THE ROOTS OF THE WORLD FINANCIAL CRISIS

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Abstract. In this paper the authors show the possible causes of the world financial crisis. In this way is presented the start of the financial crisis, and the evolution of American economy, its huge defficit, the evolution of nemployment rate, the inflation rate, the people rate debt etc.

Key words: financial crisis, oil price, national debt, solvency

JEL: G01

1. Introduction

Many analysts consider the financial crisis as a new phenomenon, without precedent in the world economy.

Real estate credit crisis led to global financial crisis, and since then central banks and governments of developed countries made great efforts to unlock credit economy, which gradually came into recession

A retrospective of the world economy reveals that there were crises in other countries such as Brazil and Mexico, but they were due to wrong government policies based on low taxation and a fixed rate of conversion of national currencies.

"The punishment of Allah", "Economic Pearl Harbor" (American billionaire Warren Buffet, one of the most respected investors on Wall Street), "Explosion of the financial Bubble", "The new financial collapse", "Financial vortex" (Alan Greenspan) are just some of the phrases used to define the global financial crisis.

2. The origins of global financial crisis

American administration policies were based on the premise that every American should be homeowner, and the facility offered by the American taxation authorities is the one of the deduction of interest from taxable income. This implies that all homeowners assume a financial risk, as it happened to the more than 22 million Americans, which in the period 2005-2007 have bought new or older houses, and who, after "real estate balloon" burst, lost a significant part of this investment. Currently, American analysts estimate that more than 10 million families own houses and their mortgage value exceeds the market value of these homes, and therefore this no longer allows them to change frequently jobs.

An important cause of the current financial crisis can be identified on the one hand in the absence of regulation in the banking (financial) system of the United States, on the other hand, in the decrease in reference interest by FED after the terrorist attack from 09.11.2001, in order to create liquidity in the banking system and to protect numerous financial institutions entering the payment inability.

A major cause identified by most financial specialists refers to the financial derivatives (contracts) market.[33] Otherwise, the unprecedented development of this from 106.000 billion

33 Klein A., Goldfarb Z., The Bubble, The Washington Post, 06.15.2008

dollars in 2002 to over 531.000 billion dollars in 2008 was intended to increase the risk instead of limiting it based on the doubts about how companies value them.[34]

Derivatives were created as a protection against losses from investments. These contracts allowed financial services firms and companies with adequate liquidity to take more complex risks that normally would be avoided.

Defender against the imposition of restrictions on financial market derivatives Alan Greenspan argued in 2003 in front of the U.S. Congress that "derivatives were and are an extraordinarily useful vehicle to transfer risk from those who should not take it to those who are willing and able to do so."[35]

The collapse of real estate credit in the United States resulted in massive losses for all investors who bought financial assets based on mortgages. These losses have affected the credit institutions which in the attempt to cover the debts sought to increase their own capital by selling shares, which resulted in negative reaction of the capital market, by dramatically lowering the shares of these banks, and pronounced reduction of equity of credit institutions.

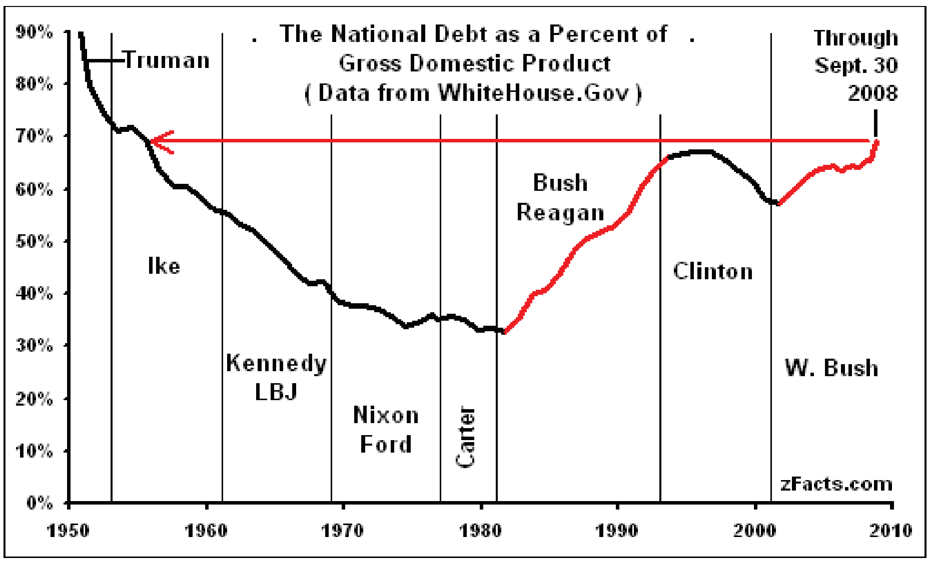


Fig.1. The evolution of public debt of the United States

Undoubtedly, a major cause that has been overlooked beginning with the Bush administration was the public debt of the United States which could reach a record level of over 70% in 2009.[36]

Also in the analysis of the financial crisis one cannot exclude the evolution of the degree of indebtedness level of the population in the United States.

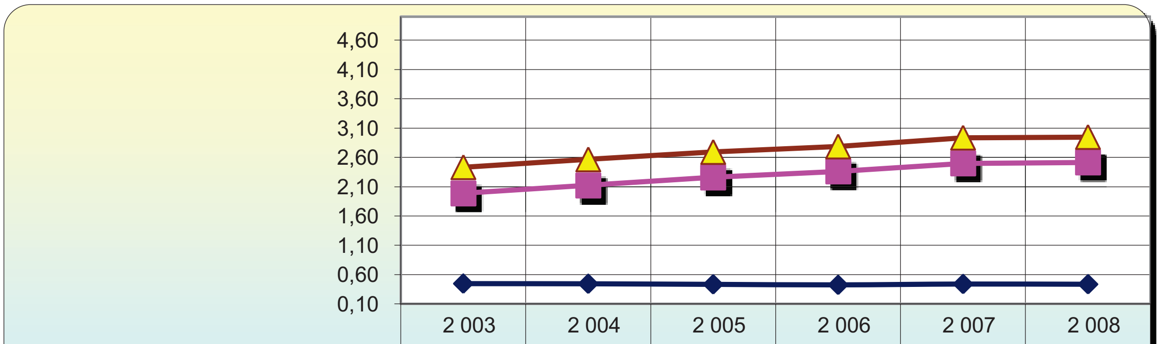
Thus, based on data obtained from the American statistics we have determined the evolution of this indicator over the period 2003-2008.37

34 www.zf.ro nr. din 13.10.2008

35 Idem

36 www.whitehouse.gov

37 The Statistic Federal Reserve Board. Statistical Suppliment of Federal Reserve Bulletin 2004-2008; US Department of Labor. Bureau of Labor Statistics 2003-2008

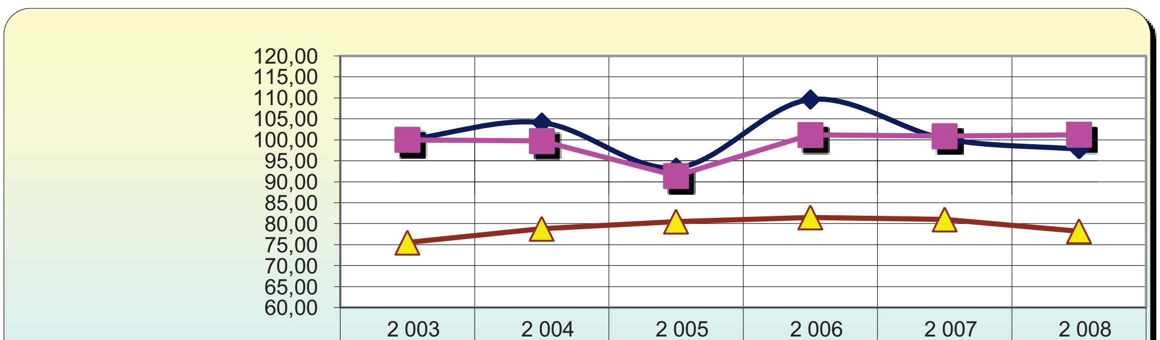


	2 003	2 004	2 005	2 006	2 007	2 008
Consumer credit/ 1USD wages	0,44	0,44	0,43	0,42	0,44	0,43
Mortgage/1USD wages	1,99	2,12	2,26	2,36	2,50	2,51
Total credits/1 USD wages	2,43	2,57	2,69	2,79	2,94	2,95

Fig.2.The evolution of degree of indebtedness level of the population in the United States

As shown in the picture above, the degree of indebtedness of the population has evolved between 2003-2008 from 2.43 USD to 2.95 USD for a US dollar income. Under American economy shrinkage conditions, as a result of the increase in the number of unemployed, those who were indebted could not pay the rates due on loans and thus triggering the foreclosure process of the respective properties.

Certainly, a major cause that triggered the financial crisis has its explanation in the evolution of industrial production in the United States.



	2 003	2 004	2 005	2 006	2 007	2 008
Output	100,00	104,08	93,34	109,59	100,26	97,77
Capacity	100,00	99,73	91,39	101,17	100,87	101,22
Capacity Utilization Rate	75,50	78,80	80,50	81,50	81,00	78,20

Fig.3.The evolution of output, capacity and the output capacity rate in the United States

Thus, it can be observed a decline in industrial production during 2004-2005 and 2006-2008, given that the rate of utilization of installed production capacity decreased between 2006-2008 from 81,50% to 78,20%.

Particularly important is the analysis of correlations between annual productivity and average annual gain as shown in the picture below.

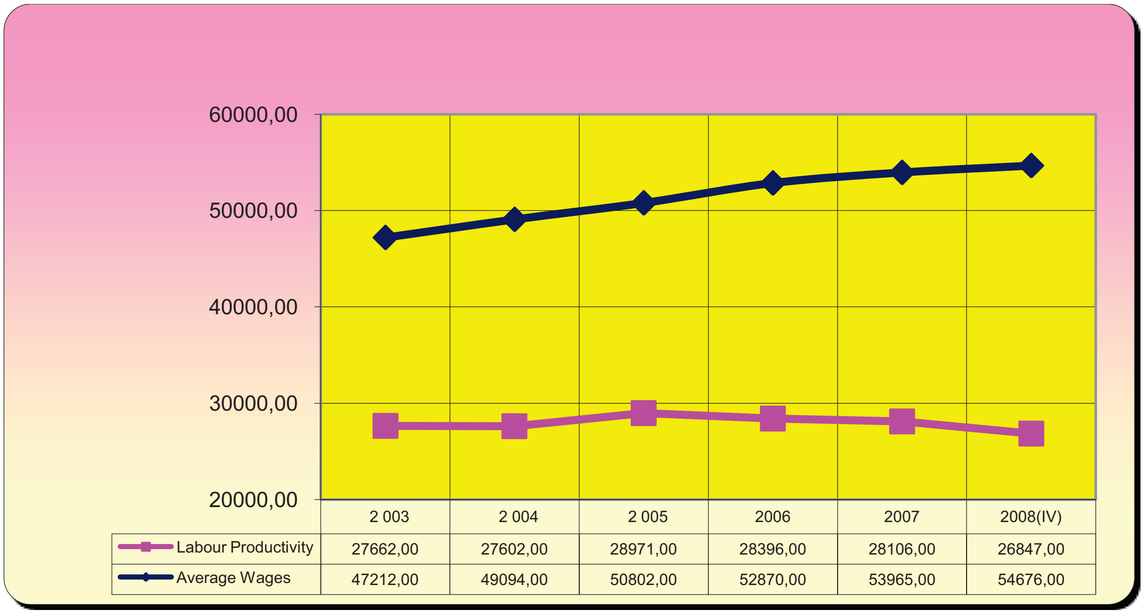


Fig.4. The evolution of productivity and the average wages in the United States

From the data presented above results on the one hand a level of productivity below the average annual earnings.

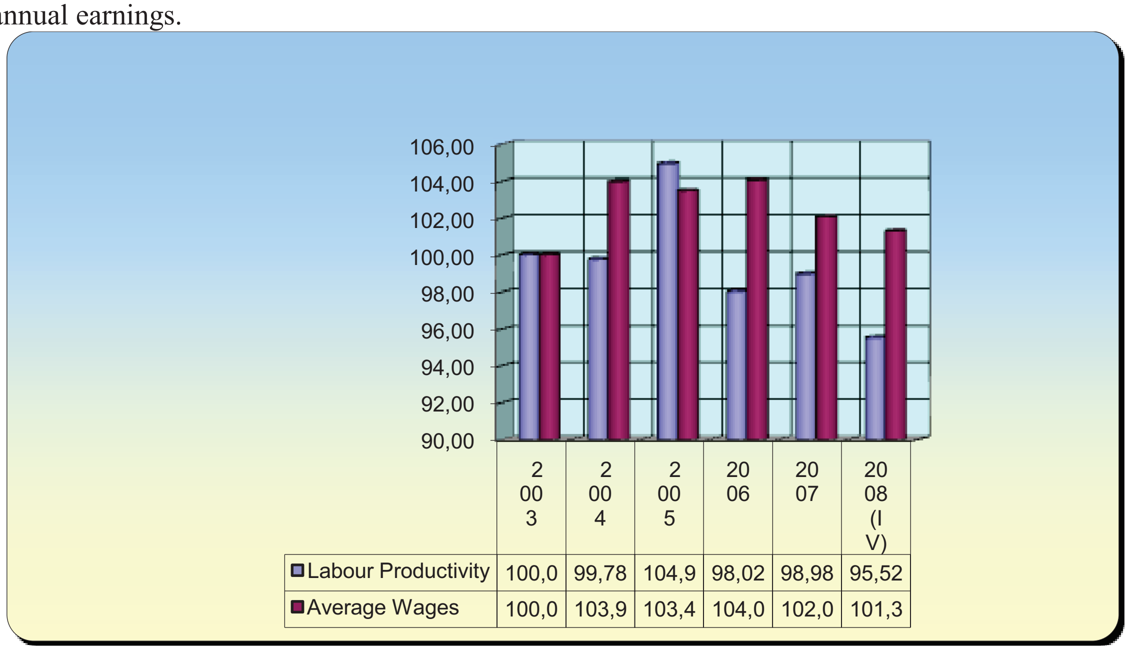
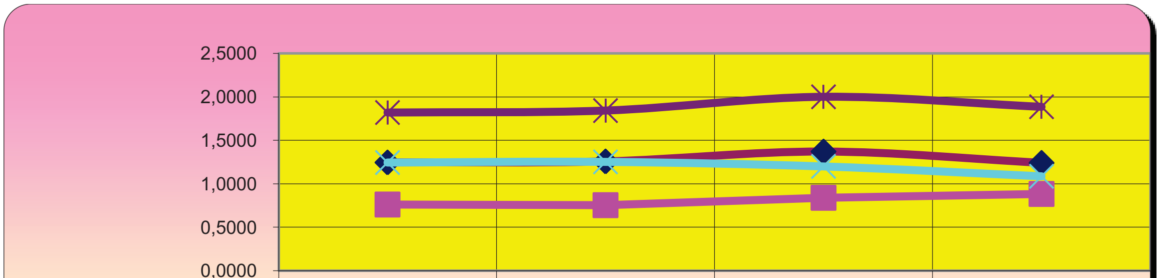


Fig.5.The dynamics of labour productivity and average wages

It is noted therefore that the average income outran the pace of labor productivity in 2004 and in the period 2006-2008.

Financial crisis triggered in the United States based on the real estate credit crisis has its explanation also in the fluctuation of the U.S. currency on financial markets on the one hand and in the evolution of oil stock.



	2 005	2 006	2 007	2008(XI)
Australia/Dollar	0,7627	0,7535	0,8391	0,8815
UE/Euro	1,2449	1,2563	1,3711	1,2400
Switzerland/Franc	1,2459	1,2532	1,1999	1,0841
UK/Pound	1,8204	1,8434	2,0020	1,8865

Fig.6. The evolution of exchange rate of USD

From the data presented above it results that one of the causes of financial crisis has its explanation in the strong depreciation of U.S. dollar against other currencies in Europe, Australia, Switzerland or Great Britain in the period 2005-2007.

On April 22, 2008, the dollar traded at \$1.60 for a euro and \$2 for a pound. After this strong depreciation, beginning with August the dollar has strengthened continuously, based on business liquidation made abroad by American investors and on the reference rate policy set by central banks: thus Fed established beginning with October 2008, 1.5% interest on overnight deposits, the European Central Bank setted interest at 3.75% and Bank of England at 4.5%. Currently the quotation is 1.36 dollars for a Euro.

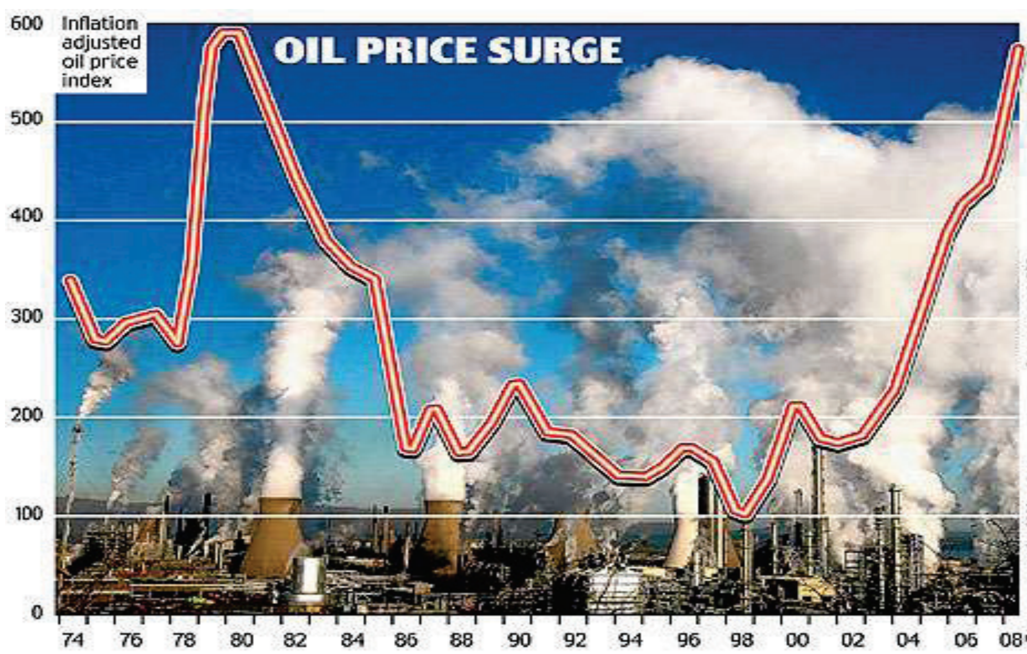


Fig.7. Evolution of oil stock in the period 1974 - July 2008

Global financial crisis has its explanation also in the development of the oil stock which reached a historical maximum of 145 USD per barrel in July 2008, after which, based on the evolution of the economic recession the stock has fallen steadily, reaching at present 51 USD per barrel.

3. Conclusions

No doubt that the current global financial crisis is unprecedented, although some analysts compare it with the one from the years 1929-1033, whose duration is estimated by most analysts at least 5 years.

Paulson and Obama plans in the United States appears not to have had the expected effects, and European plan to stabilize the financial system didn't fall into place yet.[38]

Exiting the current global financial crisis undoubtedly involves state intervention in the economy with all the negative consequences arising from this.

One of the myths dispelled by the current global financial crisis is that the bank is the fundamental actor of the market economy, whose unwritten law is that those who fail to cover their expenses with their income are out of the game through bankruptcy.

The fact that banks which have recorded huge losses have not gone bankrupt, has shown that they are no longer subject to the laws of market economy but they are utility suppliers just like the suppliers of electricity, water etc.

Finally we observe that the crisis in U.S. is engendered mainly by the generalized decrease of consumption, which was the basis of American economic growth, and that has thus contributed to the lack of liquidities in the financial market.

Financial instruments through which American companies try to increase their capital are no longer efficient in these circumstances, as investors lost their confidence in the returns offered by the capital market.

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