ABOUT THE FINANCIAL CRISIS: A REPORT ON STOCK INDICES

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Abstract

The financial crisis, after pushing governments to adopt exceptional measures to bail out banks and launch challenging plans to revive the economy, has come to expose the sovereign debt of many countries at risk of “default”. For this reason, the European institutions and national governments have had to intervene and to develop tools for crisis management, such as loans to Greece and the mechanism of European financial assistance, both to strengthen the devices of crisis prevention, based on fiscal consolidation. Pending the completion of the institutional strategy aimed at coordinating European economic policy and budget, all states were required to adopt drastic measures to rebalance national accounts and return to the Maastricht’s criteria.

This paper aims to analyze the performance of financial markets over the past three months, thus representing a true report of what has been and what will happen.

Keywords: bail out banks, financial crises, financial markets

1. Introduction: the real origins of the European crisis.

Financial crises are a recurring event in the global macroeconomic scenario. Kindleberger and Fratianni (2008) have counted today 1622. However, with the exception of that of ’29, all others have been united from having invested exclusively in developing countries.

The current crisis originated in the U.S. financial market and spread to all economies, advanced and can thus be defined as the first true systemic crisis since the Great Depression of the thirties.

Although the underlying causes of the crisis are linked to the outbreak of bubble subprime mortgages in the United States and the complex securitization mechanism associated therewith, these factors represent, however, only determinants of short period. The great crises, in fact, are often linked to deeper imbalances of a real economy that may affect the internal and international level.

Starting from the premise we want now study the determinants of the current crisis through the joint examination of the causes of short and long term.

The long-term determinants are attributable to:

1) the process of deregulation of financial markets;
2) a policy choices adopted in the United States since the eighties;
3) the accommodative monetary policy implemented by the Fed since the late nineties.
(During the analysis we will consider in particular the imbalance of the current account of the U.S. balance of payments, such as "decisive" of the global imbalance and the present financial crisis).

1) In the early eighties, in the context of a policy strategy economic time to free the market from the strings and wires that had hitherto characterized the functioning of economic systems, Thatcher - in England - and Reagan - in the United States -, gave impetus to a process of deregulation that has also affected the financial market. The measure more incisive, in this direction, was adopted in 1999 with the "Gramm-Leach-Bliley Act" which resulted in the separation between commercial banks and investment banks, the Fed transferring the Securities and Exchange Commission, the task of supervision of the banking sector. Concurrently, in 2000, were deregulated in the financial market derivatives, which were born as a means of protection against risks (currency, interest rate, price fluctuation of raw materials) in a short time were used for speculative purposes. The banks themselves, though not adequately capitalized, began to invest in these products, moved by the desire to profit from the high yields allowed by the riskiness of the instrument and the ability to hide them by losses in the financial statements. In a situation of laissez faire, the financial and banking system has not been able to regulate itself and in a few years, the U.S. financial market began to be characterized by the presence of large amounts of very high-risk investment, backed by a real basis non-existent and favoured by the possibility of increasing the leverage offered by the liberalization in 2004 of regulatory capital required of banks. One of the characteristics of the current international financial crisis, as a result of deregulation, it was precisely the forced use of derivatives, which have increased the volatility of the financial sector, shifting the focus of financial operators from the operations of the real market, savings and investment, to those purely speculative.

2) In the framework of the policies of "supply-side economics", started by Reagan in the early eighties, characterized, on the one hand, as cuts to taxation in order to stimulate the incentive to produce and invest and, secondly, by a restrictive monetary policy time to absorb inflationary pressures have started to register a process of deterioration in the current account of the U.S. balance of payments. In fact, the tax cuts stimulated consumption, helping to increase imports, while increasing the interest rate on federal funds favoured the inflow of capital from abroad, resulting in an appreciation of the dollar, and thus a reduction in exports. However, this economic policy led to a sharp increase in the deficit and the internal current account, in fact, the international competitiveness of American companies was hampered by an unfavourable exchange rate. Since then, as shown in Fig. 1, the deficit of the balance of payments current account of the U.S. went systematically worse.

Due to the rising U.S. deficits, there has been the growing surpluses of the emerging world, especially China. As has been observed by various economists, imbalances opposing the balance of payments, the United States and emerging countries, were a reflection of a structural imbalance that has seen contrasting the high propensity to save of seconds at a low propensity of the first.

![Figure 1](http://www.ijmsbr.com)

Source: our processing of data Oxford Economic Forecast

According to one school of thought (Bernanke, Frankel, Edwards) excess savings "savings glut" accumulated in countries such as China, would allow the financing painless and low cost of increasing deficits esters of the United States. In fact, the current account surpluses of emerging economies, resulting from export-led development policies have favoured the accumulation of reserves which have been used to purchase U.S. financial assets. The high demand for U.S. assets has allowed it to keep down interest rates, contributing to their already favoured by the reduction monetary policies in the Member States.

3) Accommodative monetary policy since the end of the nineties has tried to ensure a growth path, characterized by an internal support of the application, can be another important determinant of the current financial crisis, brought back to the expansionary monetary policy implemented by the Federal Reserve between from 2001 to 2003. Alan Greenspan, in fact, to limit the recessionary effects of the terrorist attack of September 2001 and the end of
the New Economy bubble, gave rise to a policy monetary expansive, entering a huge liquidity into the system in order to stimulate the private investment.

Since 2002, the money supply (M3) grew at an average rate by more than ten percent per year and expansion has been accompanied by the reduction of the interest rate on federal funds. So between 2000 and 2003, interest rates rose from 6.5% to 1%, becoming negative in real terms for most of the period. U.S. households have then started to increase consumption and their propensity to borrow, thus deepening the structural imbalance that fed the global imbalance that has arisen. In this way, monetary policy adopted by Greenspan, instead of stimulating productive activity, has resulted in a speculative bubble fueled by demand (Joseph E. Stiglitz, 2006). This is addressed in particular to real estate (real estate mortgages from banks increased at a rate of 18% every six months) and the increasing demand supported by the credit has increased exponentially in the prices of the market by encouraging the construction of new housing (even on lands that were not building). Thus, a monetary policy that sought to ensure high consumption levels for families as well as the possibility of new private investment, has come to deepen the global imbalance already begun with policy choices that led to the deregulation and persistent current account deficit in the U.S. balance of payments. What has been described are the conditions that have determined and favoured the occurrence of other "causes", the effects of which were recorded at different times and in different areas, as the UME area.

2. Monetary Economic responses

Central banks and governments around the world have reacted decisively to the challenges posed by the global financial crisis since its debut in the summer of 2007. Interventions were needed incisive, timely and unedited to maintain the liquidity of the markets and reduce systemic risk and, ultimately, restore stability in financial markets. Given the global nature of the crisis, the fiscal and monetary authorities around the world have faced similar challenges, having at the same time ensure that the answers given were commensurate with specificity of their individual financial and economic systems.

When they appeared the first signs of tensions in financial markets in mid-2007, the ECB has acted quickly to advance the supply of liquidity to financial institutions in an attempt to compensate for disruptions in the interbank market. In the following months were established swap lines between the major central banks, especially to counter the growing pressures in funding markets in the short term in U.S. dollars. After the failure of investment bank Lehman Brothers in the United States in September 2008, concerns about the solvency of financial institutions around the world have pushed the global financial system to the brink of collapse. To put an end to the malfunctioning of markets and contain the risk of contagion to the real economy and, ultimately, ensure price stability, the monetary authorities around the world have reduced interest rates to historically low levels of reference and have taken a range of non-conventional policy monetary union. At the same time, the budgetary authorities have adopted a number of measures, such as recapitalization programs or government guarantees, designed to prevent the insolvency of major financial institutions on the systemic.

It's been just four years after the U.S. mortgage crisis subprime, and UME, at this time, is in the middle of an economic crisis. The main issue concerns the public debt of some of the major European Monetary Union member countries. is under discussion, as is well known, the ability of these countries to repay their debt to succeed, at the same time, to obtain credit at interest rates sustainable. The austerity policies so far proposed and applied are quite clearly causing a widespread recession, with the result of aggravating the situation of the most indebted countries.

There are many economists who wonder why the European Monetary Union does not have recourse to counter the international financial speculation and to ensure a sustainable debt of its members, the function of the European Central Bank as "lender of last resort", even changing the status of the ECB which currently prohibit it; they ask that is because the ECB does not act as the U.S. Federal Reserve, by buying directly the debt securities of European Monetary Union member countries that, because of the tensions in financial markets, are forced to borrow at interest rates which may severely compromise the welfare and safety of its citizens.

This is in fact the only real question that was asked, in the public debate on the European management of the economic crisis. For the rest there is simply a stream of statements about the necessity of combining austerity and growth, without being credible, however, no indication about how this unlikely pair can find a concrete realization.

On the role of the ECB as "lender of last resort" against the states, however, seems to exist a kind of veto, which finds its principal expression in the attitude of the German Government. It is true that the autonomy of the central bank from political power is one of the cornerstones of economic orthodoxy, which assigns to the issuers of the exclusive task in the context of economic policy, to counter the dangers of inflation.
There must therefore be another reason, no doubt of considerable importance, which is opposed to a wider and more direct use of the ECB to tackle the economic crisis. The fact that this right is not declared openly makes the question about the role of the ECB a sort of vantage point for watching the current evolution of the economic crisis in Europe.

To understand the real reasons that are opposed to a change in the role that the European Treaties confer on the ECB is useful to look at one of the first experiments of independence of a central bank from political power. This is the "divorce" of 1981 between the Treasury and the Bank of Italy, when it was raised by a commitment to buy government bonds that the Treasury could not be placed on the market.

3. Predictions that were made for 2012

Many financial experts publishing (Time, G.Sachs, B.Italia) published at the beginning of January 2012 the rediction highly positively on the financial market for 2012. In reality, things did not go well.

Several factors appeared to be promising:

1) performance of equity markets in the month of January;
2) accommodative monetary policies;
3) U.S. economy is much better than what you think.

Premise that what the January Effect: "The January effect is a calendar-related anomaly in the financial market where financial security prices Increase in the month of January. This creates an opportunity for investors to buy stock for lower prices before January and sell them after Their value increases. Therefore, the main characteristics of the January Effect are an Increase in buying securities before the end of the year for a lower price, and selling them in January to generate profit from the price differences".

Using S & P 500 monthly averages since Bloomberg data started in 1928, the average price return for all months January is +1.69%. Not surprisingly, this turns out to be Also the highest monthly return of all calendar months and compares favourably against the +0.51% for all calendar months. Also July stands out as having the second-highest monthly return in our sample (+1.25%) while September (-0.20%) and October (-0.55%) have historically produced negative monthly averages. The historical correlation between the first days of January and the performance of the year was statistically significant. based on empirical evidence which states that a positive January probabilistically induces a positive year for equity markets, have started to make investments distorted by such a conception of the error:

a) is the first three days of January that the month of January, not yet completed, but almost - with positive equity markets by 3.70% in New York to 15% (in local currency) in the Brazilian market - are auspicious.

b) the emerging countries will once again have attractive equity returns. The monetary authorities - after a long period of monetary tightening - saw expected inflation finally falling and then are found to have a more accommodative monetary policy.

In this situation even the Economic Bulletin of the Bank of Italy in January was hope for the best, saying: "Inflationary pressures have eased and in the main developed countries and in emerging markets, benefiting from the decline in commodity prices. In November, the United States the trend in prices has fallen to 3.4 per cent year on year, from 3.9 reached in September, net of energy and food components, stood at 2.2 per cent (from 2.0 in September). In the UK inflation fell to 4.8 per cent, slightly below the peak reached in September (5.2), also due to the absence of the impact of indirect taxes, the basic component is dropped to 3.3 per cent. In Japan, the price trend has become slightly negative, both for the overall index is the component of the way."

However, for various reasons things did not go well.

The year 2011 had to endure the earthquake in Japan, the downgrade of the United States and the outbreak of the sovereign debt crisis in Europe (as well as economic growth still anaemic and political problems in various parts of the world), the yields of many asset classes were surprisingly stable. Although there was the typical variability between sectors and countries, in local currency global bond markets were up 6%, while shares have lost only 7% (in euro performances were 9% and -4% respectively). Another feature of 2011 was the proof, if ever it were needed, that the
growth of GDP is not the only variable that determines the performance of the equity market in a country as shown in the following table, the countries with higher growth (again emerging markets) do not necessarily offer the best performance.

Therefore, one of the factors that affect predominantly the performance of the markets in the coming years will continue to be the decisions of “political” and not only for what concerns the future of the Euro-zone. Social tensions in developed countries, the crisis in the euro-zone and the continued demand for trade protectionism and financial rebalance global demand and supply will remain the key variables to determine the direction of the markets. With government interventions (intended or not) in various aspects of economic, public opinion and the role of politicians become more and more important in the sphere of investment.

A purely financial level, the best investments for 2011 were gold (again as in 2010, +14.3%) and oil (+13.1%), in addition to Treasuries as “safe”, ie countries AAA and emerging markets. Other classes that have done well include bonds of those countries that have taken the fiscal austerity seriously for a couple of years, particularly in the UK and Ireland. The worst investments were instead the actions (not only the European markets but also Japan and emerging markets), industrial metals (very sensitive to the economic cycle and the expectations of global growth) and of course the bonds of the peripheral countries of Europe.

In 2011, European stock markets were driven almost exclusively by the perception of sovereign risk, in terms of sector, as it was easy to expect the worst securities were financial ones (both in Italy and throughout the Euro-zone), followed by industrial and utilities. The only sector which recorded a satisfactory performance was as pharmaceuticals, but were also positive in the energy sector and the consumer goods, more resistant to bad times.

4. Our report on the financial markets

In this section the authors want to spread three months of analysis of financial markets driven by macroeconomic predictions.

a) The following report dates back to just after the Greek elections when governments on 28 and 29 would meet to discuss what to do. In this period there was a very strong short-term volatility which makes it impossible to intervene in the markets, the risk was very high. On July 1, it also started the oil embargo against Iran, the Iranian minister said that the oil will go to 160 $ per barrel.

The macroeconomic data showed a growing scepticism on the part of Germany, ‘and z and w ifo index slightly lower than expected and in America, unemployment and home sales slightly improvement compared to the months that preceded this analysis.
b) The following report is dated July 16, 2012. The week preceding that date was characterized by the rating cut Italy by Moody’s, leading the country in just two steps from the judgment “trash.” At the same time the President Monti, in America, tried to make palatable the Italian issues, the sacrifices and the policy of debt repayment implemented from December 2011. The spread was fixed at more than 4% over the ten-year German. The good news is that on that date the report, the fundamentals had not ruinous, and the rates showed signs of firmness. That is, they are all perched on static positions and expected virtuous impulses in a market too stable. China, for its part, is sending mixed signals, ie certainly were not pleased with the strong dollar (peaked by 2 years), but the growth rates were not the best. We followed our analysis of financial reports.
c) The latest report is fairly recent as dating, dating back to the time when 01/10/2012. In this analysis, we see that Wall Street is not only to celebrate the positive manufacturing data, but also the European markets seem to gain confidence, so that both small Italian titles, as “Astaldi brembo” and chair frau to name a few, and spreads Spanish and Italians give concrete signs of improvement.

The graphs below indicate a pleasant positive progression, and we expect that Wall Street would give around November, a pulse the global financial system.
5. Conclusion

If there is a lesson to be learned (once again) on the financial markets in 2011 is that the best features for a investment success are patience and discipline.

The uncertainty in the markets is in fact the rule, not the exception: the economic realities are too complex to be modeled in a precise and financial markets, especially in the short term, are governed by behavioral science, not mathematics or physics. Things that do not have never happened are bound to happen: the risk of an investment is not given the volatility of a market or instrument, but the possibility that capital may be lost permanently.

The main story of modern risk management (and often what drives the decisions of managers, financial advisors and consultants varied, together with the short-term forecasts) is instead the belief that a full and detailed portfolio can be conducted based exclusively on historical market prices, without any reference to the underlying asset. Models such as the VaR are mathematically elegant but fundamentally flawed: they are useful to analyze and try to predict the risk only if everything is as it should (in particular, if the future is not too different from the past). The performance of the markets, however, escapes this rule, because they are less "rational" than the risk management systems assume.

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