

Macro and micro economic effects of economic crisis economics essay



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The assignment will go through analysis of the main components of the world crisis, their impact on the government debt of some European countries.

This impact will be further detailed for the impact in Albanian Economy and see how main sectors of the Albanian economy have been impacted, even why the main indicator, GDP has still keep the increase trend but with small steps than previous years.

These macroeconomic factors have been also analyzed and show the real impact of a firm, Banka Societe Generale Albania. The banking sector has been one of the most impacted sectors with decrease of the loan activity and increase of non performing loans.

Actions performed by SGAL in order to improve the situation and increase activity have been detailed and progress during 2010 is presented to prove the results of these actions.

Final conclusion with recommendation for minimizing the crisis impact and prepare actions and policy to support economical growth are presented.

Introduction

World financial crisis 2007-2010

Many economist consider the financial crises that started with, the lack of liquidity in USA banking sector and later impacted most of the world economy in the last 2-3 years, as one of the biggest recession after the one of 1930 (Roubini, Rogoff and Behravesh, 2009). They also argued that despite the fact that it is unusual for a recession to last more than 2 years,

2010 it will still be a year of slow progress and slow improvement of the situation. Other specialist of the macro economy argued that in the last 50 years there have been other recession where the GDP fluctuation where deeper and level of unemployment much higher (Schiller, 2010).

Both USA and European Union introduced a series of action for reducing the impact of crisis in their economy. One of the worst and long term impacts of this crisis was the debt crisis of many European countries. Countries like: Greece, Ireland, Portugal, Spain and many others are running in large amount of government budget deficits. These worries for increasing of government deficits, especially due to the external debt toward other countries, created alarm in financial markets.

Table 1, represents a view of the government debt in the euro area in the last 4 years. The total value of government debt as % of GDP was continuously increased, but especially on 2008-2009 were the increase was 9.3% or equivalent in million euro of 638,010.00. In 2009 the largest government deficits in percentage of GDP were recorded by Ireland (-14.3%), Greece (-13.6%) the United Kingdom (-11.5%), Spain (-11.2%), Portugal (-9.4%), Latvia (-9.0%), Lithuania (-8.9%), Romania (-8.3%), France (-7.5%) and Poland (-7.1%).

On May 2010 European Finance Ministries and International Monetary Fund (IMF) approved a financial emergency packet of 750 bn euros for improving the financial stability of European countries (BBC news, 2010). Immediately after this, it was reported that central banks started to buy government bond issued by countries in difficulties. European countries and other EU entities

continue to discuss and give alternatives for improving the situation. The latest one is a proposal for creation of a European Treasury coming from Constance Le Grip and Henri Plagnol, respectively members of France's parliament and the European Parliament. The main idea is to create an institution that would be in charge of shared management of the debt of euro zone states (CNBC news, 2011).

Table 1. Government debt in Euro area

Data available from eurostat http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-22042010-BP/EN/2-22042010-BP-EN.PDF

(Euro area includes: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Cyprus, Luxembourg, Malta, Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland. In the attached table, the euro area is defined as including Cyprus, Malta, Slovenia and Slovakia for the full period, although Slovenia joined the euro area on 1 January 2007, Cyprus and Malta on 1 January 2008 and Slovakia on 1 January 2009)

Government debt in Euro area

2006

2007

2008

2009

Government debt

(million euro)

5, 842, 888. 00

5, 940, 433. 00

6, 424, 615. 00

7, 062, 625. 00

Government debt

(%of GDP)

68. 3

66. 0

69. 4

78. 7

Macroeconomic effect of crisis in Albania

If we take as indicator for evaluating crisis the level of economical growth during the year we may conclude that Albanian economy is part of countries which have been impacted by the economic crisis, but which are not in crisis. Albanian economy continues to have a positive economical grow, which however is much less that the one of few years ago (World Bank, 2010)

Year

Economic growth as % of GDP

2007

6.00%

2008

7.50%

2009

2.50%

2010

3.00%

2011

3.70%

2012

4.20%

Table 2. Economic growth as % of GDP. Source: World Bank data

Extrapolated values

The table shows that economic growth continues but of course not with the same steps as before the crisis. The forecast for 2011 and 2012 are optimistic and promise an increase compare to other countries of the region.

If we have a quick look on the past we see that before 1990 the Albanian economy was based on a market model totally controlled by the government. After 1990 Albania went in a transition period where many social and economical changes happened. A considerable part of government owned factories and other business were privatized, by generating little family businesses, mostly focused in trading of basic goods. This was the beginning of a free market based economy. The progress in the first years was not as good as it should be, on opposite a step backward was done with the crisis coming due to collapse of private financial schema known as “ Piramids” in 1997. In 1998 with the selection of the new government the Albanian economy entered in a new area of growth but still with a lot of informal economy going on.

Banking sector can be considered as one of the most important sector and most growing business in Albania. The legislation where changed and necessary policies were applied in order to give to the Bank of Albania the authority to maintain the price stability and control the financial system and avoid recurrence of another collapse (Bank of Albania, 2009).

Albanian institute of statistics in their publication of 2010 “ Albania in Figures”, has presented that GDP is mainly composed by:

Agriculture 18. 5%,

Industry 9. 8%,

Construction 14. 9%,

Transport & Communication 9.6%, Services 47.1%. Services also include trade, hotels and restaurants. Remittances present about 9% of the GDP (US State Department, 2010).

What happened to these factors of Albanian economy during crisis time, where they impacted by the crisis? Which were the sectors with little progress or even decreasing of their growth?

Remittances. Since the beginning many experts forecasted that remittances will be a factor “importing” crisis in Albanian economy. This is mainly due to their impact in GDP and the fact that emigrants are more exposed to the risk of losing their jobs as soon as crisis appears. Albania has approximately 1.5 times more employer outside their borders rather than inside its territory (INSTAT, 2010). Most of them live in Italy and Greece and both of these countries have been heavily impacted (in a negative side) by the crisis.

Greek government has implemented new financial policies and reduced a lot the government expenditures, this will make the life more difficult for Greeks themselves and also Albanians leaving there. Remittances are the greatest source of incomes in foreign currency, they had their maximum in 2003-2004 with about 14% of the GDP and since then have continually decreased up to 9.2% in 2008 and 9% in 2009. This is also reflected on the exchange rate EUR/ALL where ALL is constantly devaluated. The change of income from remittance does affect aggregated demand curve of many goods. A reduction of remittances, experiences a decrease of incomes in the economy of many Albanian families, this will shift their aggregated demand curve of goods down from D_0 to D_1 . The overall impact on the market price will be depend on the level of shifting and reply of the suppliers toward this change.

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D1

D0

Data on this graph are for demonstration purpose only.

Another field impacted by the crisis is the construction sector. Construction sector has contributed with more than 10 % of the GDP in the last 15 years. In the last 2 years the sector has been in real difficulties with a decrease in number of constructed buildings and the total turnover (INSTAT, 2010).

There are some factors which impacted this sector, some of them are related to the crisis and some are related to political and economical situation. In the last 10 years there was a big demand for housing buildings and now this demand is decreased. In order to cope with this new trend of the market, the construction company should diversify their service and focus more in construction of services building and also consider the possibility to decrease the price. There is no correlative connection between the price of inputs and the price of selling of apartments (Civici, 2009).

The number of building permits for both residential and non-residential has also been decreased, mainly due to political condition. This has made the supply curve to shift up and reduce the effect of demand curve shifting down due to market saturation, so the final impact in price is remained unchanged.

The reduction of remittances had also a considerable impact on this sector. Emigrants have continually been a significant group of customer for this sector.

Another important factor of reducing the growth of construction sector is the decrease of loaning activity from banking sector. Many banks have decreased this activity because of reduction of their deposits and increase of risk for bad loans.

Banking Sector. In Albanian there are currently 16 banks, only 2 of them are with a full Albanian capital. In 2008 foreign capital represented 91.8% of the total capital (Bank of Albania, 2009) and the total value of their assets represents about 52% of GDP (IMF, 2009).

Data from Bank of Albania, clearly showing the decrease of loans issued to individuals. This trends shows that individuals are not anymore a target for banks, because of the high risk coming from reducing of their income and increase of prices for basic good.

According to Bank of Albania the last quarter of 2008 and 2009 has been quite difficult for banking sector. Increase in number and volume of the bad loans as well as the decrease of landing activity, mainly for individuals, are 2 of the main aspects of this market. During 2009 the value of bad loans has arrived in 20.8 billion Lek, which represents an increase with 78.9% compare to value of bad loans in 2008 (Bank of Albania, 2009). One of the most problematic sectors is construction with 13.9% (bad loans / total loan). However business is the favorable customer segment for loaning and represents 63.48% of the total loan portfolio, compare with 61.77% in December 2008.

Considering the fact that many Greek banks, which also have their presence in Albanian, are in real difficulties, we may argue that there is a possibility <https://assignbuster.com/macro-and-micro-economic-effects-of-economic-crisis-economics-essay/>

that this has an impact in our economy and specially banking sector. This argument was not supported by the governor of Bank of Albania, Mr. Fullhani. He has continuously declared that there is no risk for Albanian Banks, which operates as subsidiary of their mother company in Greek, as they operate their activity as independent banks and everything is controlled by Bank of Albania (Website of Bank of Albania, 2008-2010).

Relating to the conditions and collateral of loan issuing, banks have enforced new standards in terms of incomes and value of collateral. By the end of 2009 only 20% of the loans do not have collateral associated to them. However still 36% of loans with collateral are covered with homogeneous collateral (not based in real state property). This is relatively high value and presents a risk of not being able to cover the loan in case the loaner will fail to pay back the bank.

Government policy

Government has never accepted that Albanian has been impacted by the world crises and continuously has declared that the economy is growing up. However during 2009 and 2010 the government has applied some policies which are taken by Bank of Albania, Ministry of Finance and other institution in order to keep the positive trend of the increase of GDP.

Informal economy. Informal economy is a phenomenon existing in every economy, but on “ in development” countries it represents a significant part of GDP. In Albania in 2002 it presented about 33. 4% of the GDP (Schneider, 2002). Control over this informal part of the economy and turning it into a registered and taxable business will definitely play a role on increasing of

GDP. Tax office has amplified the control over the informal business and this has resulted in more businesses registered as confirmed by QKR and INSTAT in their reports for 2010. To support this Government has also changed the law on social contributions by decreasing the % paid by the employer and reduced the number of documents required to register a business.

Monetary Policy. As mentioned above the loan activity has been decreased. Bank of Albania has changed the interest rate by decreasing it with 1.25% three times during 2009-2010. This decrease is followed by a slight decrease of interest rate which from its side has increased the demand for loans, especially for individuals.

Others. The government applied several policies to reduce in maximum the operation cost of its main institutions. The government increased both internal and external debt and put more money on public works as well as increased pensions and salaries. These reforms have a positive impact in the economy as people spend more in the market, but could become risky if we see it in long term. Increase of government debt can become a risk for repetition of similar situations as it happened in some European countries during 2010.

Microeconomic effects

Banking system is well known for its role in the macro economy because of its main functions; a) transfer money from savers to the spenders using loans, b) generate more money by making loans in excess of total reserves (Schiller, 2010). Banks are the one who change the size of money supply, which presents the power of purchasing goods and services. Changes in this

sector reflect changes in spending behavior which are than reflected in changes in the aggregated demand curve.

Albanian banking market is a free market with 16 banks operating and fully owned by private investors. Many important European financial institutions are present in this market with their capital invested in these banks. The banks are not present in the European stock exchange and fully operate based on local policy and regulation where the National Bank controls the level of liquidity, loans, and incomes exported in terms of profits to their mother companies. Although many efforts has been made by National Bank to decrease the impact of crisis in 2nd level banks, during 2nd quarter of 2008 and 2009 banka Societe Generale Albania (SGAL) has not been performing as forecasted and has generated considerable loses. 2009 was closed with a total loss of about 5 million USD. This was mainly caused by the situation of the market during this period and some internal organization issues.

Bad Loans. The number of non performing loans (NPL) has been continuously increased and arrived almost at 15% at the end of 2009. This has generated losses by the provision of these loans. The banks assets where still able to cover all liabilities since the value of mortgage properties was not decreased.

New loans. Decrease in demand for new loans and risk of bad loans generated low number of new loans and less commission for the bank.

The level of deposits was also reduced during 2nd quarter of 2009, but it started to recuperate quickly and allowed bank to continue landing activity.

Commission fees. The number of transaction performed was also decreased and the cost for transaction was increase. In total bank generated much less income than in the previous years.

Investments. Considering the good trend of 2006-2007 the bank decided to perform significant investments in its IT systems. The part of this investment paid to the supplier during 2009 for service and consultancy generated big expenses during this year.

Actions for improving in 2010.

After the financial report of 2009 and analyzing the positive trend noticed in the two last months of 2009 for an increase in the demand for loans. The management of the bank prepared a set of actions to be implemented

Number of new loans in 2010

Decrease interest rate for deposits. Supported also be the decrease of interest rate form the central bank, SGAL reduced the interest for term deposits and saving accounts 2 times during 2010 and closing with the year with 5. 75% for deposits with 1 year maturity in local currency, whether the interest for EUR is now at 3% for 12 month deposit. This decision is expected to generate change in the behavior of consumers and increase the demand for investments as well as increase the demand for new loans and credit cards since the monthly payments also are decreased (Schiller, 2010).

Interest Rate

Rate of investment/loans

Up the end of November 2010, the results were very optimistic with many new loans generated especially in the second quarter.

Increase of capital. The bank's shareholders increased the capital two times in the last years, once in 2009 and then in 2010 respectively from 2.9 billion lek to 4.4 billion and then arrived to 5.3 billion, 1USD = 101 lek (Annual Report, 2009). This increase of capital would give the bank more available cash to be invested in new loans, national bonds and euro bonds.

New insurances. New products on individual insurance of the borrower and collateral have been applied to the bank. The main scope for this is to reduce the risk of losses in case the client fails to pay or the collateral is destroyed.

Staff reduction. In the last quarter of 2009, the bank has decided to reduce its staff with more than 120 employees, representing about 27%, mainly in non-primary services like cleaning and internal security. These services have been outsourced to third-party suppliers. This reduction has played a substantial role in the decrease of expenses for 2010.

Other cost reductions were also applied: reorganization of office premises with an open space concept reduced the bank's expenses with about 10,000 EUR/month; reduction of communication costs, by applying real competition among suppliers and reducing the price with at least 20%.

Increase of quality of our services and launch of new products for the market together with the change of image campaign allowed the bank to gain a new position in the market and change the target toward affluent and business customers.

All these actions at the end were worthy to justify an improvement of the financial situation of the company from considerable losses and turn it at the end of 2010 still to be profitable.

Conclusion

The impact of global crisis in Albanian economy have been noticed with the decrease of economical growth GDP, with the changes in public finances, public debt, decrease of incomes, deterioration of the balance of foreign trade. Another important factor is the missing of liquidity in foreign currency in the financial market, which was reflected in the decrease of loaning activity and increase of non performing loans, diminish of foreign investment and reduction of remittances.

Reactivation of loaning activity will be the key for the economy growth in the next months. This reactivation will require the stimulation of the demand for loans from all economic consumers and of course the offering of acceptable and favorable conditions by banking sector as the main supplier.

The increase of incomes in foreign currency is another important element for minimizing the effect of crisis. This could be achieved by increasing exports and applying favorable policies for increasing remittances, like could be reduction of costs for transfers, collection of remittances and use them as development fund.

Market should be left free to activate with its mechanism of automatic economical stability. The government should be prepared and careful not to combine internal policies like could be the increase of debt, unbalance

between public investments and incomes or any other macroeconomic factor which could multiply negative impacts in the economy.

Each company should look through all alternative which would allow it to maximize its profits, either be reducing the expenses which of course is more complicated, unless the firm has really abused with them, either by investing in new technologies which would allow usage of less resources for achieving the same output and automatically generate more profits.