Causes for the spread of the global financial crisis and tools for fighting it - Differences and similarities between Eastern and Western countries

Dr. Erich Keller, University of Applied Sciences of the Deutsche Bundesbank,
Dr. Thomas Dietz, University of Applied Sciences of the Deutsche Bundesbank,
Candidate of Economic Sciences Tetiana Protsyk, Ukrainian Academy of Banking of the National Bank of Ukraine

What started as the so-called subprime crisis in July 2007 has in only 18 months become the biggest financial market crisis since the Great depression. In October 2008 the International Monetary Fund (IMF) has estimated the potential global losses caused by this crisis at approximately 1,4 Trillion US Dollars[1]. The crisis put an end to the era of pure investment banking in the United States and – at its current state - is even threatening the financial soundness of highly developed industrial countries.

The developing market economies in Eastern Europe have been hit hard by the crisis, too. Ukraine, for instance, had to apply for additional support of the IMF to fulfil international payment obligations. The result of the financial crisis for both highly developed Western countries and the emerging market countries in Eastern Europe could be the same – a deep economic recession – the transmission mechanisms of the crisis and some of its features seem to be rather different.

Taking Germany and Ukraine as the examples for a developed Western and an emerging Eastern countries respectively we can investigate how exactly the downward liquidity spiral was triggered, by which mechanisms it got reinforced and how exactly the governments hope to break this circle, including some suggestions submitted by different international bodies on how to avoid future financial crises.

Rescue packages in about 30 highly developed states around the globe all show similar features and consist of state guarantees for debt obligations issued by the institutions; recapitalisation by public participation and swapping problematic (already now or possibly in the future) almost worthless securities („toxic waste“) against government bonds[2]. Part of the rescue packages is also the temporary suspension of the IFRS rules.

Apart from the public rescue packages that are supposed to mitigate the impacts of the crisis and in the end to stop it, some recommendations have been published to avoid similar future crises. They are quite consistent and reflect clearly the lessons learnt from the subprime crisis.

In Germany depending on the respective support measure the institutions have to pay different fees for the state support and the state can excert different levels of influence on the institution’s business. The strongest state influence on the institutions can be excerted if the state has granted recapitalisation. In this case it can review the institution's remuneration structure; limit the salary of the board of directors to 500.000 Euro a year; prohibit the payout of dividends to other shareholders than the state; oblige the institution to take account of the demand for credit supply of the real economy, in particular for SMEs, and to grant this supply under 'adequate' conditions[3].

World financial problems and the withdrawal of foreign capital from the economy of Ukraine by cross-border groups situated in Western Europe triggered a liquidity squeeze at the second half of 2008. Together with the withdrawal of retail deposits this caused the National bank of Ukraine (NBU) to support the banking system with sufficient liquidity support. Consequently, the refunding carried out by the NBU could partly compensate the withdrawal of retail deposits and foreign investors' deposits. However, the support of banking liquidity in considerable volumes should be only a temporal measure, before the development and realization of the complex program of restructuring national banking sector.

---

[1] IMF (2008), p.15.

[2] Sachverständigenrat (2008), p.117.

[3] Sachverständigenrat (2008), p.158.

Keller E. Causes for the spread of the global financial crisis and tools for fighting it - Differences and similarities between Eastern and Western countries [Text] / Dr. Erich Keller, Dr. Thomas Dietz, Tetiana Protsyk // Міжнародна банківська конкуренція: теорія і практика : зб. тез доп. IV Міжнародної науково-практичної конференції (21-22 травня 2009 р.): у 2 т. / Державний вищий навчальний заклад "Українська академія банківської справи Національного банку України" – Суми, 2009. – Т. 1. - С.12-13.