connection between the current economic crisis and global imbalances. It was noted that the world economy underwent a period which saw the largest decline in the postwar period until today, being dominated by a financial crisis that swept all over the world. Such economies went into recession while the rest of the economies, less developed, have slowed economic growth. The subject is of great work being addressed in many articles both at home and abroad.

Obsfeld Maurice believes that the two phenomena are interconnected, with the source driven economic policies in the 2000s in some countries (including U.S.) and distortions that have affected the implementation of these policies on financial markets [5]. Until the outbreak of financial crisis in August of 2007, globally, there has been a period of sustained economic growth, characterized by generally low inflation rates and a considerable volume of international trade and financial flows [7]. China's exports - which are prepared in the mid 2000s to replace Germany as the first exporter of the world - have supported both growth and market protectionism. Perhaps, more impressive than China's trade balance surplus was the size of savings and investment flows that generated them [9]. Official discussions about the risks entailed by the worsening global imbalances have intensified in autumn 2003, the G7 officials have strongly recommended that China and Japan to reduce its U.S. dollar reserves. United States declared its intention to promote saving among the population, while Europe has committed to increase productivity. [14].

The paper is structured in six chapters as follows: Chapter one presents the introduction the extended objective of the paper, the state of the art in the paper domain, the descriptions of the sections, the main scientific contributions, the referred bibliography, Chapter two presents a description of the current situation of world economy and turning point of the global economic order.

Chapter three examines the parallel between the Great Depression of 1929 and the current crisis has affected economies such as Britain, the United States and China. The fourth chapter presents an analysis of global imbalances in the period 1990-2003 and is presented in chapter five global trends in the period 2004-2008, global economic context marked by worsening disparities characteristic pressure because of rising real estate and stock market. The paper concludes with the sixth of which brings together the conclusions drawn from analysis of this paper.

2. World crisis, turning point of the global economic order

Banks failed, galloping unemployment destabilized markets. For historians or people reached a respectable age, everything seems sinister familiarity. Is the current economic and financial crisis to another "Great Depression"? Economists give the answer - not yet. In the past 20 years have produced major changes in international economic context, changes marked the Soviet Union collapsed and centralized economies in Eastern Europe, reforms in China and India, export-based growth strategies in East Asia, however leading to the creation of the global market and also bringing 4 to 5 billion people. Thus, we can say unequivocally that the current state of the global economy is a direct consequence of financial globalization.

Major financial shocks make deeper existing cracks in political, economic and social order and sometimes a new order replaces the old. In 2010, states across the world over blast, which invariably will lead to changing the current world order. In the contemporary period, recessions have declined both in frequency and in intensity, while the economic expansion periods were extended. But recessions associated with financial crises have become more severe and more extended than those accompanied by other disturbances. Recovery from this recession is therefore much slower and is also associated with lower domestic demand and acute shortage of liquidity.

Similarly, recessions produced simultaneously in several states are, in turn, considered to be deeper and more extended than unilateral. In this case, extremely difficult recovery occurs, the influence of international trade are lower than for unsynchronized recessions. Recession currently facing world states can be characterized as highly synchronized and coupled with severe financial crisis, a rare combination at least for the postwar period.

Thus at least for most developed economies and some emerging ones (excluding the Asian region) out of the crisis will be extremely difficult, thus justifying the historical parallels between now and the Great Depression of the 1930s, by far the most long and deep recession known by most developed countries. Nature of the current crisis events can be reported in a precedent - in particular, the current situation of financial crisis combines the most advanced economies in the world with a time of global economic contraction. But no financial crises or a period of global economic contraction is not a novelty. Therefore, the past can be a useful way of understanding this. Estimates of the economic crisis end leverage will be followed by China and India and other emerging economies, while the epicenter, the United States will probably reduce global great power status. Basically, the world economy is falling to the state in two hundred years ago, before the industrial revolution, but with one significant difference, North America.

Thus, in this new context, leaving the crisis would mean the chance to restructure the global institutions and policies, the chance to create a new global economic system suitable current century, it's a "responsible globalization", which would promote fiscal stability and an overall increase balanced. All this would result in increasing the benefits of trade and markets, investment, competition, innovation, growth, and free information. Phenomenon already described by a degree of uncertainty, the U.S. mortgage crisis, credit crisis sub-prime crisis, bring to the fore serious consequences that irrationality can cause a fragile financial system, global consequences also propagated. Grounds extraordinary expansion of sub-prime loans are not hard to spot. After 2000, with recession in the U.S. economy falling, the Federal Reserve cut U.S. interest rates until, in June 2003, they reached 1.5%, the lowest level after 1958. Consequently, increased availability of money is required for markets to be able to absorb. Not surprisingly, the most appropriate market to capture the multitude of new funds available was the housing market as home prices show a

further slight increase after a period of stagnation. Bad loans were seriously affected as U.S. banks and those engaged in this type of foreign investment and, in a domino effect, real estate crisis has triggered the financial crisis.

Immediately after the outbreak of the sub-prime crisis in the United States, outburst that culminated in August of 2007, the world economy has been severely shaken, but still had negative effects really make their presence felt. Economic activity was reduced in intensity because of tightening credit conditions, while the end of the first half of 2008 mark economies into a recession stage of moderate recession but still disrupt the relatively robust growth rates in emerging economies and developing. Deteriorating economic situation of the United States and followed its course with the second outbreak of the financial crisis in September of 2008, followed by the bankruptcy of a large American investment group, Lehman Brothers, the rescue efforts of the largest companies American Insurance, American Insurance Group - AIG, and interventions to support a number of other systemic institutions in the United States but also in Europe (Bear Stearns). Although the global economic collapse has been avoided in the last minute consecutive financial disasters have seriously affected the global economy in several ways. Credit crisis has damaged the credibility of the main companies that until recently jugglers compete in investment. Sudden fall of stock markets and real estate markets recorded depreciation led to huge losses. Moreover, because the excesses and failures occurred in the very core banking system, the effects were rapidly spread to all sectors and countries of the world economy. Gravity of the situation was exacerbated by the collapse of economic activity and consumer confidence in the fear caused by gloomy economic forecasts and the constant uncertainty induced delay the emergence of coherent recovery.

Latest analysis shows however that with the passage of 2009, economic contraction intensity began to decrease in intensity. Confidence in the economic environment shows also a slight improvement and it seems that stabilizes the volume of transactions of goods, from decreasing the price level and the anticipation of improved macroeconomic policies of the current situation. However, unemployment continues to rise, especially in the United States where, in May 2010, reached 9.8%. Policies to mitigate the crisis, although implemented quickly, widely and often unorthodox, were too narrowly designed to control spiraling chaos of crisis. After the collapse of Lehman Brothers group, authorities in most mature markets have decided not to allow a bankruptcy or other major financial institutions. Therefore, a number of large banking corporations in the United States and Europe have received government support in the form of capital inflows and guarantee losses caused by sharp devaluations.

As regards the emerging economies of Europe, significant internal vulnerabilities and in some cases relatively rigid exchange rates are complicated and difficult application of anti-crisis policies. A number of states marked by weak banking systems, currency fluctuations and balance of payments deficit have used external financial support from the IMF or other official sources. Stability induced by this type of aid, however, is only apparent, since international environment continues to be dominated by crisis-induced mutations. Some opinions say that gained international disparities by 2007 had no influence on the crisis, but domestic policy mistakes combined with the failure of fiscal stabilization, particularly from the United States. Others argue that China's high rate of savings, oil exporters and other countries that had surplus cash, leading to lower real interest rates globally, forcing investors to rush and very risky investments.

Obsfeld Maurice believes that the two phenomena are interconnected, with the source driven economic policies in the 2000s in some countries (including U.S.) and distortions that have affected the implementation of these policies on financial markets. The United States has postponed indefinitely the implementation of harsh measures of monetary policy, macroeconomic imbalances funding by foreign funds which they obtained very easily (situation applies to other countries with current account balance deficit). Thus, not only could borrow in dollars, but rein in permissive monetary policy interest rate. Moreover, the fall of 2008, external financial obligations of the United States exceeded the current account deficit.

Regarding loans, maneuver through which China has manipulated its currency to the detriment of huge amounts placed on the U.S. markets allowed it to undervalue its currency and to postpone stabilize their economies. If such an option was not available so probably would have been at crisis proportions slightly lower. Fortunately for the world economy, signs of economic recovery have begun to appear, but can not even talk about a return to all areas of the world. Is expected in 2010, world production to increase by 4.25%, a clear improvement compared to 1% in October of 2009, financial markets recovering much of the confidence of economic agents and consumers alike.

Restore U.S. economy, although later than in EU or Japan, promises to be stronger than the latter, the situation is quite surprising if the fact that the United States were the epicenter of the current crisis. Restore U.S. economy compared with the European Union and Japan reflects a number of differences between the three power centers: the United States, fiscal stimulus has been achieved in considerably larger scale, non-financial corporate sector is less dependent on lending bank (which is still a problem), securities markets have recovered relatively quickly, and the Federal Reserve reacted promptly in implementing policies to counter the crisis. Overall, it appears that the global economy will enter a stage of recovery, but inconsistent. Global growth is estimated at 4.25% for 2010 and 2011. Growth in advanced economies is set to 2.25% in 2010 and 2.5% in 2011, after a 3% fall in production in 2009. In developed economies, their growth is expected to reach 6.25% during 2010-2011, after a modest rate of 2.5% in 2009.

So, returning economies will be quite slow, both in comparison with previous statements (recessions of the mid-1970s, early 1980s and 1990) and the situation of emerging economies. Some EU countries that have suffered major financial imbalances in the crisis will go through a difficult period, not falling as economic growth forecasts, while countries such as Australia or the newly industrialized Asia (which have experienced less impact global crisis) will describe the most favorable development. For an effective economic recovery can take place, it requires drastic action, no easy task as requiring international correlation. In most advanced economies, but also a limited number of emerging economies, require a relocation application, yet focused on consumers of all (public), relocation to the private sector and coupled with consolidation of public finances and financial sector restructuring. The emerging economies and the advanced will have to boost economic growth based on domestic sources, since demand in international markets will not reach the level too soon before August 2007.

Production of quick recovery from the crisis involves the application of policies based on individual circumstances. But the temporal variation of such individual policy may cause externalities, and these should be considered in defining these policies. Externalities induced by fiscal policies have a significant impact on developed economies - contractions national economies adversely affect exports to other countries and large deficits, a lack of strategy correlated medium-term fiscal consolidation affect exchange rates. Furthermore, the lack of foreign investment or depreciation of exchange rates in some major emerging economies can destabilize trade and financial climate of other economies (whether developed or emerging) and extremely low exchange rates applied by some developed economies such could cause a whole wave of retirement investments, with potentially destabilizing states concerned.

Recovery policies should focus on the macroeconomic imperfections, which in the past decade, global imbalances have led to major changes in current accounts were regarded as harmful only if the distortion causing internal or systemic or global dislocations generated (depreciation an uneven international reserve currency). Vices financial systems of advanced economies has encouraged excessive lending and therefore inhibited savings, while some government programs and market irregularities in some emerging economies have a strong impetus. Insufficient fiscal consolidation during periods of economic boom has boosted these effects, like the massive accumulation of official reserves by Asian emerging.

Lessons that countries of the world should learn from the production of this global crisis are as numerous as it is clear. Global crisis started in 2007 has demonstrated once again the fragility of the international financial system fragility enhanced by the high degree of globalization of financial

markets. The fragility of the international financial system has been applied to severe pressures, pressures resulting from the constant desire for enrichment. Clearly, greed, perpetual threat to the integrity of the global economy will never be eradicated, since it implies a radical shift in human nature, but most likely, tighter fiscal policies and relative restriction of funding sources will help the least the medium term, to rule them.

3. Parallels between the Great Depression of 1929 and the current crisis

Until the outbreak of financial crisis in August 2007, the second half of 2000 was, overall, a period of sustained economic growth, characterized by generally low inflation rates and a considerable volume of trade international financial flows²². This apparently favorable balance was negatively influenced by various disturbances, some minor, others increasing in intensity with time: first, rapidly rising real estate market in most countries, including most developed economy in the world, the United States, then deficit dangerously high current account accumulated some states, including the United States, and eventually reached the record level of insolvency risk especially among consumers in Britain and the United States and a number of financial entities from more states. However be noted that these global imbalances have generated global crisis, but were, undoubtedly, a co determinant undeniable.

In addition to the status of the wider world economy, the United States and ranked in terms of share of private housing market and financial market dynamics. But these markets destabilized progressively since 1970, had to face an inefficient system of government surveillance. These elements led gathered together, as is known, to disaster. But how these imbalances have led to global financial collapse is not yet known. Moreover, the fall of 2008, external financial obligations of the United States exceeded the current account deficit²³. Regarding loans, maneuver through which China has manipulated its currency to the detriment of huge amounts placed on the U.S. markets allowed it to undervalue its currency and to postpone stabilize their economies. If such an option was not available so probably would have been at crisis proportions slightly lower.

There are views that argue that global imbalances are likely a benign phenomenon, a natural and inevitable corollary of reverse financial development occurs in emerging markets. Thus, it would be a beneficial situation for all participants, whereas the populations of countries with emerging economies (and governments alike) can enjoy protection and liquidity of their economies, while developed countries (mainly U.S. dollar as the sole issuer) can enjoy more favorable loan conditions. Fundamental error of this assumption is that the optical capital markets related economies, notably the U.S., are basically perfect and able to withstand increased risks caused by fluctuations in capital. However speculation could be made on the subject, the global crisis requires a test of force applied to political and fiscal systems imperfections American, British or of other developed economies, test force that many of them have failed to promote it successfully.

Great Depression of the years 1929-1933 and has strong influence on world economy, its echo is felt to this day, almost 80 years since its inception. This led to revolutionize the banking system, tax laws and has left deep scars on the nation. During the Great Depression, household savings everywhere disappeared so quickly through bank failures that had become bankers in May persecuted than bank robbers. In the United States, Great Depression left 25% of the population without jobs²⁴. Quotes Dow Jones industrial fell by 89%. Whole banking system was closed for four days by presidential order. Homeless population studded outskirts of cities, creating almost secondary cities. In matters like the Great Depression and the crisis now existing parallels are undeniable. Stock market decline has reduced the economic potential of the population and, consequently, reduced consumption. Dow Jones has a smooth contraction, but fell just 47% from September 1929 to November 1929. Between October 9, 2007 and October 27, 2008, the same Dow

²² The Global Social Change Research Project, *Basic Guide to the World – Economic Growth, 1970 to 2007*, May 2007, p. 6

²³ <http://www.iie.com/research/topics/hottopic.cfm?HotTopicID=9>

²⁴ <http://www.buzzle.com/articles/unemployment-during-the-great-depression.html>

Jones index fall by 42%, value approximately equal to the market collapse of 1929. But the difference is that stock holders of securities are more numerous now than in 1929²⁵.

The current banking system was destabilized by bad loans and speculation. In 1929, bad loans were granted stock speculators. In the current situation, bad loans were granted to homeowners and investors in real estate securities. In 1929, banks no longer lend to limit losses, a situation which affected the economy. By the mid-1930s, more than 5,000 banks had entered bankruptcy. And the current situation, banks weighted loans to avoid generating more losses and nearly froze credit markets. But there are major differences as a possible repeat of the Great Depression rather unlikely. Most of them: central bank intervention. If the U.S. Federal Reserve System Reserve U.S. to fill in some degree the role of banks for liquidity demand, thus fulfilling the purpose, not to prevent recessions, but to prevent the implosion of the tax system.

In 1929 and 1930, the federal system has increased interest rates, removing liquidity from the system, believing that the eradication of speculation is the best solution. Although there is still debate on the origin of the Great Depression, the Federal Reserve actions are deemed to have constituted the main reason for the scale of the disaster. In addition to the steps the Federal Reserve, President Hoover enhanced taxation, trying to rebalance the budget. Congress adopted the Smoot-Hawley Act of tariffs, which increased taxes on imported goods, triggering a trade war. Exports have fallen dramatically due to the position which trading took it against these charges, destroying industry.

Fortunately, the situation was not repeated, and this time the governments have played a major role in preventing economic collapse, just the fear again reaching the situation in 1929. United States by the Federal Reserve have reduced interest rates nine times since September 2007. In addition to reducing interest rates they have created many credit facilities, allowing financial institutions to dispose of problem assets that could not sell them for safest government bonds and will return them later, and to recover property²⁶. But despite the active role of central banks worldwide, there are still fears of a possible financial disaster. Amounts released today are still low compared to costs incurred by governments out of the 1930 crisis, especially when taking into account the preparations for war. One of the important lessons of the Great Depression has offered is that governments everywhere need to understand the need for a broader range of liquidity, and that monetary expansion will not itself, that single measure, to restore conditions for growth²⁷. Another concern relates to the fact that in 1929 the assets were overvalued securities exchange, but the current situation is more complex since the crisis while large overestimations of goods, exchange of securities and real estate. But the real question arises on spreads needed time to regain consumer confidence in safety and resume their economies to consume.

Between 1989 and 1997, the current account deficit of the United States, although fluctuating, never exceeded 2% of GDP in 1998 but, with unleashing the Asian financial crisis, the deficit reached 2.4% of GDP, reaching up in 2003 to 4.8%. Strongly influenced by the massive investments made in the late 1990s, the U.S. deficit reflects a low level of national reserves. By 2006, external debt would rise to 6% of GDP, with gradual decrease from 2007 to 2008 and abruptly in 2009 and 2010, less than half the level reached in 2006 (it is estimated that by 2030, it will reach 15% of GDP²⁸). Official discussions about the risks entailed by worsening global imbalances have intensified in autumn 2003, when G7 officials strongly recommended China and Japan to reduce its U.S. dollar reserves. United States declared its intention to promote saving among the population, while Europe has committed to increase productivity. Later in 2004, the G7 finance ministers and central bank governors states agreed on the fact that fiscal policies implemented over the medium term is key to

²⁵ http://www.usatoday.com/money/economy/2008-11-03-economy-depression-recession_N.htm

²⁶ <http://articles.latimes.com/2008/mar/20/business/fi-depression20>

²⁷ <http://www.cato.org/pubs/tbb/tbb-0508-25.pdf>

²⁸ Ibidem 25

address current account imbalances of world states. European officials have asked, in turn, imminent danger.

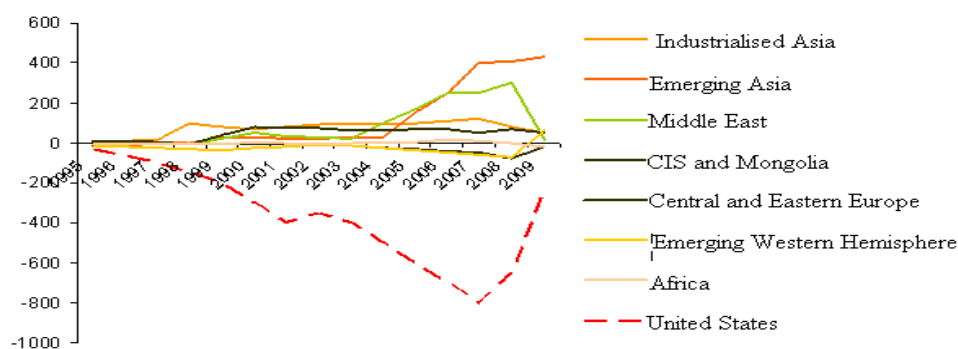
Thus, in December 2004, publication Financial Stability Review of the European Central Bank stated that the current account deficit of the United States is a huge risk for the overall fiscal stability since 2000. According to the same publications, American trained loans high values of interest rate risk and increases in unemployment, a situation which could adversely affect creditors - particularly banks, worsening the housing sector deficit is not an issue previously considered relevant to the current account deficit situation. Italian finance minister, Tommaso Padoa-Schioppa, it looks as worried about the U.S. external deficit and rising oil prices, considering their two major risk factors, together with fluctuations in the European property market as regards the relationship between amount budgeted and actual value of property²⁹.

But nevertheless, argues that its conclusion the risk of major financial imbalances had fallen since 2003 due to the situation in some way to strengthen the real economy. What the ECB has failed to specify, however, is that while the aggregate state of the whole euro area current account was more or less unbalanced, several Member States or major deficits faced a fragmented way surveillance financial markets. President of the Federal Reserve System of the United States, Alan Greenspan said in February 2005 that the current account deficit of the United States can not increase indefinitely and that, fortunately, the increased flexibility of the American economy will facilitate any adjustment without major consequences on general economic activity.

Thus, although at that time the situation was hardly realized, with 2004 world economy was entering a new and dangerous phase, marking the beginning of a widening global imbalance. While the factors that have favored the expansion of global imbalances in 2004 originated in the years immediately preceding policies, several mechanisms have grown strong propagation effects. Therefore, in order to understand the growing forces of destabilization that led to the worsening global disparities in 2004 should be reviewed period that followed the Asian crisis, Asian crisis, although the effects themselves are not accountable only to a lesser extent the global crisis started.

4. Global imbalances between 1990-2003

Status of current account deficits in the mid-1990s was diverse as possible, however, still no concern. The 1995 emerging Asia (including China) and the Western Hemisphere states had deficits comparable countries in Western and Eastern Europe with a similar status, the receiver of funds, but in a limited scale.



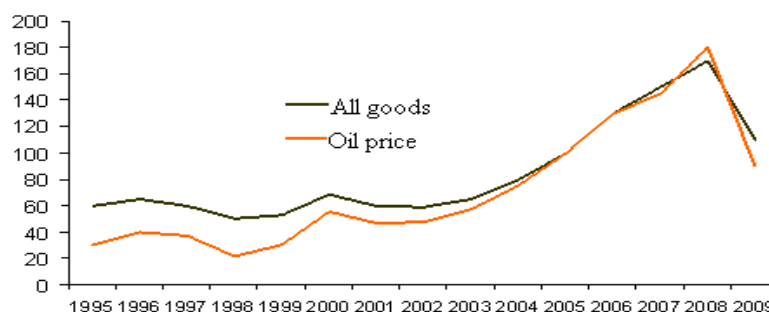
Source: Federal Reserve Bank of San Francisco Asia Economic Policy Conference, 2009

Figure 1. Global current accounts between 1995 and 2009
(U.S. \$ billion)

²⁹ <http://www.imf.org/external/np/tr/2007/tr071020b.htm>

Other regions recorded surpluses mature economies representing major sources of financing for developing receivers. Undoubtedly, the U.S. deficit in 1995 was considered high in all respects but in terms of GDP, half the rate reached the highest values recorded during the Reagan administration (approximately 1.5% of GDP)³⁰. Then in 1997 follows the Asian crisis. Turbulence Asian currency crisis began with Thailand, Thailand time maintaining a fixed exchange rate of the baht's dollar to withstand pressure. In the period before 1996, with the sudden end of a period of sustained, rapid credit expansion in a liberal tax system has caused problems for the stock market and real estate. Asset prices rose, and then began a steep decline, while the current account deficit reached 8% of GDP. Currency speculation against the bats exploded in May 1997 and the crisis has spread to other Asian countries.

Under market pressures, however, several vulnerabilities banking systems began to be felt, affected states resorting to using the International Monetary Fund. Severe consequences of the crisis, especially the IMF conditions for financial assistance quid pro quo left deep traces of the states concerned.



Source: IMF

Figure 2. Global price developments of goods (2005 = 100)

According to Figure no 1, the emerging Asian countries and Asian new industrialized group consists of Hong Kong, Korea, Singapore and Taiwan, and then recorded a surplus of current account balance. With the dissipation of the crisis, the global price of goods increased, leading to the generation of surpluses for Middle East oil producer and the Commonwealth Independent States. At the same time, it increased the deficit of developed economies. U.S. deficit increased from 2.4% of GDP in 1998 to 3.2 of GDP in 2009 to 4.3% of GDP in 2000, reducing slightly in 2001 (when the U.S. economy entered in a brief period of recession), then continue to trend upward³¹. Surpluses of Asian and oil producers have proven to be sustainable. In newly industrialized Asia, total revenues have kept more or less, the level before the crisis, but investment has decreased.

In emerging Asia, earnings matched the previous one crisis only in 2002 (33% of GDP), after which he entered a new period of growth, reaching the record level of 47% in 2007. Net investment again reached recorded before the crisis, 35% of GDP until 2004 and even though their levels continued to increase, they could not match the level of savings³². In support of surplus current account balance recorded they maintained exchange rate policies at much more competitive than record before the crisis. One reason for foreign intervention in Asia was to promote export-based strategies to maintain high growth rates. Another reason seeking substantial accumulation of international reserves, which mitigated the effect of a possible financial crisis in the region, would

³⁰ Obsfeld, Maurice, Rogoff, Kenneth, *Op. Cit.*, p. 10

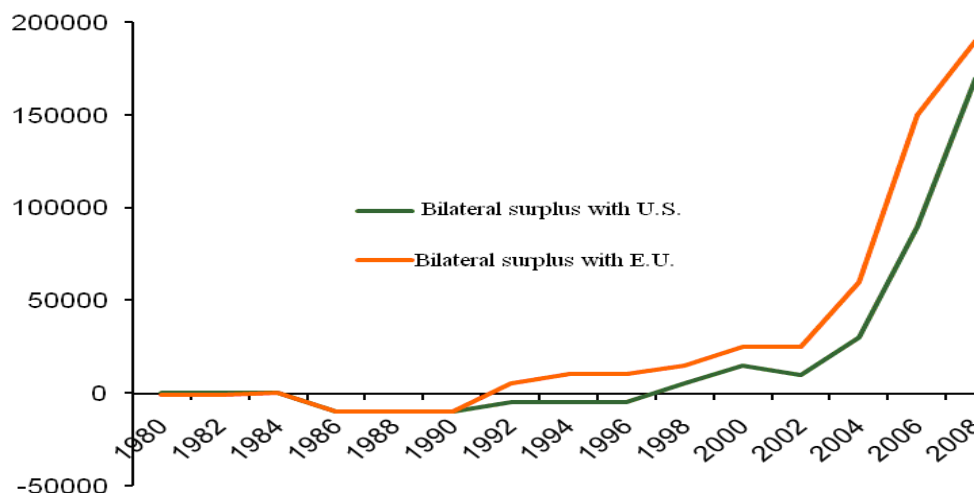
³¹ Obsfeld, Maurice, Rogoff, Kenneth, *The Unsustainable US Current Account Position Revisited*, National Bureau of Economic Research, 2005, p 3

³² Rajan, Ramkishen S., Hattari, Rabin, *Understanding Bilateral Foreign Direct Investment Flows in Emerging Asia*, Institute of South Asian Studies, University of Singapore, 2009, p. 2

be returned to the IMF dependency relationship. Early 2000s unprecedented rises in U.S. stock markets, resulting in crisis "dot com" - the creation of a speculative corporation enhance their quotation by simply adding the prefix "e-" or suffix "com" name and thus artificially rising stock price on stock markets. The failure of this maneuver involved a contraction of world market demand, and accordingly, since savings rate was still high real interest rates should decrease. It appears that real interest rates show a remarkable consistency vis-à-vis the development of stock markets: both reached maximum values between February and October 2000, and both have described a sharp drop in the future. Iraq War started in 2003, has fueled fears of a possible new disorder of economic stability. In early 2003, concerns about economic instability driven by the war in Iraq would leave a footprint on the world market, but the spring of that year marked the beginning of a new stock market boom. Coupled with low real interest rates in the short term, monetary policy allowed the United States was a key element in expanding the housing market excesses and global imbalances for the year 2004.

5. Global trends in the period 2004-2008

During 2004, global economic context marked by worsening disparities was characteristic pressure because of higher prices on the stock market and real estate. Among the main causes of this situation is the foreign policy of China, the rising price of global assets, financial innovations their U.S. and European banks' demand for U.S. structured financial products. Therefore, one of the major repercussions on the global economic balance came from China. GDP real growth China has experienced rapid growth at the end of the Asian crisis, reaching on average about 10% between 2003 and 2005, then jumped to 11.6% in 2006 and 13% in 2007. Along with this rapid development, China also increased external surplus, which rose from 3.6% in 2004 to 7.2% in 2005 and 11% by 2007³³. China's exports - which is preparing to mid-2000 to replace Germany as the first exporter in the world - supported both growth and market protectionism. Perhaps even more impressive than China's trade balance surplus was the size of savings and investment flows they generated. China's gross investment rate has increased steadily during the 2000s, reaching 45% at the outbreak of the global crisis. But the savings rate increased further³⁴.



Source: Index Mundi

Figure 3. Chinese trade balance surplus with the U.S. and EU
(U.S. \$ million)

Since the 1990s, China has steadily boosted Asian influence on trade flows, becoming an important center for re-export. In other words, most Japanese exports, with the direct purpose of the United States, now are passing through China, which re-exports to the United States. Together with

³³ http://www.indexmundi.com/china/gdp_%28purchasing_power_parity%29.html

³⁴ Ruiz-Arranz, Marta, Zavadil, Milan, *Are Emerging Asia's Reserves Really Too High?*, IMF Working Paper, 2008, p. 5

China's current account surplus, the bilateral surplus with the United States and later the European Union rose to turn in early 2000. Thus, in 2004 China was seen as a "currency manipulator", which drew the United States adopt a punitive trade legislation in 2005³⁵. China's policies and activities, as well as several other emerging markets, but were not the only cause of global surpluses agglomeration economies. Another important source was created by exporters of goods. Under the influence of monetary accommodation, low real interest rates and accelerating economic growth, prices of commodities, especially oil began to grow fast. The immediate effect similar situations boom in commodity prices, the constant current account surplus of the exporters. Figure no 2 illustrates the growing surpluses in the Middle East and other emerging countries since 2004. These cash surpluses had therefore to be absorbed by other states.

As shown in Figure 3, the aggregate current account surplus own advanced economies except the United States has seen accelerated growth in 2004, reached its peak that year, then began to decline. But the U.S. deficit has continued to increase until 2006. Total deficit grew rapidly emerging economies, the Eastern Europe for boosting global demand for liquidity. With regard to savings deposits, current account developments in the situation are observed since 2004, namely rapidly rising U.S. external deficits and increasing surpluses of liquidity in the euro area. Although the European Central Bank has established a unique level of interest rates for a number of national economies, the euro area showing a microcosm of diverging global current account status. Since 2004, Germany's external surplus rose sharply, but its growth has been offset by rising deficits recorded by countries such as Italy, Greece and Spain in particular. In the U.S., low interest rates generated a strong multiplier mechanism based on unrealistic expectations and distorted markets, especially financial ones. Therefore, assessment of assets that followed, especially in real estate, was the trigger for the contraction of the population and boost consumption as much credit³⁶. Property prices in the United States supported increased nearly a decade. The only decrease is reflected in urban housing quotation Case-Schiller index from 1997 to July 2006 took place in November 1998 and December 2001³⁷, being then very small changes in intensity. So, no Asian crisis or recession around 2001 failed to disrupt the U.S. housing market.

Property appreciation expectations have led to accelerated growth of this sector after 2003. Debts incurred by mortgage and they have expanded rapidly, while the performance of these loans continued to deteriorate. Property prices rose by double-digit figures in 2004 and 2005, while rival mortgage amount the total GDP of the United States in 2006³⁸. Low nominal interest rates in the U.S. market and moderate growth perspective it has encouraged the proliferation of mortgage loans with variable interest. Meanwhile, nominal rates and low inflation have encouraged the lending. The rising inflation rate, monthly nominal interest payments reflects to some extent real depreciation of the loan, which further affects income beneficiary of the loan. Unfortunately, the U.S. real estate credit conditions have deteriorated much more than they could provide consumers. European banks have bought U.S. real estate securities rated AAA many (though not transparent and systemic risk). This has been one of the determinants of growth of aggregate assets and liabilities industrialized states.

U.S. housing market price decline began in 2006 triggered a current account adjustment process. External value of the dollar, although quite volatile in August 2007, did not collapse. Instability in the U.S. has spread globally because no change in exchange rates, but because of strong linkages between large financial institutions and the global nature of the real estate crisis. Fragility of the tax system was undervalued prior to the crisis. Magnitude of accumulated global disparities by 2008 reflects the instability of system instability that, in time, he boosted weaknesses. Figure no 3 captures the global rebalancing those disparities. In addition to the U.S. deficit, the surplus of other advanced economies, the Middle East or the Commonwealth of Independent States experienced a

³⁵ Obsfeld, Maurice, Rogoff, Kenneth, *Op. Cit.*, p. 13

³⁶ Dunaway, Steven, *Global Imbalances and the Financial Crisis*, Council of Foreign Relations Inc., 2009, p. 10

³⁷ http://www2.standardandpoors.com/spf/pdf/index/SPCS_MetroArea_HomePrices_Methodology.pdf

³⁸ Crotty, James, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the 'New Financial Architecture'*, Working Paper 2008-14, University of Massachussets, p. 12

steep downward slope. Asian newly industrialized maintains its position before the crisis, while emerging Asia continues its growth (mainly due to China.)

Reducing the current account deficit leads invariably a medium-term depreciation of the currency. Necessary contraction of domestic demand relative to domestic supply price implies a decrease of indigenous goods and some restriction of trade reduces the relative price of imported goods with domestic demand. This explains the deterioration of the dollar exchange rate as a result of reducing the current account deficit of the United States. Origins of huge current account deficit of the United States coincided with the appreciation of the dollar appreciation which amounted to 20%. Findings were supported by an investment boom, the Asian crisis and the strong perception of "Great moderates." However, under pressure from highly permissive monetary policy and the period after September 2001, from 2002 until early 2007, the dollar depreciated by more than 16%, significant increase, but temporary, in 2005, will continue its depreciation in 2006, the current account deficit was fueled by poor trade balance.

However, with housing boom reverse light and reduce the external deficit, the dollar collapses, depreciating by more than 11% between January 2007 and April 2008. Intensifying financial instability in the spring of 2008 induces a new appreciation of the dollar. A second determinant of the dollar appreciation has been established sources of funding shortages in the short term dollar shortage-induced toxic and bad investments made by foreign banks in U.S. dollars. These factors have led to real appreciation of the dollar by 16% between April 2008 and March 2009. Spring 2009 marked a new descent of the dollar; its exchange rate is hovering below 5 percent recorded in early 2007, shortly after the start of the current account adjustment process. It seems that the dollar will continue weakening while the U.S. major trading partners, especially China, are showing signs of appreciation of their currencies.

6. Conclusions

For an effective economic recovery can take place, it requires drastic action, no easy task since it requires an international match. In most advanced economies, but also a limited number of emerging economies, require a relocation application, yet focused on consumers of all (public), relocation to the private sector, and coupled with consolidation of public finances and financial sector restructuring. The emerging economies and the advanced will have to boost economic growth based on domestic sources, since demand in international markets will not reach the level too soon before August 2007. Production of quick recovery from the crisis involves the application of policies based on individual circumstances. But the temporal variation of such individual policy may cause externalities, and these should be considered when defining such policies. Externalities induced by fiscal policies have a significant impact on developed economies - contractions national economies adversely affect exports to other countries and large deficits, correlated with lack of fiscal consolidation strategy in the medium term, affect exchange rates.

Furthermore, the lack of foreign investment or depreciation of exchange rates in some major emerging economies can destabilize trade and financial climate of other economies (whether developed or emerging) and extremely low exchange rates applied by some developed economies such could cause a whole wave of retirement investments, with potentially destabilizing states concerned. Recovery policies should focus on the macroeconomic imperfections, which in the past decade, global imbalances have led to major changes in current accounts were regarded as harmful only if the distortion causing internal or systemic or global dislocations generated (depreciation an uneven international reserve currency). Vices financial systems of advanced economies has encouraged excessive lending and therefore inhibited savings, while some government programs and market irregularities in some emerging economies have a strong impetus. Insufficient fiscal consolidation during periods of economic boom has boosted these effects, like the massive accumulation of official reserves by Asian emerging.

If economies must restore the level of private capital (United States), it requires a balancing and acceleration of financial reform, in order to recreate the proper economic recovery. Such a framework would remain permissive monetary policy, inflation or stability without affecting domestic and international markets. This work is important mainly for the United States, given its systemic role in international financial markets. In addition to fiscal consolidation, financial sector

reform progress should be considered a priority for both developed economies and for the advanced, whereas the current global crisis has been propagated only by financial market inefficiencies. Given the integrated nature of markets and financial institutions, reforming their synchronization needs worldwide collaboration. In short, efforts will be needed to fix damage from the crisis:

- ✚ recapitalization of banks: it needs an influx of cash to absorb the deterioration of credit quality and to foster sustainable growth in the light of tightening standards on financial markets;
- ✚ restructuring banks: will help stabilize the banking system and lead to avoid future turmoil from external bodies to support them when leaving the states;
- ✚ reinvigorating the market for claims: although still dependent on the state, has become an integral part of bank lending in most advanced economies

Looking forward, an effort will be devoted to restoring order in the markets. This can be achieved only through actions on several fronts: higher capital needs, new financial instruments, reducing the size of financial institutions to be more easily operated and controlled, if necessary, direct restrictions on the size and scope of financial activities. Internationally, despite advances in time, the financial crisis confirms the existence of imperfections in terms of market supervision, financial stress propagation process and procedures to improve the imbalances. All these flaws must be addressed. Another issue that threatens economic recovery consists of unemployment. Much of employment is involved in temporary work or work part-time and part of the population occupied, but able to work, abandoned the idea of hiring, so is not included in statistics. Influence on unemployment decrease in production was observed varied among developed economies.

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