POST CRISIS EFFECTS ON THE EU FINANCIAL MARKETS. WHAT ARE THE FUTURE CHALLENGES?

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Abstract

The purpose of this study is to ascertain the effect of the 2008 global economic crisis in the European financial markets. The methodology used in this study would be provided from the main literature sources on the post crisis effects in the financial markets and the basis for reaching a very well elaborated conclusion will be built on analogical comparisons.
The research paper shall be focused on three main areas like: banking, financial management and investments which are considered the essential driving engines for the European markets. New policies on banking supervising, innovative fiscal policies and procedures of bail-outs in fighting the sovereign debts of the European Union were genuine results of the economic crisis that deeply re- dimensioned the European Union legal instruments.

What could probably stand as future challenges for the European Union financial markets after the Greek bail-out constraining policies, the latest Cyprus issue on a probable collapse of the banking capital how would the Euro zone reshape its economic engine and face the risk of liquidity?

The study concludes in displaying that the effects of the post crisis on the European markets were very profitable because they helped towards a new financial and macroeconomic policy for a better regulation of the banking markets, a thorough supervising of the central banks. The future challenges represent in fact optimistic thriving opportunities in investing broadly and a better evaluation of the financial risk. Moreover, European markets on the post crisis heighted even more the rise of the powerful economic axe such as the German power.

Keywords**:** *crisis, financial markets, European Union, bail-out*

Introduction

The purpose of this study is to ascertain the effect of the 2008 global economic crisis in the European financial markets. The origin of the economic crisis and the interconnectedness of the global financial system explained the “domino effect” towards European Union. The methodology used in the paper would be provided from the main literature sources on the post crisis effects in the financial markets and the basis for reaching a very well elaborated conclusion will be built on analogical comparisons.

The research would be focused on three major aspects of the post crisis effects on renewing policies, labor effects and the sovereign debt crisis. New policies on banking supervising, innovative fiscal policies and procedures of bail-outs in fighting the sovereign debts of the European Union were genuine results of the economic crisis that deeply re-dimensioned the European Union legal instruments.

The cost of the sovereign debt crises and the bailouts may represent future chances for promoting the economic growth and the euro currency sustainability. The rise of the powerful financial axe of Germany as a fundamental promoter of austerity plans might represent in fact long-term profits and thriving optimistic opportunities for the European Union’ future.

1. Origin of crisis

The 2008 economic crisis is considered by the literature as without precedent in the post-war economy due to its extent and involving features. As the economic behavior regard the cycle effect, the preceding period included credit growth and abundant liquidity with strong leveraging as well. In the American market the soaring asset prices and liberal credit growth developed the real estate bubbles. Financial institutions over-stretched the leveraging and were not able to correct the market which happened in the Asian economies in late 1990 but at these global levels since the Great depression in 1929[1]. In times of economic crisis the main characteristic is the acute liquidity shortage among banks and financial institutions, their solvency was considered difficult leading to collapse such as Lehman Brothers the great investment bank in US.

Moreover, the financial distress has been transmitted in the business sector with a rapid speed due to the high integrated supply chains in the market. Traces of the recession involve social and cultural effects affecting the concept of doing business and leading the market economy. As a result the banks and governments started to strengthen the monetary policy and launched the EU coordination on the fiscal union components. Therefore the economic crisis provided an extra opportunity for far-reaching policy actions.

The global economic crisis has shrinked by 4% the real GDP in EU. The main recovery strategies were performed as austerity measures starting from year 2008. Stabilizing the financial market and boosting economic investments remains a priority for overcoming the recession. Although it has been anticipated that the year 2014 would bring new signs of coming out of the recession, the European Union business confidence is being restored. There are four aspects of the post crisis effect on the European markets:

Firstly, few economies were "kept alive" by economic injections challenging the rising unemployment and low skilled workforce; secondly, the decline of the investments in the economy; thirdly, cutting off the research and development costs; lastly, the public investments in supporting the healthcare and education infrastructure would decline.

[1] Blanchard, O. (2009), *"The crisis: basic mechanisms, and appropriate policies*", IMF Working Paper 09/80

EU financial recovery is depending very much on the rise of the German[2] economic axe. With a tough fiscal policy, a balanced industrial policy and cutting off all the unnecessary public spending the return of the German investments fulfills their balance of payment effectively at surplus levels. It would be essential in challenging the costs of the recession through the austerity plans and power of the governmental economic policies in order to fight the financial distortions and the diminishing growth potential.

Effects of the economic crisis embraced the juridical and corporative governance of the European Union as well. The agreement between 27 member countries of the EU in facilitating the economic and monetary union known as the Stability and Growth Pact (SGP) highlighting the maximum limit for the governmental debt and deficit and the fiscal surveillance had to be modified at the light of new financial changes occurring. The sovereign budget debt crisis is the basic consequence of the crisis. Therefore the regulations on the budgetary surveillance and financial policies coordination had to be renewed to maintain the sustainability of the euro currency. Based on the SGP each country had to keep the limit of 3% of GDP on government deficit and debt level at 60% of GDP[3]. The EU countries kept the fiscal indicators a relatively good scale nevertheless the influence from the overseas American stock exchanges and market diminished the prevalence of the fiscal responsibility. For example, Germany had maintained an outstanding fiscal discipline and a low-inflation policy which ensured its powerful financial presence in the Euro zone. Taken into approach the main account indicators, the debt level and external imbalances the financial sector risk increased. At this framework, the EU prepared new strategies to enhance the governmental support for hard-hit industries. Fiscal stimulus accompanied by a consolidation of the fiscal policies would reverse the accumulated unsustainable debt. As consequence the financial sector would start healing in terms of competitiveness. Two outcomes: the vertical and horizontal coordination referred to closer fiscal governmental measures of the economic policy; horizontal coordination between member economies to avoid economic spillover effects and ensure that the growth strategies should not diverse the economic recovery.

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[2] European Commission (2008a), Quarterly report on the euro area, fourth quarter, December 2008. European Commission (2008b), *"EMU@10, successes and challenges after 10 years of Economic and Monetary Union"*, European Economy 2/2008. European Commission (2008c), Commission Communication on the recapitalization of financial institutions, COM(2008)8259

[3] Ahrend, R., B. Cournède and R. Price (2008), "*Monetary policy, market excesses and financial turmoil*", OECD Economics Department Working Papers 597

In March 2011, the major reform undertaken for challenging the European sovereign debt crisis as a result of the economic crisis embracing four major strategies such as: boosting competitiveness, fostering employment, enhancing the public finances sustainability [4]and strengthening the financial stability. The aim was reinforcing the tax policies. On the other hand, these components are correlated with the economic situation therefore may be contradictory to implement them in recession market.

2. Crisis Control

The economic crisis has outlined the importance of risk management in these aspects:

- Prevention of crisis. The causes have to be clarified; the financial symptoms and supervisory policies have to support the economic potential respecting the regulatory framework.
- Control of crisis. The financial system has to keep the right balance and stabilize the output losses at recession
- Resolution of crisis. Facing the crisis at the lowest possible costs, intervening for restoring the economy with fiscal measures and promoting sustainable growth.[5]

New initiatives resulted as post crisis effect in reviewing the existing regulatory policies and legislation in the European Union market. Mitigation initiatives for controlling the initial stages of the crisis pursued to minimize the debts and reinforce the market confidence. Coordinative policy actions were the fast response towards the crisis effects in the banking system. Restructuring the capital of banks and the banking liquidity is a basic challenge at which even recently countries like Slovenia, Spain, Greece and Cyprus, Italy are undertaking. Bank deposits and current accounts sustain partly the overall liquidity in the market; therefore the central banks raised the guarantees for deposits and cut interest rates policy hoping to refresh the European banking system. Financial governmental interventions provided liquidity facilities and state guarantee liabilities as well as injections of banking capital for

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[4] Dennis J., *"The impact of the global financial crisis on Europe and Europe's Responses"* Snower Kiel Institute for the World Economy

[5] Molle, W. (2009) European innovation policy; increased effectiveness through coordination with cohesion policy; in: Molle, W. and J. Djarova (eds): *Enhancing the effectiveness of innovation in Europe; new roles for key players*,Edward Elgar, Cheltenham, 167-200

their assets. According to the European Central Bank these strategies had to be altered with the fiscal stimulus of 2% of GDP [6]to ease the socio-economic tensions. Mitigation of the crisis effects involved the permission of operating with the automatic fiscal stabilizers for member countries.

Moreover, the EU extent policies reached protecting the human and entrepreneurial capital through a sustainable support of crucial industries taking a major role of labor market design policies. Competition was hard –hit by the crisis this explains why the EU insisted in aid policies for the financial sector and supervising the competition rules. International financial institutions like World Bank and [7]IMF support the economic activity of the EU directly by loans whereas the European Investment Bank mission has been focusing in the disbursement of structural funds acceleration. Crisis control policies beyond the financial vulnerability of the European balance sheets, due to the substantial support of central banks there has been a stock market recover. Finance contractions are being stemmed and austerity plan is being activated in improving the debt level in the real GDP.

3. Renewing Policies

Three components of EU policies for facing the post crisis effects include[8]:

- Financial policies. If these policies would not embrace constraints of stiffer credit activity, consolidation of the solvency and reinforcement of the banking supervision, chances for over passing the recession are no visible. Urgent priority lies in restoring the banking system partly by governmental interventions and by the European Central Bank. EU policies on its financial market renewed the transparency and effectiveness on declaring the true state of the balance sheets. Concerns would be neutralized through financial repair measures such as maintaining the sustainability of public finances and exit form long term increase of the tax burden. These financial policies would enhance potential growth.

[6] Molle, W. (2011a) *"Economic Governance in the European Union; the quest for consistency and effectiveness"*, Routledge, London

[7] Basel Committee on Banking Supervision (2009b), "*International framework for liquidity risk measurement, standards and monitoring*", consultative document, December, available at www.bis.org/publ/bcbs165.htm

[8] IMF (2009), *Global Financial Stability Report*, October

Moreover, EU most prominent post crisis effect was displayed in strengthening the regulatory framework, in holding the majority of financial assets by cross border banks. The role of the supervision in financial markets, hedge and private equity funds increased. Operational regulatory of the bank has been modified towards effective bank stability and increasing reserve capital funds.

- Macroeconomic policies. Central banks have the competence of keeping the financial stability of the local economy besides monitoring the monetary policy. Stability orientated objectives and diminishing of the extensive inflation pressure could affect in equilibrating the macroeconomic environment. However, the fiscal discipline displayed at austerity strategies implied tax increases no matter the rise of social tensions. This has to be reflected in improving the public finances quality for a higher efficiency. Adapting credible local fiscal reforms has to be coordinated with the EU authorities. Additionally, to avoid the creation of financial imbalances between countries, the intra-area adjustments would diminish. New fiscal surveillance element should be attached to developing macroeconomic approaches.

- Structural policies. Tending the economic growth with relatively higher levels of it rather than the previous 2012 year,[9] European Union is adapting structural policies on unemployment. Preventing the exclusion of the workforce, supporting the competitiveness and promotion of innovation may turn out to become the key force in productivity rise. Structural policies need to carry a low budgetary cost. Furthermore, the structural reforms affect in deleveraging ease and in balance sheet restore. Future developments in structural reforms should improve the incentives policies.

3. Labor Market Effects

The global economic crisis of 2008 influenced greatly in Europe. The "contamination" from the American housing crisis turned out to be inevitable, as the scale of its effects can be still felt nowadays in the European markets even though heterogeneously between countries.

[9] Aiginger, K., Horvath, Th., Mahringer, H. (2011*). "Why labour market performance differed across countries in the Recent Crisis"*, EUROFRAME (European Forecasting Research Association for the Macro-Economy), *http://www.euroframe.org/fileadmin/user_upload/ euroframe/docs/2011/EUROF11_Aiginger_Horwath_Mahringer.pdf*

Majority of the EU countries have experienced high inflation and unemployment. At time of economic crisis the labor market has been affecting deeply despite its specific policies and structural characteristics of the economy.[10] The difference lies in the suffering scale from it. Spain and Greece have climbed at record levels of unemployment according to the Spanish National Institute of Statistics reached 25.02% in October 2012. Based on the Hellenic Statistical Authority the rate was to 27.2% in January 2013. Although labor market imbalances Germany had experienced the lowest rate of unemployment after its reunion in 1989. The crisis effect has spread in creating economic gaps between EU states and their relation with the economy of the United States. Transformational reforms are on way for the labor market in terms of promoting the investments and increasing labor productivity. The financial background of the European Union has experienced renewals and is tending towards reducing the public expenditures and increasing taxes. On the other hand the overall financial performance of a country is correlated with its labor market. A study research of Aiginger, Horvath, Mahringer, [11](2011) took in consideration financial indicators like current account balance and real GDP growth arranged in two time moments before and after the economic crisis and categorized the local economies due to their labor performance. The paper concluded that relevant employment protection policies are needed as intervening measures. Cutting jobs may raise the social tensions in times of crisis but it long-term effect would result with lower costs for the companies to adapt with the structural changes. A healthy market orientated employment policy could be a key factor in overcoming the labor market recession at lower social costs.

4. European Sovereign Debt Crisis Effects

Six EU countries: Greece, Portugal, Italy, Ireland, Spain and Cyprus failed in generating economic growth due to the economic crisis considered to be the most serious one since the Great depression in 1930's. Indeed global economy was slowly growing especially after the

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[10] Aiginger, K., Horvath, Th., Mahringer, H. (2011*). "Why labour market performance differed across countries in the Recent Crisis"*, EUROFRAME (European Forecasting Research Association for the Macro-Economy), *http://www.euroframe.org/fileadmin/user_upload/ euroframe/docs/2011/EUROF11_Aiginger_Horwath_Mahringer.pdf*

[11] Casado, José María, Fernández-Vidaurreta, Cristina, Jimeno, J.F. (2012). "*Labour Flows In The Eu At The Beginning Of The Crisis", *Banco De España-Economic Bulletin, Spain, January

US financial crisis of 2008 started to affect the Euro zone. Growth rhythm is equivalent to the tax revenues; therefore high budget deficit appeared along the slow pace of economic growth. Combined with a liberal fiscal policy like the Greek one debts turned out to swallow the entire country's economy. Greek bonds were demanded on higher yields by the global investors as the country needed bail out procedures to face the heavy indebted budget. The cause of rising the bond yields lies in the high risk bond implied a higher return. The Greek bailout involved a disbursement of $163 billion[12] in 2010 the first term; the second bail out in the mid 2011 Greece profited $157 billion. Additionally, Portugal and Ireland in May 2011 and November 2010 became a part of the bailout politics. The European Central Bank provided a total value of €489 ($639 billion) in credit available in financing the banking system from 2011 to 2012.

Moreover, in relation to the global financial connection, bank failures will appear as spiral or "domino effect". The US financial crisis is reflected in the European financial market. The world financial system is very connected so that the sovereign debt crisis influence the US budget.

From 2010 to 2012 the sovereign debt crisis brought along political implications. The genuine by product of the economic crisis was the European austerity plan of cutting expenses and raising taxes. Bailout process tended to maintain the Greek and Cyprus economy inside the euro currency zone since their exclude would represent a large magnitude of the euro sustainability in Europe. On the other hand German austerity plan suggested for these countries lead to slower growth because of government spending reductions. Protests lead to a loss of investor confidence in the region. The fundamental issue remains the high government debt.

Euro zone intervened in saving the Cyprus banking system from collapse with huge losses. Taxes on deposits exceeding €100,000[13] would be imposed to regain liquidity in order to keep the economy moving forward, despite the contractions it may experience in the near future. The post economic crisis influenced in putting the bank of Cyprus in a immediate

[12] European Commission (2009d*), "The impact of the financial and economic crisis on potential output"*, European Economy – Occasional Papers 49, Directorate-General for Economic and Financial Affairs.

[13] Molle, W., (2011b) "*Integrated territorial policy; high ambitions, limited means"*, in: Kolczynski, M. and Zuber. P. (2011) New paradigm in action; recent developments and perspectives of regional policies

restructuring. The bail out money would not be recapitalized whereas the depositors with over €100,000 at the bank have to deal with a full 30% loss[14]. As a series of the crisis or a probable cut of the black Russian bank liquidity, the Cyprus bailout prove to be the next austerity measure for saving Europe's euro pride.

5. Future Challenges

European Union to protect the euro currency and its political and economic supremacy, as well as to reach a sustainable growth has to deal with these five key challenges in the future[15]:

1. The growth potential may be at increased risk because of the capital stock suffering. According to (Costello et al. 2009) the financial distress results in losses in outputs estimated to reach 5%. However, economic crisis involve big chances for long-term structural measure taking, which would be considered positively.

2. The rapid rise of unemployment. Cutting off jobs especially in Spain and Greece where austerity measures are developing very toughly may raise social conflicts and tensions. Mostly it would affect negatively on the high indebted hit by the crisis households.

3. Sovereign debt crisis. Fiscal deficits and debts have risen. Public indebtedness as well experienced an increase. The firm disciplinary policies in cutting the public expenditures would save these economies millions of euro that would serve in the upcoming economic recovery phases.

4. Intra-EU adjustments are threatened by the asymmetric crisis effect. Therefore, the level of being affected from the economic crisis is different regarding the fragility of

[14] Thomas, A. (2009), "*Financial crisis and emerging markets trade*", IMF Staff Position Paper, No. 09/04, Washington, D.C., International Monetary Fund (IMF)

[15] OECD (2009a), "*The Financial Crisis: Reform and Exit Strategies*", OECD, September, Paris, available at www.oecd.org/dataoecd/55/47/43091457.pdf

the economy. Patterns like: countries facing the crisis at housing bubbles would shift their economy into an independent export-oriented country; and the other type of countries with large surpluses in current accounts intoxicated by large financial assets at which they were exposed. Adjustment policies are required in both countries.

5. Global Imbalances. Resulting from the economic crisis corrections in the US current account have to face the non equivalent surpluses of current accounts in the Asian economies. Moreover, the euro zone as the unified economic and currency union has to bear the euro dependency.

Conclusion

The EU post crisis effects fully reshaped the banking system, fiscal policies and financial stability regulatory framework. These fundamental areas were reborn to provide economic growth through a tough fiscal discipline, precisely oriented industrial policy and high surveillance of the banking liquidity. Austerity plan divided Europe considered as a long-term successful German receipt on one hand; or rather too tough in cutting off jobs, government expenditures and increasing taxes on the other. Post crisis effects patterns highlighted the sovereign debt crisis altogether high fiscal deficit, social tensions in bailed out countries such as Spain and Greece. Cyprus bailout avoided the banking system collapse putting European Union at draconian bank system supervision from the European Central Bank, while saving the euro currency pride. Renewal of the fiscal and banking policies represent thriving long-term opportunities for surpassing the recession. Lastly, austerity would generate profitable outcomes just like it has been anticipated for the Europe coming out fully from the long recession.

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23. Thomas, A. (2009), "*Financial crisis and emerging markets trade*", IMF Staff Position Paper, No. 09/04, Washington, D.C., International Monetary Fund (IMF)