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The Impact of Credit on Economic Growth in the Global Crisis Context

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Abstract

Is there a connection between credit and economic growth in the present economic context? Credit was one of the factors which triggered the global crisis, thus, in the present paper we attempt to show whether there is a connection between credit and economic growth, the economy being unable to develop in the absence of credit. With the aid of a statistic software we have tried to determine the supposed existence of a connection between the GDP, credits offered to public administration and credits offered to households. The results of the analysis show that credits offered to households contribute to a greater extent to the formation of the GDP than credits offered to public administration.

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1. Introduction

The present financial crisis started at the beginning of 2007 in the USA, later on spreading on a global level. This crisis is already among the most costly in history. Indeed, economists already refer to the downtown in 2008 and 2009 as the "Great Recession". It is possible that the economy may never again reach the trend line that prevailed prior to the crisis. (Huertas, 2011) In other words, there is a possibility that the crisis may leave a permanent scar on the global economy, so that the level of economic output is permanently lower as a result of the crisis. Beginning with February 2007, more and more US-based clients no longer pay off their „subprime” credits (high risk mortgages), a fact that leads to the bankruptcy of specialized banking institutions.

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In 2007, some trends materialized in the US housing market, which negatively affected particularly the subprime segment and impacted all subprime-linked instruments. The declining housing price growth in the United States was accompanied by rising interest rates, stretched borrower affordability, low underwriting standards, and lax risk-control standards. About 20% of the subprime mortgages originated during 2005 and 2006 are expected to end in foreclosure, while declining housing price growth leads to lower-than-expected recovery for foreclosed properties (Felsenheimer, 2008).

Anca Bidian, vicepresident of Kiwi Finance, holds that the worldwide credit market was not only affected by the economic crisis, but was the origin of the crisis itself. Thus, at the end of 2008 we can witness an abrupt contraction of credit. She holds that the effects of the crisis on credit were most dramatic in all industries, with contractions of up to 70-80%. Even if one can notice a slight decrease in interest rates, this is not enough to revive the credit market, just as the rise of interest rates was not the only factor which determined its standstill. Anca Bidian holds that a revival of the economy is not possible in absence of creditation. In 2008, for the first time after the 1930s, the financial system was on the brink of collapse.

Considering the causes of the present economic and financial crisis a discussion of the term globalization is paramount. Globalization is simultaneously economic and financial. Romania can speak about globalization beginning with the year 1989, along with the downfall of the former socialist block. One of the characteristic elements of the present economic globalization is its manifestation under the form of its main instrument, financial globalization (Totir, 2011). The time-span between 1989-2008 is characterized by a high degree of globalization, both on a social, and on a political and financial level. During this period one can witness a strong development of global financial markets, with transnational corporations playing an increasingly important role. The financial globalization we have witnessed during this period was largely possible due to technological innovation. This is actually a synergy of various means of communication such as mobile phones, credit cards, the internet, all of which aid communication even over great distances. Differences in time zone are quite welcome in this context, ensuring the continuity of transactions on financial markets: when European markets close, the Asian ones open.

The financial crisis we are experiencing at the moment originates in the subprime credit system – those mortgages which pledge the value of the acquired good. This type of credit was offered primarily to American citizens who did not fulfill credit worthiness requirements. Along with the drop of prices in the mortgage sector, it became increasingly challenging for the population to pay off these credits.

In his valuable analysis „Economic Cataclysms which Shake the World” Professor Dan Popescu maps out some of his ideas regarding the crisis we are currently experiencing. He holds that in Romania the crisis will manifest itself through „serious economic phenomena and processes which are already visible in Romanian economy: an acute onset of the decapitalization of banks, an increase in interest rates for credits, difficult to explain rationally from the perspective of the confused client, the end or the diminishing of activity of small and medium-sized companies who report a standstill of activities”. Professor Dan Popescu also sheds light on the economic sector which will likely be most strongly affected by the crisis: the banking sector; however, the diminishing of companies’ activities, especially of construction companies, the real estate sector and in important domains of speculative economy will surely have effects also on the financial and administrative sector and on state and public institutions. The only good news is that prices of apartments and land will drop, unable to experience growth due to their being tied to a diseased credit system (Popescu, 2010).

If we are referring to the causes that triggered the global economic crisis, we have to mention the fact that all difficulties which have arisen on the capital market represent opportunities for others. The collapse of some banking institutions based on subprime credits led to important gains for some hedging funds – private investment partnerships for wealthy individual investors and for which the minimum investment is 1 million dollars. If we are referring strictly to the existence of money, it is obvious that it does not disappear, but remains on the market, the only thing that changes being the owner of these sums.

One of the main factors of outbreak of the crisis is the placement of production in economically challenged countries with cheaper work force. The ones who profited most from this were enterprises, which witnessed a significant increase in profit margins through reducing production costs and the payment of wages much lower than the ones which would have been paid in the country of origin. This has however affected national economies negatively through loss of jobs, generating unemployment, through the loss of economic autonomy of the state, and last but not least through loss of technological excellence.

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