Crisis, Economic Governance and Macroeconomic Stability in Central and Eastern Europe

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ETHICAL CONSIDERATIONS ON BANKING SYSTEM FACING FINANCIAL CRISIS

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ABSTRACT

Bankers’ role has always been one based on mutual trust. We are trusted by those who expect us to take care of their money and to lend the funds to safe borrowers.

But what happens when financial crisis confronts traditional banks with ethical dilemmas? Ethics is a main concern of global banking system, but there have been situations, in the last years, when banks acted in ways that could be considered flawed by the public.

In this paper I try to pinpoint some considerations regarding ethical aspects in recent developments of banking system and practices. Also, the question raises if a new kind of bank or financial institution should be the solution - as an ethical bank.
DEPRECIATION, LIQUIDITY SHOCKS AND CREDIT CRUNCH IN CEECS

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ABSTRACT

We hypothesize that depreciations have possibly improved the competitiveness of industrial enterprises but increase the financial vulnerability especially of foreign banks, which used foreign funds for financing their credit expansion in the CEECs. The main objective of the paper is to present general approach to identify the link between macroeconomic shocks, the institutional environment and the responses of the financial sector in CEECs to the financial crisis. We would like to compare the impact of the depreciation shock with the output and inflation shocks.
FINANCIAL CRISIS AND BANK EFFICIENCY: AN EMPIRICAL STUDY OF EUROPEAN BANKS

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ABSTRACT

This paper presents new findings on the impact of financial crisis on banks efficiency across European Union by using the frontier technique. We also intend to highlight any potential differences between different groups of countries (member of Euro area, non-member of Euro area, old members of EU or new member of EU) or between types of banks in terms of size and public quoted. First, the results show that crisis has a significant and positive impact on cost and profit inefficiency of banks from European Union. Secondly, that impact is higher on banks from countries member of Euro area. In terms of cost efficiency, the most affected by crisis are banks that are public quoted, large banks and banks from old members of the European Union. In case of profit inefficiency, the publicly quoted banks and large banks were less affected by crisis.
SOME THOUGHTS REGARDING THE CENTRAL BANK’S ROLE IN PROMOTING THE FINANCIAL STABILITY UNDER THE POST-CRISIS ENVIRONMENT

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ABSTRACT

The “Great Moderation” period, characterized by a low macroeconomic volatility and a non-inflationary economic growth worldwide, has ended with the outbreak of the global financial crisis in 2007 and it has been followed by a global recession which has brought to the forefront of the debate the importance of financial stability and the role of central banks in maintaining it. The events after August 2007 have also showed that the structural changes induced on the financial system in the recent decades poses new challenges for the general macroeconomic policy, given the fact that during this period it has been observed serious effects of the financial instability produced in the social field and the inherent difficulties of the monetary policy to counteract severe episodes of financial turbulence.

On the one hand, the new macroeconomic framework imposed by the crisis underlines the importance of the clear and proper regulation, as the main condition for defense against the financial instability, and on the other hand, underlines the strengthened link between the financial stability and the macroeconomic policies, especially the monetary policy, to support it. Thus, it becomes obvious the increase of the Central Bank’s responsibility, with the monetary policy as an element of the macroeconomic policies’ mechanism.

Based on these ideas, the paper aims to emphasize the role of the monetary policy and the central bank's position concerning the financial stability in the new context created by the global financial crisis. The analysis highlights the need to review the position of the central bank in order to promote a more proactive stance to deal with financial stability, beyond the traditional framework of regulation and supervision. Yet, it is not well established how to...
implement the new framework, in particular, the specific role of monetary policy in conjunction with macro-prudential policy.

Current conditions require more and more the involvement of a precautionary monetary policy by adjusting the interest rates to counteract the medium and long term risks associated with critical macro-financial imbalances, especially those occurring in the banking sector. However, some limitations and monetary policy’s constraints remain strong. Thus, there is a risk of emerging conflicts derived from the pursuance of the primary objective (the price stability) while maintaining financial stability. Focusing on another objective (that of financial stability), could be to the detriment of the price stability’s management. Also, the interest rates might be less appropriate tools to manage the specific imbalances of the financial stability. The Tinbergen principle, according to which there must be a certain number tools in order to achieve the same amount of purposes, shall not be neglected. In other words, the increasing complexity and difficulty of the central banks’ role would require an increasing number of instruments needed to implement its objectives.
EUROPEAN INTEGRATION AND INTEREST RATE TRANSMISSION IN EU: AN EXCHANGE RATE REGIMES APPROACH

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ABSTRACT

The paper aims to analyze the implications of European integration on the Eurozone interest rates pass-through to the non-Euro countries – members of the European Union, and to assess the correlation degree of interest rates in the European Union non-Euro countries to the Eurozone money market interest rate. We use the methodology of Frankel et al (2004) in order to test the monetary policy autonomy degree of the non-Euro European Union countries versus the European Central Bank policy, in a framework of different exchange rate regimes. After a first OLS panel estimation we found evidence of heteroscedasticity and autocorrelation having as consequences inefficient coefficient estimators (although unbiased and consistent) and biased coefficient variance estimators. Thus, we employed OLS fixed effects estimation, with Newey-West variance estimators, which are heteroscedasticity and autocorrelation consistent. The research is performed for 1999-2010 period on EU27 non-Euro countries, including pre-adoption data for those which adopted Euro during this period. According to our results, the Euro area interest rates pass-through to non-Euro EU countries reveals differences by country groups and exchange rate regimes. Thus, we notice a better adjustment in the case of old member countries whose economies are more developed. The new EU member countries, including those that subsequently adopted the Euro, do not show a thorough adjustment of exchange rates. For the recent Eurozone member countries we notice a weak correlation for all types of regimes, except the fixed arrangements in the pre-crisis period, while for the new EU member states with floating regimes evidence shows an over-adjustment, i.e. weaker autonomy of monetary policies. A de facto exchange rate regimes classification, used for robustness check, seems to deliver better results in terms of statistical significance, as well as in terms of theory support.
A TALE OF TWO CYCLES IN DEVELOPING AND ADVANCED ECONOMIES: A COUNTRY CASE STUDY COMPARISON ON TEN EUROPEAN ECONOMIES

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ABSTRACT

When speaking about the cyclic behavior of an economic variable, economists generally refer to economic cycles i.e., to changes in the economic activity that vary from a long term growth trend. Nevertheless, some patterns of cyclical nature can also be identified in the credit growth process, i.e. cyclical fluctuations (in time) of the bank lending process (or credit cycles). There is a widespread view in the economic literature that banks, through their lending capacity, play a very important role in promoting long-term economic growth.

Hence, the analysis and understanding of the credit cycle or leverage cycle and its connections with the business cycles is extremely interesting and important, especially during these times of distress, for academic circles, as well as for policy makers who are still striving to find a pertinent answer to the current financial turbulences.

That is way researchers test for correlation between bank credit and measures of economic activity such as real GDP. In this context, this study aims at performing an econometric analysis of the credit cycle and business cycle from a comparative perspective, with a focus on ten developing and advanced economies from the area of Central, Eastern and South-Eastern Europe (including the Romania), with the purpose of understanding their behavior and the impact of the interactions between them. To achieve this aim, the study focuses on two strategic objectives: a) on the one hand, we plan to analyze the short-term (from one trimester to the other) causality relations between the credit cycle and the business cycle in order to understand which cycle influences the other; b) on the other hand, we want to investigate the nature of the relations which appear between the frequency at the level of the business and credit cycles within a bigger time period.
This research dares to be more than just an analytical retrospective on the economic and credit cyclicity and financial crisis in the European Union; it intends to analyze, in a perspective mode, the interferences between the business and credit cycles as important and sensitive signals of shifts in the economic paradigm and baring in mind the dynamics of the European Integration process (the Banking Union being an important phase). The research promises to provide valuable insights on European policy proposals and “tectonic movements” in the current economic paradigm.
THE QUEST FOR SUSTAINABILITY AND INCLUSION IN FINANCIAL SYSTEMS

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ABSTRACT

The economic and financial crisis has been a turning point in the development of financial systems, in particular in the banking sector. The diminishing number of solvable customers, added to the empowerment of a large part of the population, lead to the quest for evermore opportunities to keeping existing and reach new banking customers. Thus, there is an ever growing need for banks (in particular those in Eastern Europe) to apply new innovative business strategies, aside from the traditional market models used by Western banks.

The emerging markets model focus primarily on financial inclusion (attracting 'un-bankable' clients) and creative distribution channels, in view of improving the sustainability of the system, and, through this, ensure a reduction of risk of potential investors. This paper focuses on these types of new, innovative business models for the banking sector, stemmed in emerging markets, and the opportunity of implementation of a like model in Eastern Europe.

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IMPACT OF GLOBAL CRISIS ON ECONOMIC GOVERNANCE IN ROMANIA

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ABSTRACT

This paper aims to present the impact of the global crisis on economic governance in Romania. The crisis has exposed the weaknesses of economic governance in Europe. EU decided to strengthen budgetary and macroeconomic surveillance and creating a crisis management mechanism. Long-term financial stability, restore growth and maintain prosperity requires a quantum leap in economic governance. The decision makers in our country is aware of the need for more structural reforms, but there is support of the majority population and are doubts about our ability to line with EU standards in a reasonable time. Conclusions drawn from this crisis will determine EU’s economic and social models in the future. We see a series of measures centered on transparency and predictability of financial developments at country and EU. Discussions about demography, education and training permanent pension system and health care reform are relevant in terms of economic governance in our country.
LOOKING AT CENTRAL AND EASTERN EUROPE: CRISIS CHALLENGES AND ITS IMPACT ON MACROECONOMIC STABILITY

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ABSTRACT

The global economic crisis has raised several challenges for all the European Union member states, which, within this context, have refocused their attention on identifying proper and fruitful measures in order to solve and overcome the core issues and problems which the EU is currently facing: productivity versus competitiveness. A main goal of the EU is to achieve inclusion in all aspects of life by promoting a culture of partnership between local, regional and national authorities, as well as social partners. In addition, the adoption of the open method of coordination and the initiatives of the Europe’s 2020 Strategy are likely to determine, although not instantly, a common European orientation towards an objective reality, one that is less permissive regarding budgetary deficits, unemployment or political compromise, which will eventually lead the Union to the severely needed sustainability. So far, the European economic development and its promoted policies framework were inevitably unequal and complex and their importance continues to generate intense debates. Regarding the EU member states in Central and Eastern Europe, most of them have paid greater attention to economic restructuring than to developing effective policies, in accordance to their national particularities. The widespread lack of social dialogue, the dwindling resources, the lack of capital and long-term visions, as well as some deeply rooted traditions within the communist era, represent some of the factors which determined a rather slow progress in these countries. With the support of these considerations, the current paper will analyze, on the one hand, the correlations between key indicators that define the nominal and real convergence in the countries of Central and Eastern Europe, before and after the economic crisis, in order to grasp the manner in which this crisis has reflected upon the trends of development, and on the other hand, the adopted policies, the purpose being to identify the states that have acted most efficiently within such context.
PATTERNS IN THE COMPOSITION OF PUBLIC EXPENDITURES: CURRENT VS. CAPITAL EXPENDITURES IN CEE COUNTRIES

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ABSTRACT

The aim of this study is to investigate, from a theoretical and empirical point of view, the composition of public expenditures in Central and Eastern European Countries, and its impact on private sector productivity and economic growth. Even if the problem of optimal public expenditures structure was largely debated in literature, especially from a neoclassical perspective, only a few studies have addressed the optimal composition of public expenditure in European developing countries. The findings could be valuable for policy makers, especially when one looks at arbitrary cuts in public expenditures adopted in most of these countries in recent years, as a response to the financial crisis and public debt and deficit crisis. Neither economic theory nor empirical evidence provides clear answers to the question of how the composition of public expenditures affects economic growth.

Using regression analysis for data over 1995-2010 for the CEE countries, we estimate the correlation between the two types of public expenditures (current and capital) and economic growth. Comparing to neoclassical model, our estimations shows non-optimal composition of public expenditures for the analyzed countries, suggesting the need for budget adjustments in the allocation of public financial resources.
THE FISCAL COMPACT. LEGAL STATUS AND IMPLICATIONS

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ABSTRACT

The EU legal framework consists of two interconnected categories of acts: the primary sources of law (the treaties concluded among the member states) and the sources of law derivated from them (mainly reglements, directives and decisions). The huge amount of norms and legal documents adopted at EU level are structured into piramidal form, the most powerful being the rules bearing the function of constitutional act (the fundamental treaties and the treaties of accessions to the EU). Also, the norms elaborated at EU level may interact with the Member States legal systems, generating conflicts of law, eventually solved by the ECJ. In this complicated still perfectly functional legal order, each actor respects willingly the superior power of the EU sources of law.

The Fiscal Compact, at first entitled The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), is a piece of treaty that seems to do not fit in the strict hierarchy of the EU rules of law. Actually, it represents an intergovernmental treaty concluded on 2 March 2012 by members of the EU, all but the Czech Republic and the United Kingdom. The Fiscal Compact develops a stricter version of the Stability and Growth Pact, which belongs, without any reserve, to the EU source of law.

Analyzing the procedure of adoption, the ratification and its specific provisions we may only conclude that the Fiscal treaty is a very particular legal document. Although it is drawn on a previously mandatory act of the EU law, it does not belong to the EU legal order. It is a treaty in connection with the EU law but apart of it, at least at present. Its implications to the EU activity and the liabilities for the EU member states are only reflecting the particularities of the relationships among the actors of the EU and do not result from a mandatory rule that is a part of the EU legal order.
THE NEW BASEL III REGULATIONS ON CAPITAL AND FINANCIAL STABILITY

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ABSTRACT

Under crisis conditions, the Basel Surveillance Committee acknowledged the necessity to improve the capital and extend the capacity of risk analysis within the Basel Accords. The capital is the essential component of the financial reform and, therefore, the introduction of Basel III proposes new capital standards meant to strengthen the regulation, supervision and risk management of the banking system. The aim of this article is to emphasize the impact of the new regulations on the financial stability providing an analysis of the world’s largest economies. The new agreement will strengthen the relation between risk and capital and will increase the capacity of the banking sector to deal with economic crisis. Basel III Accord offers: greater protection to the banking system through the rebuttal of the previously identified errors, an improvement of the quantity and quality of capital requests and liquidity of the banking system and a more adequate risk management procedure.

The integrated, timely and consistent implementation of the rules set by the Basel Committee is followed by: an increase in the stability of the global banking system, the preservation of market confidence in regulatory factors and the creation of equal conditions of competitiveness. In the absence of such implementation, it will be impossible to materialize the benefits derived from the latest recent regulatory reforms. As for the implementation of the norms set by Basel III, official reports show that there are differences between countries, the impossibility to meet the deadline imposed being clearly stipulated in some of them. With the exception of the countries belonging to the G20, only India, Japan and Saudi Arabia have published their final rules of implementing the new norms.
It is under these circumstances that the analysis performed on the largest economies of the world shows that improvement of capital requirements is related to loans, banks performances, as well as to all the other indicators. The variable that best estimates financial stability is Tier1/Total evolution risky assets, followed by loans to financial institutions and the performance of these loans. As a result, an adequate capital can ensure bank adequacy and desired financial stability can be achieved by means of increasing performance credits. Moreover, another well-established fact is that the regulatory capital generates certain effects on the entire banking system, thus, providing financial stability.
DOES PRESENT INTERNATIONAL FINANCIAL CRISIS AFFECT THE STRUCTURE OF ROMANIAN BANKING SYSTEM?

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ABSTRACT

In this paper we intend to perform a structural analysis of the Romanian banking system in the 2007-2011 period, starting from the indicators of the first 12 industry players. In the first part of the paper we analyze the evolution of the main structural indicators of the Romanian banking system, while in the second part we evaluate the structural changes on the evolution of market shares in terms of deposits and loans for the first 12 banks in the system, using the analytical methods performed by Mereuta (2004, 2012). We found that the international financial crisis has impacted differently the evolution of market shares in terms of total deposits and loans of the major banks in the system, banks being more active in the competition strategy of deposits attracting than in the loans field.
CHALLENGES OF THE ECONOMIC AND MONETARY UNION IN THE CONTEXT OF THE ECONOMIC CRISIS

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ABSTRACT

The global financial crisis which started in September 2008 and was followed by the most serious economic recession of the last decades has determined the design and implementation, at the level of governments, of vast ranges of emergency measures for the stabilization of the financial sector and for the amortization of the negative effects on the national economies. The effects of global economic crisis as perceived also in the European economies seem to have an important impact on the functioning of the Eurozone. This new financial and economic context determined the debate and reinterpretation of problems and questions, which refer to the functioning norms of the Eurozone, the efficiency of a monetary union which contains countries with different development levels and in the absence of a fiscal cohesion, the opportunity of a new extension of the Eurozone or even the future of EMU.

The main objective of this study is to identify the amplitude of the effects of the economic crisis on the functioning and stability of EMU. Following the main objective, the study is meant to analyze the theoretic fundamentals what were at the basis of the creation of EMU and an analysis of the financial policies and instruments meant to render stability and sustainable economic growth in the countries of the Eurozone. The study shows that the crisis is not merely related to sovereign debt and bank financials but also highlights structural problems and important implications for the real economy. The Eurozone and especially the peripheral economies (Portugal, Ireland, Italy, Greece, Spain) face four major economic challenges: (1) failures in the European banking sector; (2) alarming quotas of the budgetary deficit and of the public debt; (3) internal commercial disequilibria; (4) high unemployment levels and economic recessions.
Therefore, the debt crisis in the PIIGS countries (Portugal, Irland, Italy, Greece and Spain) seems to be not only a debt crisis, but rather a competitiveness and growth crisis, that created structural imbalances in the Eurozone. Current economic situation seems set for a change in the way in which the Eurozone will need to manage its monetary, fiscal and financial system. The last part of the study analyzes the effects of various types of measures what have been implemented in order to solve the Eurozone crisis.
SHARES AND DEBT SECURITIES ISSUES IN THE EURO ZONE

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ABSTRACT

Financing a company is a subject that, in our opinion, will never be exhausted due to its own importance and also due to the changing economic and financial environment that implicitly influences and shapes this decision. In particular, financing the company through the capital market by issuing new shares or selling long term debt securities becomes a center of interest for both international practice and literature.

Recently, studies have identified a number of interesting trends in the international practice about these two studied decisions, among which we can mention the adoption of a certain dishonest behavior for the companies that issue shares and then repurchase them, frequently in time, in order to increase the stock price and facilitate the execution of share option plans granted to employees. Another bad behavior regards those companies that prefer to finance through bonds, instead of shares, in their attempt to avoid future liabilities such as providing dividends to shareholders. Also, the global financial crisis and the need for liquidity with uncertain future income influenced both decisions of the company, to finance by selling shares or long term debt securities.

Considering these ideas, we used the European Central Bank official data associated with the issuance of shares as well as bonds, made by nonfinancial companies resident in the euro area, in order to study the relationship between these two controversial decisions. The database was created by using monthly reports published by the ECB for the period 2005 to 2012. Working with monthly data, we identified for each variable, considered in the analysis, 96 values, corresponding to the 96 months of study. The main variables that we used were the gross value of share issues and also buybacks, the gross value of bond issues and bond redemptions, variables that allowed us to work with net issuance of shares or bonds.
To what extent the shares issues of non-financial companies in the euro area depends or is explained by share buybacks, bond issuance or redemption, how the global financial crisis influenced these decisions of firms are some of the questions we seek an answer. As research methods we chose correlation and multiple regression analysis, being permanently aware that we worked with global numerical data. The conclusions of the study proved to be of interest but we consider that a panel approach, with the same categories of variables for each counted company would bring an added value to the initial analysis. At this level we do not deny the importance of the present study as a starting point and a general framework for the desired analysis.
IMPACT OF GLOBAL FINANCIAL CRISIS ON TRADITIONAL AND SHADOW BANKING PERFORMANCE: EVIDENCE FROM EUROPE

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ABSTRACT

The global financial crisis of 2007-2012 restores the issue of how sensitive is the performance of banks and other entities within the financial system to macroeconomic conditions. A major concern is on the part of the financial system called shadow banking that refers, according to the Financial Stability Board’s work, to the activities related to credit intermediation and involving liquidity and maturity transformation and leverage that take place outside the regular banking system. This experienced a significant growth in the years before the financial crisis, rivaling the traditional banking system in the intermediation of credit to households and businesses. Though the crisis had a major impact on overall profitability of both traditional and shadow banking, there is significant variation in the different measures of performance of financial intermediaries across countries during that period.

This paper seeks to investigate the main factors that determine the performance of commercial banks and shadow banking entities across European countries before and during the current financial crisis. The aim is to assess the differences between internal (bank level) and external (macroeconomics and financial system level) variables. We also intend to highlight and explain any potential differences between various groups of countries according to their European Union or Eurozone membership, and, more important, between commercial banks and financial intermediaries within the shadow-banking perimeter. We use the Eurosystem’s approach, according to which the grouping other financial intermediaries (OFI) sector in ESA 95 includes many of the entities that could be involved in shadow banking activities and obtain the micro-level data from the Bankscope database for the period 2004-2010. The data on financial crisis, financial systems characteristics and macroeconomic variables is taken from World Bank, EBRD, ECB reports and recently updated database of Laeven and Valencia (2012).

We use a linear model estimated using the panel least square fixed effects methodology. Performance is proxied alternatively by several variables - return of average assets, distance to default or cost efficiency, which are regressed on a set of common explanatory variables, following the empirical literature on bank performance.

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Our findings show that the global financial crisis has exerted a negative and significant impact of the performance of both traditional and shadow credit intermediaries, with differences in magnitude at country-level and also between commercial banks and other financial intermediaries.
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