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FESSUD

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Synthesis of country studies on financialisation and the financial and economic crises

(FESSUD D3.07)

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Outline

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    2.2 Export-led mercantilist countries

    2.3 Intermediate cases

3. Type of development and the financial and economic crises

4. Preliminary conclusions

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1. Theoretical considerations

➢ Macroeconomics of financialisation and crisis (Hein 2012):

1. Re-distribution of income in favour of shareholders (rentiers) vs. firms, firms vs. workers, managers vs. workers (distribution channel)
2. Rising shareholder power, dividend payments and share buybacks affect objectives and constraints of firms and hence real investment in the negative (preference channel and internal means of finance channel)
3. Financial asset price booms, house price booms, and financial market liberalisation allow for **wealth-based and debt-financed consumption boom** ➔ compensating for the contractive effects of financialisation ➔ risk: financial fragility and over-indebtedness of private households
4. Deregulation and liberalisation of international capital markets and capital accounts, has created the potential to run and finance persistent current account deficits, and for counterpart **mercantilist export-led strategies** as alternative to generate demand for some countries ➔ risk: global imbalances and over-indebtedness of current account deficit countries

Theoretical considerations

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- Types by financial balances and growth contributions of demand aggregates:

- The **debt-led consumption boom type** is characterized by negative financial balances of the private household sector, positive financial balances of the external sector, and hence, current account deficits, high growth contributions of private consumption, and negative growth contributions of the balance of goods and services.
- The **export-led mercantilist type** is characterized by positive financial balances of the domestic sectors as a whole, negative financial balances of the external sector, and thus, current account surpluses, only small positive growth contributions of domestic demand, but high growth contributions of the balance of goods and services.

- The **domestic demand-led type** is characterized by positive financial balances of the private household and external sectors, and hence, current account deficits, positive growth contributions of domestic demand without a dominance of debt-financed private consumption, and negative growth contributions of the balance of goods and services.

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2. Pre-crisis types of development

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The *debt-led consumption boom* type:

USA, UK, Spain, Estonia, Greece

The *export-led mercantilist* type:

Germany, Japan, Sweden

The *domestic demand-led* type:

Turkey, Poland, Hungary, South Africa

France, Italy, Portugal

Pre-crisis developments:
Debt-led consumption boom economies

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Table 1: Sectoral financial balances as a share of nominal GDP, in per cent

	USA	UK	Spain	Estonia	Greece
	2001-2008	2002-2008	2002-2008	1999-2008	2002-2008
External sector	4,8	2,2	6,3	9,6	10,4
Public sector	-4,4	-3,4	0,0	-0,9	-5,3
Corporate sector	0,5	1,5	-4,2	-4,4	3,9
Private household sector	-0,5	-0,3	-2,1	-4,9	-9,1

Source: AMECO, own calculations

Pre-crisis developments:
Debt-led consumption boom economies

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Table 2: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	USA	UK	Spain	Estonia	Greece
	2001-2008	2002-2008	2002-2008	1999-2008	2002-2008
Real GDP growth	2,1	2,5	3,1	5,8	3,5
Private consumption	1,7	1,7	1,6	3,8	2,6
Public consumption	0,3	0,5	0,9	0,5	0,7
Investment	0,2	0,4	1,1	2,8	1,1
Balance of goods and services	-0,1	-0,1	-0,7	-1,5	-0,8

Source: AMECO, own calculations

Pre-crisis developments:
Export-led mercantilist economies

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Table 3: Sectoral financial balances as a share of nominal GDP, in per cent

	Germany	Japan	Sweden
	2003-2008	1998-2008	2001-2008
External sector	-4,9	-3,2	-7,0
Public sector	-2,0	-5,7	1,0
Corporate sector	1,2	5,5	3,1
Private household sector	5,7	2,8	2,4

Source: AMECO, own calculations

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Pre-crisis developments:
Export-led mercantilist economies

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Table 4: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	Germany	Japan	Sweden
	2003-2008	1998-2008	2001-2008
Real GDP growth	1,5	0,8	2,6
Private consumption	0,3	0,4	1,0
Public consumption	0,2	0,3	0,2
Investment	0,4	-0,3	0,9
Balance of goods and services	0,6	0,4	0,5

Source: AMECO, own calculations

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Pre-crisis developments: Turkey-Poland-Hungary-South Africa

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Table 5: Sectoral financial balances as a share of nominal GDP, in per cent

	Turkey	Poland	Hungary	South Africa
	2001-2008	2002-2008	2003-2008	2001-2008
External sector	3,3	3,7	7,4	3,2
Public sector	-6,5	-4,9	-6,6	-0,5
Corporate sector	3,2 *	0,1	-2,0	-2,8 *
Private household sector		0,7	1,2	

** Financial balance of private sector (corporate and private household)*

Source: AMECO, own calculations

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Pre-crisis developments: Turkey-Poland-Hungary-South Africa

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Table 6: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	Turkey	Poland	Hungary	South Africa
	2001-2008	2002-2008	2003-2008	2000-2008
Real GDP growth	4,5	4,4	3,0	4,2
Private consumption	3,3	2,6	1,3	3,0
Public consumption	0,4	0,7	0,3	0,9
Investment	1,1	1,4	0,7	1,6
Balance of goods and services	-0,3	-0,5	0,8	-1,2

Source: AMECO, own calculations

Pre-crisis developments: Turkey-Poland-Hungary-South Africa

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This group consists of catching-up domestic demand-led countries, having their own currency, where financial integration and in particular financial inflows came to have a significant impact beginning in the 1990s. These are also the countries more susceptible to balance of payment crises.

- **Turkey**: Financial inflows dominated the developments of the Turkish economy, in particular since 2002, bringing about long-lasting exchange rate appreciations, current account deficits and increased private consumption based on a reduction in private saving and consumer credit - in this context Turkey had been showing some features of the debt-led consumption regime, despite positive financial balances of the private sector.

- **Poland**: high growth domestic demand driven economy, however with high government deficits; non-EMU.

Pre-crisis developments: Turkey-Poland-Hungary-South Africa

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- **Hungary**: During the decade preceding the financial crisis Hungary showed many features of a domestic demand-led growth regime, however with quite high current account and public sector deficits, as well as a substantial decline of private household sector surpluses.

- **South Africa**: A brief growth spurt from the mid-2000s until the global financial crisis, driven by household consumption and capital investments associated with large infrastructure projects. While current account deficits were moderate in the 1990s, they increased rapidly during the 2000s.

Pre-crisis developments:
France-Italy-Portugal

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Table 7: Sectoral financial balances as a share of nominal GDP, in per cent

	France	Italy	Portugal
	2003-2008	2003-2008	2003-2008
External sector	0,4	1,2	8,5
Public sector	-3,1	-3,2	-4,7
Corporate sector	-0,2	-0,7	-5,5
Private household sector	2,9	2,6	1,7

Source: AMECO, own calculations

Pre-crisis developments: France-Italy-Portugal

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Table 8: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	France	Italy	Portugal
	2003-2008	2003-2008	2003-2008
Real GDP growth	1,7	0,9	1,0
Private consumption	1,0	0,5	1,0
Public consumption	0,4	0,1	0,3
Investment	0,7	0,2	-0,2
Balance of goods and services	-0,4	0,0	-0,2

Source: AMECO, own calculations

Pre-crisis developments:
France-Italy-Portugal

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Best described as mature domestic demand-led economies.

- **France**: a mild domestic demand-led economy; income-financed consumption was predominant and the economy did not see a real estate bubble develop. Deterioration of current account due to a loss of competitiveness, in particular vis-à-vis Germany.

- **Italy**: a domestic demand-led economy since the 1980s, with private consumption rather than investment being the main driver of growth, and with saving rates of private households remaining roughly constant even in the years leading up to the crisis. Loss of price competitiveness and associated decline in exports thus negative current account since the early 2000s.

- **Portugal**: In the context of waves of privatization and financial sector liberalization, the booming economy saw increasing indebtedness of domestic private sectors in the 1990s. High indebtedness levels inherited from the previous years have hindered the development of asset price or stock market bubbles in Portugal in the years leading up to the crisis.

3. Type of development and the financial and economic crises

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- Transmission mechanisms of the financial and economic crises:

1. contagion effects of the crisis in the international financial markets,
2. problems related to financial flows (BoP),
3. transmission of the economic crisis into the respective economy via international goods markets, i.e. exports and imports,
4. the role of economic policies in dampening or accelerating the financial and economic crises.

- Commonalities within country groups?

Crises in debt-led consumption boom economies

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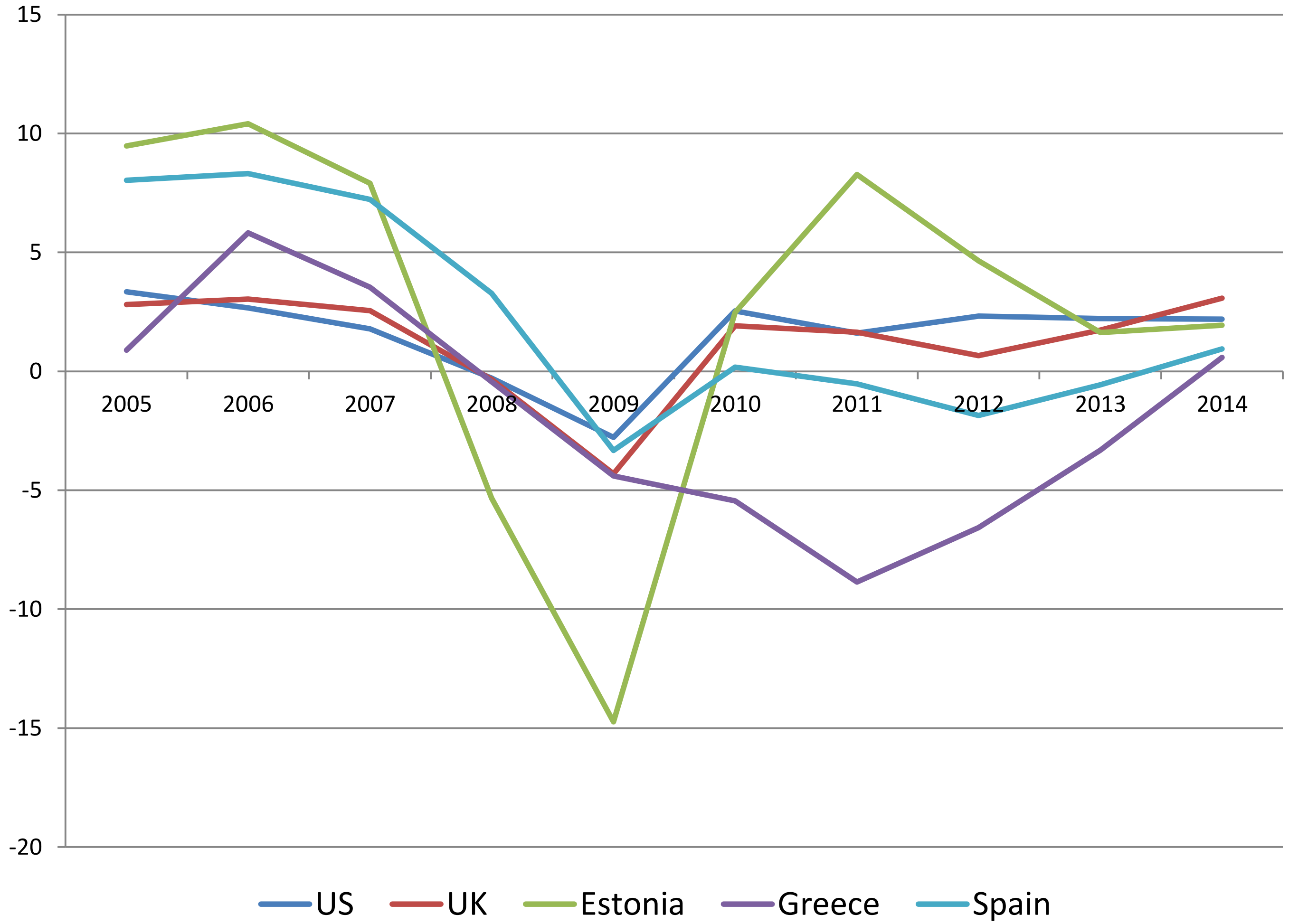
Figure 1: Real GDP growth, selected countries, 2005-2014, in per cent



Source: AMECO, own calculations

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Crises in debt-led consumption boom economies

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- **USA**: country of origin of the financial crisis, from where the crisis spread worldwide mainly through bank transactions; the economic crisis via international trade channel was transmitted from the US to other countries following the deep downturn in US output in 2008/09, which had a negative impact particularly on Europe. By 2012 the US economic growth recovered to the pre-crisis level, not least due to wide government stimulus packages and an immediate and prolonged supportive action by the Fed.

- **UK**: Affected strongly and immediately by the crisis in the US due to its strong linkages to global markets, resulting in a series of massive government-backed recapitalization of banks as well as an immediate response of the Bank of England which enacted a substantial package of measures to prevent the breakdown of the financial system.

Crises in debt-led consumption boom economies

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- **Spain**: Due to its dependence of external funding in the years preceding the crisis, massive deleveraging and abrupt decline in aggregate demand followed the outbreak of the global financial crisis. Banking crisis after Spanish risk premiums reached unparalleled levels (with the Greek crisis of 2010) turned into a sovereign debt crisis → financial support from EU requested and followed by austerity policies hindering the recovery.

- **Estonia**: The crisis hit Estonia pretty hard, with two main channels of transmission: (i) liquidity and funding, arising from the high presence of foreign banks which have reduced lending even faster than domestic banks after the outbreak of the crisis in 2008, and this led to a drop in asset prices and high uncertainty, weakening investment and consumption, and (ii) external trade channel, to which Estonia was particularly vulnerable due to its high degree of openness, which aggravated the situation further as Estonia is indebted in foreign currency and depends on foreign exchange income to pay for imports.

- **Greece**: Two channels – (i) credit crunch in the domestic banking system and the almost total collapse of interbank financing, and (ii) explosion of the already high fiscal deficits. Rising uncertainty over Greek solvency led to a practical exclusion of Greece from the capital markets, leading to the request for bail-out under conditions of harsh austerity measures which deepened the crisis.

Crises in debt-led consumption boom economies

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- *Debt-led consumption boom economies were most vulnerable to contagion effects from the financial crisis originated in the US, either directly (like the UK) due to substantial holdings of toxic US financial products, or indirectly (Spain, Estonia, Greece) due to widespread global panic and uncertainty affecting the health and terms of lending of domestic banking sectors.*
- *Prolonged deleveraging due to excessive build-up of debt by the private sector, also by non-financial corporations, and high unemployment rates.*
- *The absence of the lender of last resort and associated market uncertainty penalizing banks and national governments in the EMU → High public sector deficits in several EMU countries following the attempt to save domestic banking sectors and ultimately sovereign debt crises .*
- *Economic crisis harsh and prolonged in those cases where austerity policies were implemented instead of government stimulus being provided.*

Crises in export-led mercantilist economies

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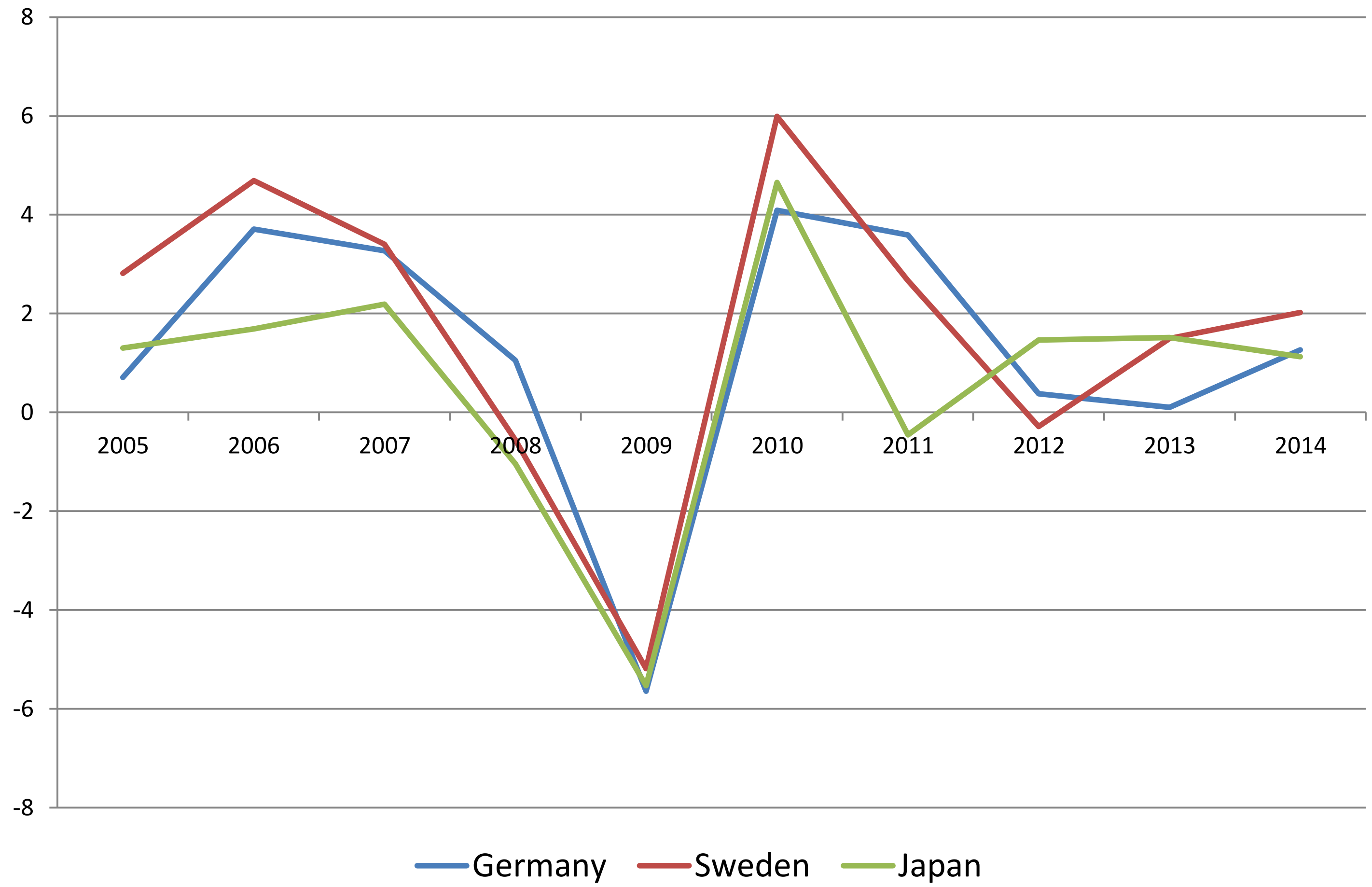
Figure 2: Real GDP growth, selected countries, 2005-2014, in per cent



Source: AMECO, own calculations

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Crises in export-led mercantilist economies

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- **Germany**: financial contagion contained by the government bailout of several public and private banks which held excessive amounts of toxic financial products from the US; main channel of transmission of the crisis was trade channel – in particular a sharp decline in exports to other European countries.

- **Japan**: transmission via trade (export) channel; no financial contagion since the Japanese banking system was not exposed to sub-prime financial products. Despite massive government intervention Japanese stagnation and deflation is ongoing.

- **Sweden**: no contagion from the US directly, but rather through Baltic countries where Swedish banks are highly present; only one bank was bailed out, credit crunch was avoided and financial recovery was relatively quick. In addition market interest rates were low due to safe haven effect (like in Germany). Main impact on Sweden occurred via trade (export) channel, however it was short-lived.

Crises in export-led mercantilist economies

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- *Export-led mercantilist economies were affected by the crisis primarily via trade channel, in particular falling exports due to a contraction in foreign demand.*
- *However, recovery came much faster than it did in debt-led consumption economies: on the one hand, financial crisis was dealt with immediately and succesfully by respective governments, and the long process of deleveraging did not need to take place since the indebtedness of the private sector had been low relative to the other group of countries. On the other hand, foreign demand picked up from other global players, in particular China in the case of Germany, and export performance was strong despite the lack of demand from debt-led consumption economies.*
- *Safe haven effect, both in case of Germany and Sweden.*
- *In the EMU, forced internal devaluation and export orientation of crisis countries resulted in the EMU as a whole becoming an export-led mercantilist region, vis-a-vis the rest of the world.*

Crises in Turkey, Poland, Hungary and South Africa

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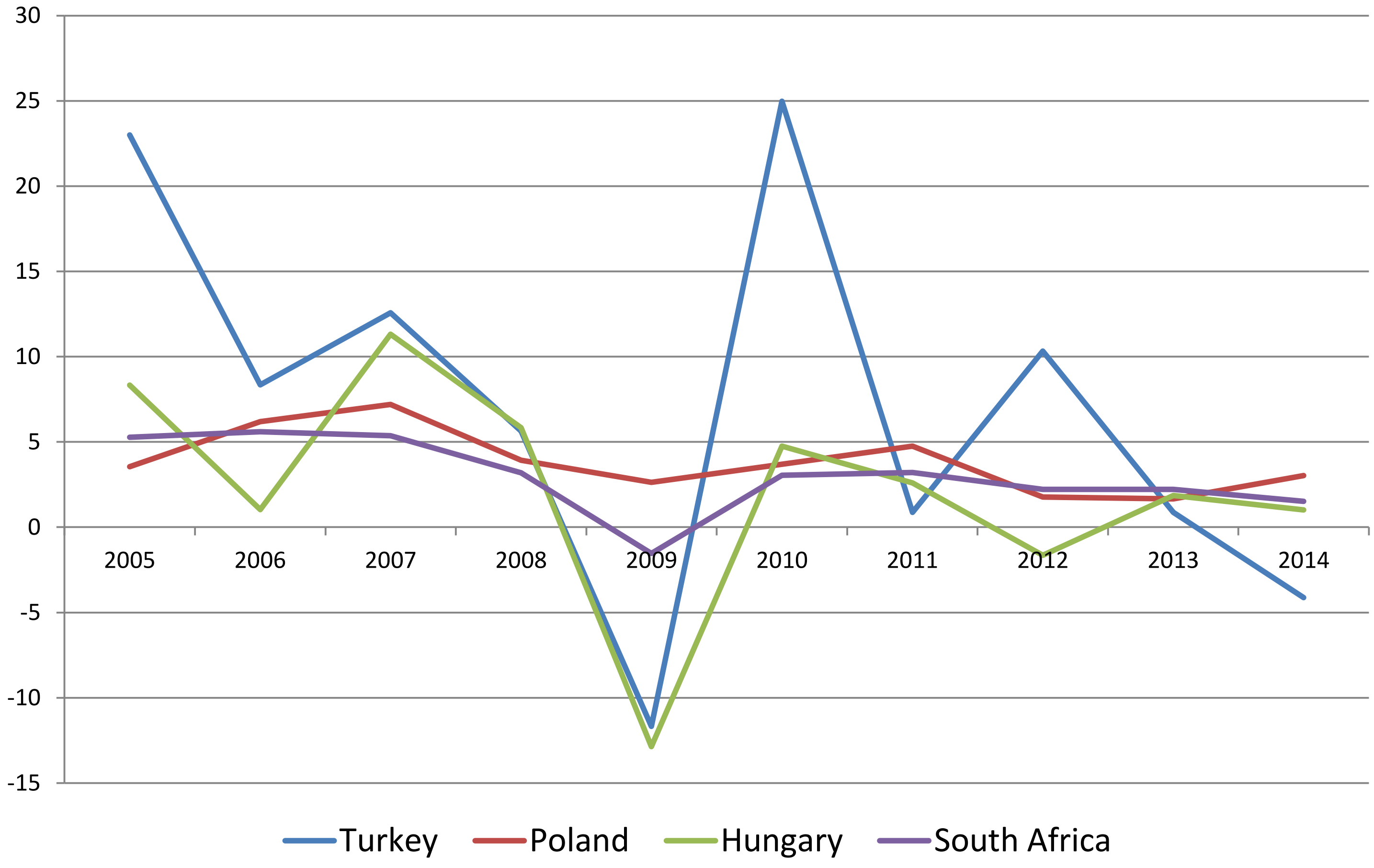
Figure 3: Real GDP growth, selected countries, 2005-2014, in per cent



Source: AMECO, own calculations

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Crises in Turkey, Poland, Hungary and South Africa

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- Turkey: The crisis was transmitted via three main channels: (i) expectation channel, indicated by a substantial deterioration in consumer and investor confidence, in particular in early to mid 2008, and resulting in a fall in firstly investment and then consumption expenditure; (ii) trade channel, through a strong and negative export shock, and (iii) financial flows channel, demonstrated by a a sudden stop in capital inflows which had an adverse effect on the credit conditions. The latter was short-lived, however.
- Poland: Poland has been affected only mildly by the crisis and shows signs of a healthy recovery based on increasing private consumption and improvement in trade balance.
- Hungary: The crisis hit Hungary pretty hard, but this was not indeed due to the problems in the financial sector, but had to do with the fact that Hungary was extremely dependent on and exposed to foreign exchange income. In addition, due to its high accumulation of private debt and public external debt, Hungary needed to request IMF financial assistance in 2008. The following austerity policies it needed to implement prolonged the recession.
- South Africa: The crisis was transmitted through two channels: (i) trade channel, with exports declining substantially in 2009, partially due to the collapse in commodity prices, and (ii) the collapse of capital inflows in 2009. This led the financial sector to scale back credit, which hit manufacturing, retail and wholesale sectors. However, both exports and capital inflows recovered relatively fast.

Crises in Turkey, Poland, Hungary and South Africa

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- *The particularity of the crisis transmission experienced by this group of countries is that it had played out mainy via financial flows – balance of payments channel – although this channel affected the countries rather briefly.*
- *Weak recovery, affected by the euro crisis.*
- *The economic crisis which developed as a result of contracting domestic demand was the more pervasive one, in particular when combined with weak (Turkey) or adverse (Hungary) government responses.*

Crises in France, Italy and Portugal

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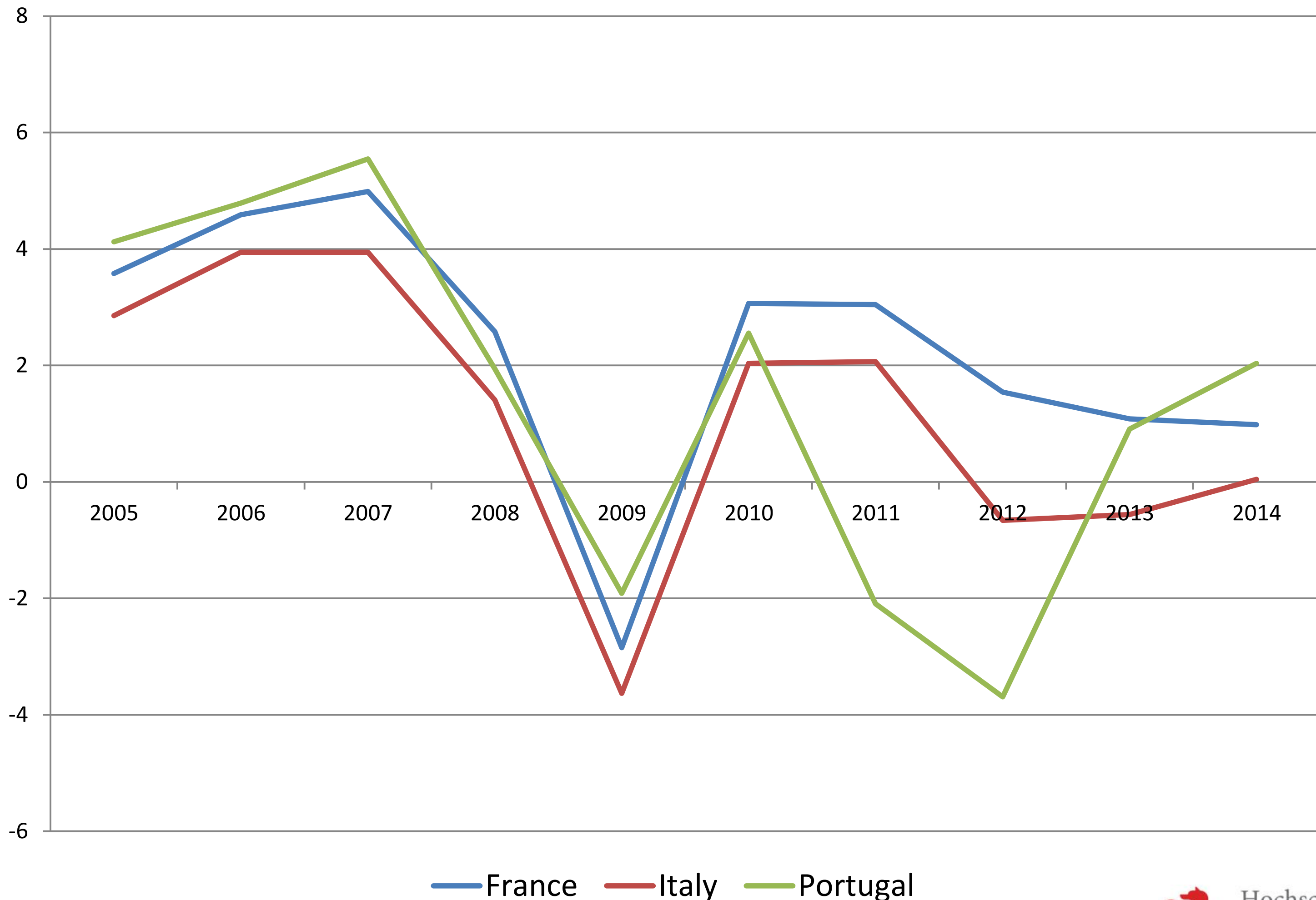
Figure 4: Real GDP growth, selected countries, 2005-2014, in per cent



Source: AMECO, own calculations

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Crises in France, Italy and Portugal

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- **France**: The crisis affected French economy via two channels: (i) consumption and investment demand slowdown, due to international financial crisis and increased uncertainty; and (ii) the lack of foreign demand due to problems abroad which worsened the French trade balance. With some help of government stabilization policy, French banking system withered the crisis, there were no major bankruptcies since 2008 nor a credit crunch developed.

- **Italy**: Like in France, Italian banking system did not suffer particularly during the crisis; leverage ratios were low in international comparison. However, the obstacle to Italian recovery stems from fiscal austerity measures, in particular tax hikes.

- **Portugal**: Portugal's banking sector was not affected by the crisis since it was not involved in buying subprime financial products from the US, and also was not involved in excessive lending to support bubbles because Portugal did not have a house price boom. The global financial crisis affected Portugal's economy through increasing perceived credit risk which pushed up interest rates and thus adversely affected consumption and investment. Ultimately the problem in Portugal was the high public debt, with debt-to-GDP and deficit-to-GDP ratios worsening after government's attempt to stabilize the economy, which finally resulted in the need for Portugal to ask the assistance from the IMF and EFSf in 2010. The conditionalities of the rescue packages worsened the crisis in Portugal.

Crises in France, Italy and Portugal

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- *Affected by global financial crisis via rising borrowing costs and rising uncertainty, but no major or prolonged problems in the banking sector given the low exposure of domestic banks to sub-prime financial products from the US.*

- *Recovery in 2009-2010 but with the euro crisis came a slowdown in private consumption and investment → result primarily of 'soft' (France and Italy) or severe (Portugal) austerity policies; weak growth since.*

Current account balances before and after the crisis

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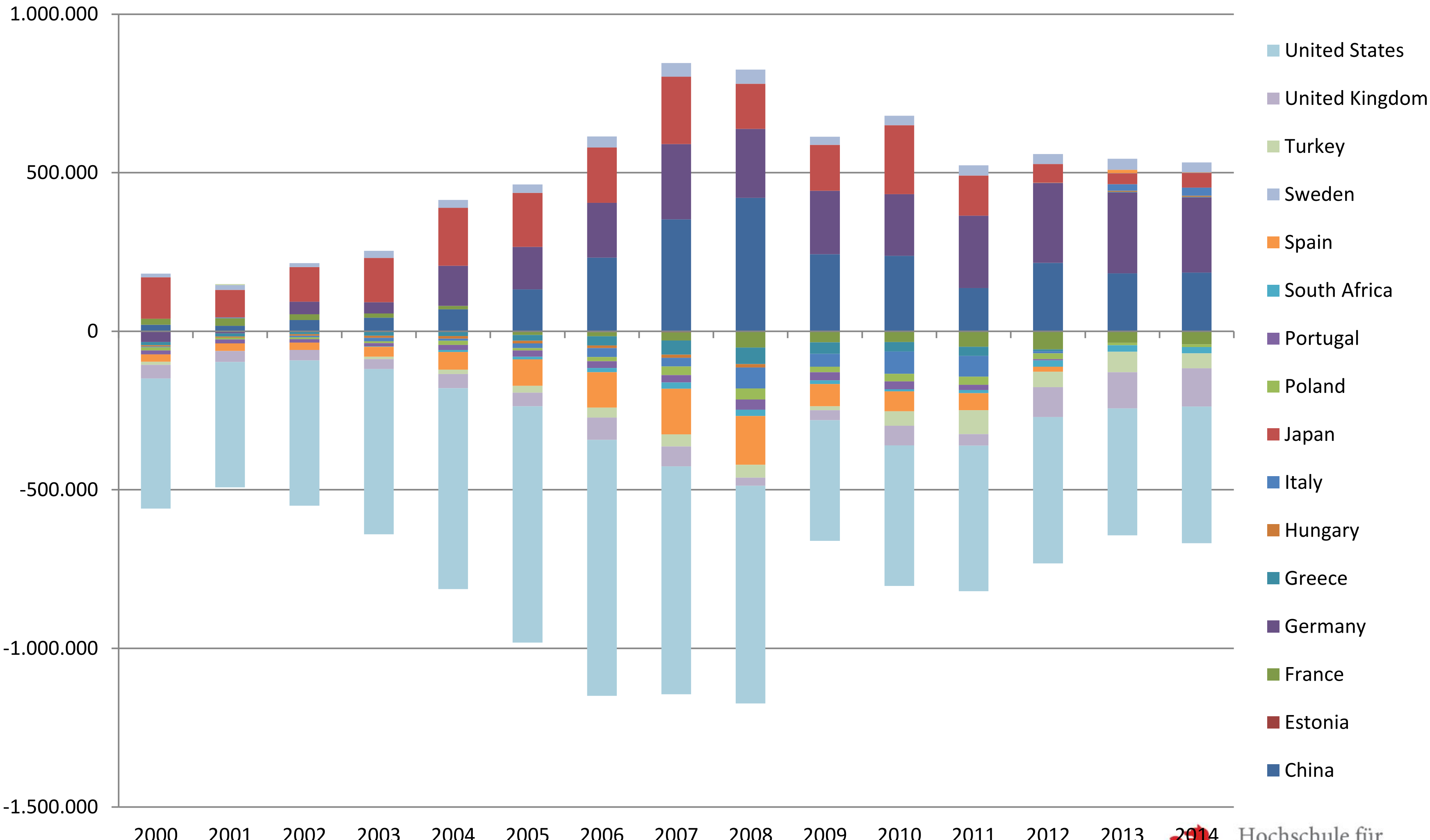
Figure 5: Current account balance, selected countries, 2000-2014, in billions of US dollars



Source: IMF, World Economic Outlook

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4. Preliminary conclusions

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- ‘Debt-led consumption boom’ and ‘export-led mercantilist’ type contains internal contradictions, with respect to household debt and with respect to foreign debt of the counterpart current account deficit countries, which finally undermine the sustainability of these regimes and lead to financial and economic crises.

- Importance of tracking balance sheets as well as growth contributions of demand aggregates, for early identification of the sources of potential instability.

Preliminary conclusions

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- Quick recovery in export-led mercantilist economies: domestic balance sheets were in order, financial crisis quickly contained, benefited from recovery of world economy + temporary active macroeconomic stabilisation

  ➔ no role model for world econmy because of „beggar thy neighbour“

- Debt-led consumption economies with monetary autonomy were successful in stabilising the financial sector and the economy by government deficits, however, weaker growth

- Debt-led consumption economies without monetary autonomy, stabilisation terminated by financial market pressure and then by fiscal austerity

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Preliminary conclusions

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- Catching-up/dynamic domestic demand-led economies (with monetary policy autonomy): relatively fast recovery, financial flows recovered rather quickly.

➔ Problem: accumulation of private and/or public debt in foreign currency during a boom and stabilisation of exchange rate constrain room of manoeuvre.

- Mature domestic demand-led economies (without monetary policy autonomy): euro crisis + austerity policies.

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Thank you for your attention.

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Table 9: Sectoral financial balances as a share of nominal GDP, in per cent

	USA	UK	Spain	Estonia	Greece
	2009-2014	2009-2014	2009-2014	2009-2014	2009-2014
External sector	2,8	3,1	1,2	-2,9	5,5
Public sector	-9,1	-7,9	-8,7	-0,9	-9,8
Corporate sector	3,3	2,8	4,2	2,1	12,4
Private household sector	4,0	1,9	3,3	1,6	-8,3

Source: AMECO, own calculations

Crises in debt-led consumption boom economies

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Table 10: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	USA	UK	Spain	Estonia	Greece
	2009-2014	2009-2014	2009-2014	2009-2014	2009-2014
Real GDP growth	1,3	0,8	-1,0	0,7	-4,7
Private consumption	1,0	0,3	-0,8	-0,2	-3,4
Public consumption	0,0	0,2	0,0	0,2	-0,9
Investment	0,1	0,1	-1,7	-0,2	-2,5
Balance of goods and services	0,1	0,1	1,5	0,9	2,3

Source: AMECO, own calculations

Crises in export-led mercantilist economies

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Table 11: Sectoral financial balances as a share of nominal GDP, in per cent

	Germany	Japan	Sweden
	2009-2014	2009-2014	2009-2014
External sector	-6,6	-1,8	-6,1
Public sector	-1,2	-8,5	-0,9
Corporate sector	2,6	7,7	0,7
Private household sector	5,2	2,5	6,2

Source: AMECO, own calculations

Crises in export-led mercantilist economies

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Table 12: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	Germany	Japan	Sweden
	2009-2014	2009-2014	2009-2014
Real GDP growth	0,6	0,5	1,1
Private consumption	0,5	0,6	0,9
Public consumption	0,2	0,3	0,4
Investment	0,1	0,0	0,0
Balance of goods and services	0,0	-0,3	-0,2

Source: AMECO, own calculations

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Table 13: Sectoral financial balances as a share of nominal GDP, in per cent

	Turkey	Poland	Hungary
	2009-2014	2009-2014	2009-2014
External sector	6,3	1,7	-4,4
Public sector	-2,6	-5,5	-3,7
Corporate sector	-3,8*	4,9	4,5
Private household sector		-1,0	3,6

** Financial balance of private sector (corporate and private household)*

Source: AMECO, own calculations

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Table 14: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	Turkey	Poland	Hungary
	2009-2014	2009-2014	2009-2014
Real GDP growth	3,7	2,9	-0,1
Private consumption	2,1	1,4	-0,8
Public consumption	0,7	0,3	0,1
Investment	0,8	0,4	-0,3
Balance of goods and services	0,0	1,0	1,3

Source: AMECO, own calculations

Crises in France, Italy and Portugal

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Table 15: Sectoral financial balances as a share of nominal GDP, in per cent

	France	Italy	Portugal
	2009-2014	***2009-2014***	***2009-2014***
External sector	2,0	1,0	3,4
Public sector	-5,4	-3,6	-7,3
Corporate sector	-0,7	1,2	-0,4
Private household sector	4,1	1,5	4,3

Source: AMECO, own calculations

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Table 16: Real GDP growth (in per cent) and growth contributions, selected countries (in percentage points)

	France	Italy	Portugal
	2009-2014	***2009-2014***	***2009-2014***
Real GDP growth	0,3	-1,3	-1,1
Private consumption	0,2	-0,7	-0,9
Public consumption	0,4	-0,1	-0,3
Investment	-0,3	-0,9	-1,3
Balance of goods and services	0,0	0,6	1,6

Source: AMECO, own calculations