

WORLD IN CRISIS. THE ROLE OF BANKS IN REDUCING THE EFFECTS OF THE GLOBAL ECONOMIC AND FINANCIAL CRISIS 2008-2013

Romuald N. Hanisz, Prof.

rhanisz@wsb.edu.pl

Academy of Business in Dąbrowa Górnicza

Abstract

The subject of this article is to present the economic and financial crisis, and the instruments implemented, mainly monetary, to overcome the negative effects on the global economy. The financial crisis that struck the United States quickly become real and moved to the social area, and affected the condition of the economies in the European Union. Governments affected by the crisis have developed special programs to save the global financial systems and restore the economy to growth. The battle on crisis, however, would be impossible without the participation of the largest central banks that have used unconventional tools aimed at restoring the balance in the global markets, not only financial.

Key words: financial crisis, mortgages, securitization, credit derivatives, monetary policy, liberalization of financial markets, quantitative easing.

1. Introduction

Economy has been accompanied by crises for a long time, but globalization has made them more frequent and easy to spread quickly. The current economic and financial crisis that began in 2007 in the United States is compared to the Great Depression of the late 20s and 30s and basically affected the whole world. The main reason for its emergence was the overheating of the economic situation especially in the credit market. The result of a spec-

ulative bubble in the U.S. mortgage market was the chaos in the financial market. In addition, the crisis that initially was mainly related to financial institutions, also affected state budgets (the debt crisis) and entered into the real area of the economy. Governments affected by the crisis, including Europe, have developed special programs to save the financial systems and restore the economy to growth. However, without the participation of banks, mainly central ones, especially without the Federal Reserve and the European Central Bank the fight with the crisis would be of little effects.

The purpose of this article is to present the economic and financial crisis, and the instruments implemented, mainly monetary, to overcome the negative effects on the global economy.

2. Is the liberalization of financial markets the main premise of the occurrence of the financial crisis in 2007?

Capitalist economy has been accompanied by crises for a long time. However, the effects of the crisis which began in the U.S. in 2007 – in the center of the global financial system – turned out to be much broader in its scope and impact than one might initially expect. It was not caused by external factors, but it was a “child “ of the system as a whole (Flejterski 2011: 105). The current financial crisis, which has caused serious disturbances in the sphere of real processes in the United States and European countries, has many causes. Within the conditions of the global economy (Kowalik 2011: 58)¹, the crisis quickly spread to European countries, including the developed ones. According to Wojtyna, “the transfer effects” currently occur primarily through financial channels rather than trade ones (Wojtyna 2011: 9). It is not easy to make a distinction between the transfer effect of shock from one country to the other, and a common shock affecting at the same time all those countries in the case of financial channel. It follows that, contrary to the product and labor market, adjustments in the financial market are made with virtually no delays. Studies show that liberalization, including financial liberalization, on the one hand has a positive effect on long-term economic growth, on the other hand increases the risk of crises (Kawa 2011: 45).

Economists have divergent opinions on the causes of the current crisis. Wielecki thinks that there has been a great crisis of civilization taking place

¹ T. Kowalik believes that the term “globalization” is a hoax equivalent term of neo-colonialism and imperialism, and the former Secretary of State Henry Kissinger said that globalization is another name for the “Americanization” (Kowalik 2011: 58).

for thirty years, and the current economic crisis is only a side effect. (Wielecki 2010: 35). Kaczmarek believes that the current crisis is rooted in the lack of trust and lack of social responsibility as well as consumption, which has reached monstrous and pathological dimensions. "Reasonable limits of the growth of the global economy have been exceeded." (Kaczmarek 2009: 142). However, Bootle believes that the current crisis is the result of interactions of eight strong factors: "banks" in the property market, the debt explosion, the financial weakness of banks, improper risk valuation, erroneous monetary policy, excessive tendency to save money in some countries (e.g China), indulgence and incompetence of the governing bodies and the submissiveness of credit rating agencies (Bootle 2009: 9).

Kołodko claims that the current crisis is fundamental and systemic. This is a systemic crisis of contemporary capitalism, its liberal mutation. The reasons for the crisis are to be found in the structural changes that accrued in the global economy, especially in the U.S., and with the correlated neo-liberal ideology. Neo-liberalism made a state and its regulations a specific enemy number one (Kołodko 2010: 92 and 95), (Kołodko 2013: 35)².

The event which led to the crisis in U.S. in 2007 and the disaster in 2008 was the gradual deregulation of the financial system, mainly in banks. Among others, the Interstate Banking and Branching Efficiency Act was enacted in 1994, which resulted in a creation of a national banking system and then in November 1999, the Financial Services Modernization Act – Gramm – Leach – Bliley Act (GLBA), which abolished restrictions on the conduct of the various categories of financial services and speculation limitations imposed on banks in 1933 by Glass – Steagall Act (GSA), (Mishkin 2002: 348-350). GSA regulated the financial system by separating the banking sector /deposit and loan/ from the investment and public sector – securities. GLBA was enacted primarily to legally remove any barriers that were separating GSA investment banks from public savings and deposits, and to allow banks to carry out operations characteristic for insurance companies. While signing GLBA, President Bill said: "This is a historic change. The fact is that the Glass – Steagall Act no longer corresponds to the economy in which we operate", and U.S. Secretary of Finance Larry Summers promised: "With the new law, the U.S. financial system is entering the twenty-first century"

² Neo-liberalism cannot be confused with liberalism. According to Kołodko "A better future can be built on values such as freedom, including economic freedom. Ideas such as liberty, freedom of choice, democracy, pluralism, private property, entrepreneurship, market competition are positives worthy of treatment. Neoliberalism, however, in a cynical and effective way, exploits these liberal values to transfer income from the mediocre and poor people to the rich and wealthy minority" (Kołodko 2013: 35).

(Mason 2010: 69). The best evidence of how the U.S. financial system has entered the twenty-first century are the crises of 2002 and 2007.

Deregulation was a single, but at the same time very important, factor in the rise of modern investment banks and new financial market instruments, including the derivatives. While searching for the causes of the current crisis, one cannot overlook the factors that contribute to the emergence and development of the crisis:

- Modern IT technologies, whose implementation by the financial market institutions has resulted in the increase of information asymmetry in the economic system and the quick increase of money circulation;
- The emergence of the global market of derivative financial instruments (derivatives) as a result of deregulation and information technologies;
- An increase in currency speculation;
- Imbalances in trade and income distribution expressed in the statements like: “The West consumes and Asia produces” or “The poor saves (China) and the rich consumes (USA)”;
- The increasing dominance of the financial sector in the overall economic activity. The process of financialisation of the U.S. economy has the following characteristics: Revenues of the financial markets in the U.S. in 2000 totaled 508 456 billion and were higher than in 1990 at 123.5%. In 2000 the financial market revenue exceeded the U.S. GDP 51 times while in 1980 – six times, in 1990 – 42 times. The U.S. GDP in 1980 was 15.7%, in 1990 – 2.6%, in 2000 – 1.9% of the financial revenues (Żyżyński 2010: 29).

At the outbreak of the current crisis, the scale of the detachment of the financial sector from the real economy was so great that the necessary adaptations could have been accomplished only by the crisis shock adjustment (Kołodko 2010: 93).

From the point of view of this chapter, it is worth talking about the reasons related to the functioning of the financial system, especially the banking system. The immediate cause of the crisis was the collapse of the mortgage market – the speculative bubble burst. The bubble was generated in the real estate market as an effect of a very rapid growth in mortgage lending, resulting from the softening in financial capacity assessment, and particular institutional and legal solutions making the access to loans for a wide range of customers much easier, often not having a job or an adequate income – NINJA (No Income, No Job, No Assets). In 2000-2007, the debt of households with mortgage loans increased in relation to U.S. GDP from about 49 to 76%. The relaxation of credit criteria was reflected

in the deterioration of credit quality and an increase in the risk of insolvency. The value of substandard mortgages, the so-called subprime, increased from \$ 190 billion in 2001 to \$ 600 billion in 2006, and their share in the total value of mortgage loans in these years changed from 8.6% to 20.1% (Kacprzyk 2009: 85). It is believed that the crisis in 2007 did not result from the collapse of the mortgage market substandard because it was “only an ignition of a bomb whose strength was accumulated through pathological relationships characteristic for neo-liberalism...” (Kołodko 2010: 97). Other sources may include the unprecedented development in the securitization of assets and the monetary policy of the Federal Reserve System.

3. Securitization – as a source of financial crisis in 2008

The deregulation of financial markets has enabled the change from a traditional model of financing the purchase of real estate to the securitization of mortgages, i.e. the sale and issue of securities, collateralized by the real estate financed by the loan. In the process of securitization, credit derivatives have been used, including collateralized debt obligations – CDOs (Rawski 2011: 9 and onwards) and CDS – Credit Default Swap (Demko 2011: 30 and onwards), which transferred risk, including credit, from one financial institution to another³.

A new model of mortgage financing was born (Rosati 2010: 105 and onwards). The most obvious reason why banks and other lenders, including mortgage lenders, decided on securitization was to quickly obtain financing /cash/ and to get rid of the medium – and long-term assets /receivables/ at risk, particularly credit risk. Loans, especially mortgage, are paid in installments over the period of many years, while in the case of a bond issue, initiator has cash on their emissions through a broker. In the case of investors, which included the investment banks, insurance companies and banks possessing the funds, higher rates of return and risk diversification worked encouragingly to buy bonds. Relatively homogeneous mortgage packages were sold by banks to intermediate entities, including Freddie Mac and Fannie Mae, which had the status of being sponsored by U.S. government. These institutions, on the basis of the “packages”, issued MBS (Mortgage

³ The structures, mechanisms of actions and the risks associated with the use of CDO and CDS are reported by: Rawski M. 2011, “CDO jako pierwotne źródło kryzysu finansowego zapoczątkowanego w 2007 r.”, pp. 9 and onwards, and Demko A. 2011, „Mechanizm instrumentu CDS – podstawowe zagrożenie dla stabilności sektora finansowego, pp. 30 and onwards, in: Matysek-Jędrzych (ed.), Instytucje i rynki wobec kryzysu finansowego – źródła i konsekwencje kryzysu, CeDeWu, Warszawa.

Based Securities) and sold them to other institutions, particularly financial, not only in the U.S., but also in Europe and Asia. The pursuit of profits generated a situation where new financial institutions offering increasingly complex financial products joined the process of securitization. This meant that “the securitized assets were becoming diverse and consequently, the basic type of the instrument, on which the structured product was protected, became difficult or even impossible to identify” (Glinka 2011: 149). As a result of the dispersion of risk and difficulty of the correct valuation, new investors were not aware of the risks held on derivatives. Reputable agencies and financial market supervision, while using the traditional methods of assets valuation, were not able to properly assess the risks associated with the increasingly complex securities which were based on mortgage loans, including subprime. Symptoms of the looming crisis appeared in the second half of 2005, when a slowdown in house price growth and a gradual increase in the number of homes available for sale occurred in many areas of the U.S. Those trends were intensified in 2006 and early 2007 when the bonds collateralised by subprime securities turned out to be without coverage. First financial institutions began to bankrupt. And banks experienced multibillion-dollar losses.

The deterioration of the mortgage loan portfolio, with serious decline in property prices, has led to the deterioration in the quality of credit derivatives, thereby deepening the problems of banks and other financial institutions in the field of financial liquidity and economic activity. It has turned out that the credit derivatives did not secure mortgage banks and other financial institutions against risks, they served only for the purpose of withdrawing bank charges of various risks and for speculators. It is believed that the insurance debt resulted in increased losses caused by poor risk assessment. Given that the value of securitized investment totaled 25 billion U.S. dollars, when the speculative bubble of subprime loans burst and the value of the credit risk transfer contracts was estimated for 58 billion U.S. dollars in 2008 (which was almost the value of global GDP), the initial losses were evaluated at three trillion dollars (Mason 2010: 110-111).

The powerful growth in mortgage lending, as a result of i.a. securitization, would be impossible without the participation of the Federal Reserve System (FRS). During the economic downturn in the early years of the twenty-first century, the FRS aggressively lowered interest rates as an attempt to prevent a recession resulting from the collapse of the new technologies market. From the beginning of 2001 to the third quarter of 2003, it lowered the interest rates on federal funds /reference rate/ from 6.5% to 1%, which, obviously, resulted in the reduction of the discount rate at which funds are lent to banks. Along with the ongoing economic recovery, i.a. in

the real estate market, there has been a crucial change in the interest rates policy. From 30 July 2004, the SFR slowly but steadily raised the reference rate from 1.00% to 5.25% (29 June 2006). As expected, the increase in the value of money contributed to the decline in GDP growth from 3.6% in 2004 to 2.0% in 2007, and a major increase in the cost of mortgages which led to a bursting of the speculative bubble in this market. Banks and other financial institutions began to have problems with maintaining liquidity and started to incur losses. The assistance from the State proved to be necessary.

4. The activities of the federal reserve system alleviating the consequences of financial crisis

The financial assistance of the central bank and the federal government of the United States aimed at rescuing banks and other institutions from bankruptcy resulted only in a temporary tranquility amongst the distressed financial markets. The announcement of the bankruptcy of Lehman Brothers Holdings Inc. on 15 September 2008 (UKNF-2010 – p. 7)⁴ – one of the largest investment banks with a 158-year tradition – led to a global crisis of confidence, and thus to a significant changes in the mindset of bankers and the conduct of banks and other subjects of the financial market that supply the economy with money. The refusal to grant financial support by the federal government to such a huge investment bank as Lehman Brothers Holdings Inc. resulted in the paralysis of the financial market with its negative consequences for the real economy (Hanisz 2011: 144-145). Banks being afraid that their existing strong partners in the banking sector may also fall, stopped lending each other money. The crisis of confidence among the banks generated in turn the crisis of public confidence in banks and financial institutions, banks stopped trusting private companies, and companies stopped trusting each other. At the end of 2008, the crisis afflicted the automotive industry that was cooperatively linked with thousands of businesses. The car companies like Ford, and General Motors announced mass dismissals of workers, withheld production for a period of time and did not prolong the employment of temporary workers. The signs of recession appearing in 2008 deepened the concern about the liquidity of the financial market entities, including banks, people's lending capacity, and non-financial companies. Rating agencies – complicit in the crisis – reduced the position of a number of major financial market subjects (Wieprzowski 2010: 92).

⁴ The date 15.09.2008 is considered to be the beginning of the crisis in Poland. Polish Financial Supervision Authority /UKNF – 2010/: „Polski rynek finansowy w obliczu kryzysu finansowego w latach 2008-2009, Warszawa, May 2010, p. 7.

Initially, it was not expected that the collapse of the mortgage market in the U.S. could result in the entire wave of consequences and uncover the imperfections among the operations in derivatives, and even abuses/frauds and failures within the whole financial market. It quickly became clear that the crisis was not just a problem of one country or market, but it was a global crisis of a systemic nature. This fact caused the situation that individual countries and central banks, starting with the U.S., decided to intervene in order to prevent further escalation of the phenomenon and continuation of the increase in systemic risk.

On 6 February 2006, after A. Greenspan's 18-year career, Ben Bernanke, an expert of the Great Depression of 1929-1933, became the head of the Federal Reserve System by the choice of President Bush. The new head of the Fed began his career during the threat of inflation, and the overall defeat in economy, especially within the real estate market, and the credit sector (Harris 2009: 18). In this situation, he continued the activities of his predecessor by raising the value of money. The first actions of the U.S. government and the Fed were aimed mainly at providing banks with money to improve the situation of current liquidity.

The catastrophe in the financial market which appeared after (probably not very well thought over) the activities leading to the collapse of Lehman Brothers Holdings Inc. forced the federal government and the Federal Reserve to direct huge funds for rescuing banks and other financial institutions, and to support the real economy. By the initiative of the Federal Government, the Troubled Assets Relief Program (purchasing risky government debt) – /TARP/ was designed. The amount of money involved in this program was 700 billion dollars. Due to its controversial nature, it was not approved until December 2008. The amount of money the banks were provided was only a half of the sum – \$ 350 billion. They counted that TARP 2 or a “bank of bad debts” would be created.

To kick-start the economy throttled by the crisis, the fastest in its actions, for obvious reasons, was the Fed. By the end of October 2008, The Fed stated that it would finance the purchase of short-term debt from the money market funds by the total of 540 billion dollars. The founding of the Money Market Investor Founding Facility (MMIFF) was complementary to the previously created Commercial Paper Funding Facility (CPFF), which, starting from 27 October 2008, was financing the purchase of highly reliable, denominated in U.S. dollars, three-month, unsecured and asset-based short-term bonds issued by the American subjects, and also complementary to Asset Backed Commercial Paper Money Market Fund Liquidity Facility (AMLF), created on 19 September 2008, which offered loans to banking organizations allowing the purchase of asset-backed short-term bonds from

money market funds. AMLF, CPFF and MMLFF were designed to increase liquidity in the market for short-term bonds, and thus, the availability of credit (Politi, Mackenzie 2008). Despite the steps taken by the government and The Fed, the recession occurred, and it has cost the economy millions of jobs. The unemployment stabilization rate – NAIRU (non-accelerating inflation rate of unemployment) has been disturbed. It sets a maximum level of unemployment that does not accelerate the inflation. (Harris 2009: 35-40).

The fight with the recession and restoring the economy on the path of growth is a challenging task for any central bank. Based on previous experiences, the basic tools in this area can include, among others:

- the reduction of interest rates of refinanced loans /funds/, preferably to zero – ZIRP (Zero Interest Rate Policy). Such actions were undertaken by the end of 1990s by the Bank of Japan. Thanks to this operation, on one hand the liquidity of the banking sector is protected, and on the other, the economy is provided with money at the lowest cost. The lowering of the interest rate by the central bank will reduce the profitability of the securities not laden with risk – especially treasury risk;
- purchasing unlimited amounts of free-risk debt securities, in the first wave – treasury securities;
- interventions in foreign exchange markets aimed at weakening the national currency and the increase in prices of imported goods and services;
- increasing the money issue /reprint/ by the central bank.

The Fed seriously eased monetary policy. Since 2007, the interest rate on federal funds has been sharply lowered, virtually to zero. As a result of such action, the real funds rate since 2008 has been placed below zero (-2,1% in 2008).

The lack of positive reaction of the U.S. economy on such a substantial reduction in interest rates made it necessary to implement a very controversial operation in November 2008, which involved the introduction to the market a huge amount of dollars. The operation was called “quantitative easing” (QE), in the jargon of financiers: “quantitative money easing” or “the reprint of money” – virtual dollars were added as entries in the accounts (Prusek 2011; Siemiończyk 2011). In simple terms, the central bank buys various assets in the secondary market, mainly debt securities, for reprinted money. Within QE 1 and 2, until the end of the first half of 2011, The Fed bought assets for more than 2.3 trillion dollars, including about \$ 1 trillion of treasury securities. Pumping such huge amounts of money did not result in the expected growth in the U.S. economy, but it also did not

cause the increase in inflation (Maciejewicz, Prusek, Matusiak 2012). In this situation, the Fed decided to reprint additional money in the QE3 program (Kaminska, Koziel 2012). In December 2012, the U.S. central bank adopted a stimulus program – from the beginning of January 2013, bonds worth 45 billion dollars have been bought every month. The new buy-back program is being carried out at the same time with the covered bond purchase program of mortgage-backed MBS, worth \$ 40 billion per month. Thus, the Fed buys assets worth 85 billion USD a month (Saxo Bank, PAP)⁵. Taking into consideration the increasingly better data coming from the U.S. economy, a great number of investors is still confident to launch QE3 program restrictions as early as September 2013. The key question that remains is the scale of the reduction program, chosen by the Fed. Initially, the program was expected to be reduced by 10-15 billion USD. At the moment, the amount of money taken into consideration is \$ 5 billion, which would be the signal for the market to maintain super-loose policy. It is believed that there could be a change in the structure of bonds bought: the increase in the purchase of MBS covered mortgages bonds, the decrease in treasury bonds. The Fed intends to maintain the current low interest rates, at least as long as the inflation projection for the next 1-2 years will remain below 2.5%, and unemployment between 6.0-6.5%. Currently, the unemployment rate is above 7.2%. The new head of The Fed will decide about the monetary policy of United States in 2014. Ben Bernanke probably will leave at the end of his term in January 2014. However, speculations about his successor do not subside. The first in line is Janet Yellen, the current deputy head of Reserves, and the second in the race for the seat of the head is Larry Summers, former U.S. Secretary of State (Nurczyk 2013).

5. The actions of the European banks aimed at overcoming the effects of the economic crisis

Since February 2009, Europe has begun to fall into recession. However, some symptoms were evident as early as at the end of 2008 (Kuk 2009). The crisis, which at the beginning was mainly related to banks and other financial institutions, quickly affected budgets of states (the debt crisis) and entered into the real economy. A quite rapid inhibition of economic growth occurred, even in the richest countries. European governments, realizing the seriousness of the situation and the effects of the crisis in the U.S., were launching programs designed to improve the current liquidity of banks and

⁵ Saxo Bank, „Niejednoznaczny komunikat Fedu” 22.08.2013; PAP, „Fed: Polityka monetarna bez zmian.” 19 June 2013.

to reduce the negative effects associated with the emerging recession, the bankruptcy of enterprises of the real economy and the rising unemployment, especially among the youth. In November 2008, The Swiss government announced a stimulation plan – 1.55 billion francs (1.31 billion U.S. dollars) to support the economy during the worsening economic climate in the world. It was also stated that, if necessary, it could still set aside an additional 1 billion francs (PAP 2008)⁶. Germany allocated 80 billion Euro to the banking industry, Sweden 155 billion Euro, and France 40 billion Euro. The governments of Belgium, the Netherlands and Luxembourg decided to transfer 11 billion Euro to Fortis bank, which was on the verge of collapse. The sum of 6.4 billion Euro was allocated by the governments of Belgium, France and Luxembourg to Dexia. Central Bank of Portugal powered the banking sector with the amount of EUR 20 billion. The Irish government guaranteed the deposits for two years in all banks with Irish capital, and Iceland nationalized all major banks. The help for the banks during the financial crisis meant that a large proportion of them started to be controlled by the governments, and the state became one of the main shareholders. This situation, in addition to recapitalize the institutions, was to increase their stability by their control and the state guarantees (Walewska, Więclaw 2009).

Independently from the government's programs to decrease the negative effects of the crisis, the central banks have undertaken dynamic actions: the European Central Bank, the Bank of England and the national central banks of the countries belonging to the European Union⁷. The governments and central banks of Europe with the leading European Central Bank (ECB) basically copied the actions of the U.S. monetary institutions. However, they modified them significantly including the characteristics of the economy and the crisis in Europe. The changes were implemented in the field of public finance of the 27 countries making up the European Union and the 17 countries of The Economic and Monetary Union (EMU). The ECB also raised interest rates before the crisis and then quickly lowered them. From March to July 2007, ECB raised the base rate of the MRO (Main Refinancing Operations) from 3.50 to 4.25%, the credit operations to 5.25%, and the deposit operations to 3.25% in order to, after the paralysis of the financial market in USA following the collapse of Lehman Brothers, lower them from October to December respectively to 2.5%, 3.0%, and 2.0%. In the face of the already apparent recession in the European market, the ECB cut main refinancing rate to 1.0%, credit operations to 1.75%, and the deposit operations to 0.25%. The operations took place from January to May 2009 (Kuk

⁶ PAP, 12 November 2008.

⁷ Due to the variety of the implemented tools, the monetary policy of EBC will be presented in a shortened form.

2008). At the same time, the providing operations and the purchase of treasury and private bonds on the secondary market designed to calm the panic that began to engulf European financial market were declared (Kochaniak 2012: 80-83; Matusiewicz 2012: 20 and onwards). On July 11 2012, the ECB again lowered the rate on the main refinancing operations. Lending and deposit rates at the end of the day were reduced by 25 basis points, respectively to 0.75%, 1.50% and 0.00%. The price rate remained at 150 basis points: – 75 basis points on either side of a fixed rate of MRO (EBC2013 – Part 2)⁸.

With the decreasing effectiveness of the standard tools of monetary policy, especially in terms of interest rates with the spread of the crisis in the money market, the European Central Bank implemented an intervention program. Among others, it included (Kochaniak 2012: 74-75):

- Enhanced credit support – a package of instruments increasing liquidity and improving the performance of banks and financial markets;
- Securities Markets Programme – a program stabilizing the secondary markets in debt securities

The most important step was to extend the maturity of long-term operation of the open market firstly from 3 to 6, and later to 12 months. In this way, an attempt to reduce the uncertainty about the availability of bank loans for longer periods of time and to keep the money market interest rates at a low level was made. As a result, the banks have received funds at the lowest cost in history.

Regarding the actions taken for a long period of time, the scale of LTRO operations (Long – Term Refinancing Operations) was increased from 150 billion in June 2007 to over 600 billion Euro at the end of 2008. In July 2009, the ECB started buying covered euro-denominated and issued in the euro-area bonds, which was to additionally support LTRO operations.

Europe in crisis needs “fresh” money. The main task of the European Central Bank is to stabilize the purchasing power of the euro and thus the level of prices in the euro area. It was thought that for treaty reasons, the ECB cannot print more Euro, as does The Fed and the Bank of England, the Bank of Japan, and the Bank of Canada. The idea of printing money by the banks was treated in terms of the highest irresponsibility, because it was thought that it would spin hyperinflation, similar to that prevailing in Germany in the years 1922-1923 (Hongbing 2011: 175 and onwards). However, the replacement of the head of the ECB J.C. Trichet, the declared enemy of inflation, by a pragmatist M. Draghi resulted in the change of how the financial market was provided with money. New European Central Bank

⁸ European Central Bank (EBC) 2013, Annual Report 2013, Frankfurt, Part 2.

President Mario Draghi said that in the fight against the crisis and to save the single currency, the ECB will buy the domestic bonds on the secondary market with a maturity of three years without any restrictions. The program was designed to reduce the record cost of debt service in Southern Europe and Southern Euro zone, especially Italy and Spain, and to improve the situation of the whole Euro area (PAP – 2012)⁹. The program was designed to reduce the profitability of debt in countries with financial trouble and having difficulty obtaining financing on the market.

Within the LTRO operation conducted in December 2011, the ECB offered EUR 489.2 billion to 523 banks. As a result of the first round of these operations, there was a significant decrease in investors' aversion towards risk, which led to the increased demand for emerging market assets and the bonds issued by peripheral euro zone countries. In the second long-term refinancing operation (LTRO), the European Central Bank lent in March 2012 EUR 529.5 billion to commercial banks. 800 institutions signed up for the loans (euro www.biznes.onet)¹⁰. Carrying two operations for an amount exceeding 1 trillion in such a short time led to excessive liquidity in the money market. Banks in the first period deposited their money in overnight deposits at the ECB, which exceeded EUR 700 billion (Fairless, Feher 2012). In the subsequent period, the borrowed funds were partly used to finance lending and the purchase of bonds, which resulted in, i.a., profitability of Italian two-year bonds fell to its lowest level in half a year, and the rate on ten-year securities became the lowest since September 2011. The reaction of other countries at the risk of fiscal problems in the field of profitability was similar.

In September 2012, the ECB informed about Outright Monetary Transactions (OMT). Its purpose is to ensure the proper transmission of monetary policy and the unitary character of the policy in the euro area (ECB – Part 2)¹¹. In May 2013, the ECB cut interest rates again. The main interest rate of refinanced credit fell to 0.5% against the previous 0.75%. The interest rate on loans was set at 1.00% against the previous 1.50%. The interest rate on deposits remained at 0.0%. Thus, the interest rates in the euro area are the lowest in the history (Draghi 2013)¹². At the same time the ECB announced the extension of LTRO.

⁹ PAP, „Plan skupowania obligacji przez EBC dobry, ale nie wystarczy”, 06 September 2012.

¹⁰ The European Central Bank gives banks three-year loans with a value of 529.5 billion, available at www.biznes.onet, accessed on 29 February 2012.

¹¹ European Central Bank (ECB) 2013, Annual Report 2013, Frankfurt, Part 2.

¹² ECB cuts interest rates, Draghi: Mild monetary policy will be carried into effect, available at bankier.pl, (accessed 02 May 2013).

The ECB's monetary policy includes such instruments: main refinancing operations (MROs), longer-term refinancing operations (LTRO), fine-tuning operations, central bank deposit and credit operations, and intervention operations. It is difficult to assess the effectiveness of these operations. The arduous recovery occurs in most euro area countries of the European Union. The banks borrowing money at a price well below the rate of inflation and investing them in the purchase of bonds, including treasury bonds exceeding 4% profitability – earning much without risking excessively, have benefited the most from the ECB programs. Countries with high public debt have also benefited. A large supply of money created by the ECB (as well as The Fed, the Bank of England and the Bank of Japan, which eliminated interest rates at all) led to lower profitability of the newly issued treasury debt securities, thereby reducing the cost of debt servicing.

6. Summary

While trying to make some assessment of the causes of the current crisis, one should take a look through the prism of its impact on the global economy. The crisis has been going on for six years and it is difficult to predict its end. One should agree with the view expressed by G.W. Kołodko that the current crisis is a systemic crisis of capitalism, its neoliberal mutation, and the causes must be sought in the structural changes that have accrued in the global economy, especially in the U.S, and which are linked with neoliberal ideology (Kołodko 2010: 92 and onwards). The systematic deregulation of the financial system in the United States meant that the state, acting through the supervisor institutions, lost control on the functioning of the financial market. The effects were devastating not only for the U.S. economy but also caused the European paralysis in the financial markets, the financial collapse of banks and enterprises of the real economy, the recession, the sharp increase in unemployment, especially among young people. The multi-billion dollar government anti-crisis programs of countries affected by the crisis have been insufficient to overcome the crisis – they were mainly of temporary nature intended to save banks from bankruptcy. The fight with the crisis in the financial market would have been impossible without the participation of the largest central banks that used unconventional tools aimed at restoring the balance in the global markets, including financial markets.

However, despite the injections of trillion dollars and Euro, both in the U.S. and Europe, the reduction the interest rates to almost zero, and other large-scale activities, it has still not been managed to direct the economy of the U.S. and Europe to the target level. The crisis has demonstrated the

importance of efficient regulation and adequate supervision for the proper functioning of the financial markets. It highlighted the strong interdependence between the credit market and the derivatives market, the capital resources of banks and the size of the undertaken investments. Despite the six years since the outbreak of the crisis, the key issue for systemic risk in the banking sector remains unsolved – the problem of large banks “too big to fail” (TBTF). In the U.S., the Glass-Steagall Act of 1933 was not reverted to, despite the fact that banks in result of the acquisitions have become even more powerful. In Europe, hopes is placed with a creation of a banking union, which would incorporate three elements: a single European banking supervision system, the European system of deposit guarantees, the European system of restructuring and orderly liquidation of banks. It is hoped that the experience related to the causes of the current crisis will be used by governments and institutions of the banking system, and the crisis in such form and on such a scale will not happen again.

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