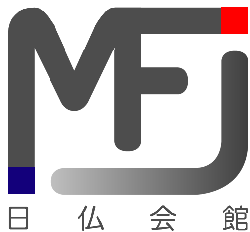

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Financial crisis view from Europe.

by

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Financial crisis view from Europe.

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Crisis deepens every day and the more its deepens the more it enlarges both by sectors – from a subprime crisis at a full global financial crisis- and by country from the US to Europe, Japan and now to emerging countries. It is the first true global crisis, based on major disequilibrium, massive financial surplus in some countries, major debts in others.

Since early 2008, forecasts are regularly downgraded which, in return, regularly depresses the market, deepening the liquidity and real crisis, a kind of vicious cycle is at work and nobody knows the end of it.

The contamination process

Many countries were in a rather good shape just before the subprime crisis; in particular Europe and Asia were thought to be safe from the financial turmoil. Take for example Germany: since the end of 2004, the German economy has made a spectacular come back due to Schroeder ambitious reforms both of the labor market and the fiscal system. German growth rate was one of the highest in Europe, productivity gains were also very high, unemployment was decreasing very fast, budget balance was just in equilibrium and German banks were not much involved in toxic assets.

Germany should have escaped the crisis. Some of these remarks could apply to the Japanese economy as well, except that its total public debt is very higher compare to European levels.

In Europe in general except for the UK, Spain and Ireland most countries did not have real estate bubbles or even stock market levels did not seem to be at unsustainable levels. Most banks were thought to be rather safe as regard subprime exposure. But in part, many of these banks under-estimates their real exposure due to the extraordinary complexity of the new investment vehicles invented in the last decade.

Therefore contamination came through the financial channel.

- Stock market started to collapse in August 2007 in developed countries with the bank stocks ahead but other sector follow.
- Doubt emerges about the real exposure of banks.

- As collateral value started to collapse then the need for banks to maintain their prudential ratio they started to look for liquidity.
- With the Lehman Brother bankruptcy the search for liquidity became a matter of survival for any financial institution whatever the quality of their management.

  US firms were massively selling all their non strategic assets at whatever price possible all over the world –which contributes to the contamination process through:
- The appreciation of the dollar against the Euro singe August 2008,
- The transmission to emerging countries as many firms became short of dollars for their exporting activities.
- Recession in the US and Europe means a collapse in world trade

  The deleveraging will probably take more than six months to come.

Policy reactions in Europe

In Europe, official authorities take action rapidly to face the liquidity problem first by injecting large amount of liquidity, second by offering guaranty for the bank credits to restore inter-banking liquidity and credit to consumer. Last they choose to offer recapitalization for the banks.

There are still discussions for the best way to restore normal financial activities:

First shall we withdraw toxic assets before recapitalization?

Second credit guaranties to what extent?

How does it work?

In France, recapitalization offer to banks were of the amount of 40 billion Euros, and financing credit guaranty covers 360 billion Euros.

Up to now, it seems these actions were successful to avoid the worst that is a massive bankrupt, the collapse of the financial sector.

From the rescue program to the stimulus program

Financial crisis becomes since mid-September a real crisis, therefore the financial rescue will not suffice to fix the recession, and stimulus package became a necessity.

Consumer confidence was declining sharply as the drop of 30% in the automotive sector shows.

Unemployment is rising very fact

Exports activities are suffering a lot

But the countries have different room for maneuver depending on their debt ratio and, as in the case of the Euro zone; there are institutional constraints on public deficits. One of the problems is also the lack of coordination between European governments which could weaken the effectiveness of their stimulus packages which in part psychological.

Another question which is probably the most difficult to anticipate: When the return to normal come, how will we manage the enormous public debt?