

Chapter 2

Impact of the 2008 Global Financial Crisis

This global financial crisis is believed to be a direct result of the risky investments in the USA, fueled by a combination of low interest rates, loosening lending standards, growing consumer appetite for debt, and extensive use of securitization. The questionable assessments of credit rating agencies, less disciplined risk management, failure in adequately applying regulations, and the global nature of the financial markets had resulted in the crisis with serious repercussions worldwide, particularly in Europe.

The sign of a financial problem started to surface in 2007; in late 2008, it became clear that the global conditions were much worse than initially envisaged. When businesses ran short of capital, their daily operations were affected, including cessation of production and shedding excessive manpower. When consumers could not get credit or when they lost their jobs, they refrained from spending money and purchasing goods. This cyclical problem affected the real economy, which then developed into the deepest and the most synchronized global crisis seen in the last eight decades. With the two largest import regions, the USA and Europe, in deep financial crises, global international trade dropped drastically, credit tightened, and direct foreign investments were swiftly withdrawn, which resulted in a domino effect of global recession. In the increasingly interconnected world, no country was able to avoid the impact of this financial crisis. By estimation, from January to October 2008, the world stock markets lost 40% of their value. For the entire world, the estimated US\$ 2 trillion total in stimulus packages amounted to approximately 3% of the world gross domestic product (GDP). This exceeded the call by the International Monetary Fund (IMF) for fiscal stimulus by 2% of the global GDP.

The USA is the origin of the sub-prime mortgage problem that led to the global financial crisis. The other four advanced countries (Australia, Canada, Japan, and New Zealand) reported in this volume were not immune to this financial turmoil. From its peak in November 2007 to its lows in March 2009, the Australian market declined by 54%, compared to the peak to trough decline of 57% in the US market, 60% in the Japanese market, and 61% in the European market. At the time of their most recent lows, the Australian stock market had returned to its level seen during mid-2003, the Japanese market was back at levels last seen in 1984, and the US market had fallen back to the levels last seen in the mid-1990s.

In order to present the impact of the 2008 global financial crisis, this chapter will first graphically compare the overall economic development of the five countries during the time period from 2005 to 2010. Further, it elaborates on the impact of the financial crisis on each country individually in the sequence of Australia, Canada, Japan, New Zealand, and the USA.

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The impact of the 2008 global financial crisis on each country can be easily observed from Figs. 2.1, 2.2, 2.3 and 2.4, which show the percentage of real GDP

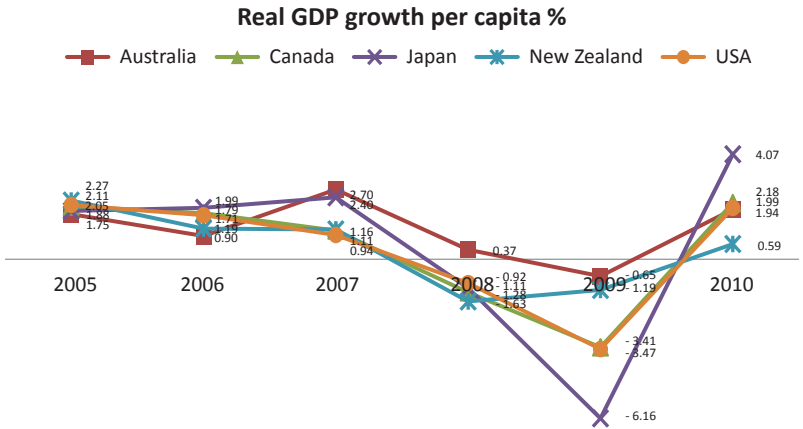


Fig. 2.1 Real GDP growth per capita of the five advanced countries, 2005–2010

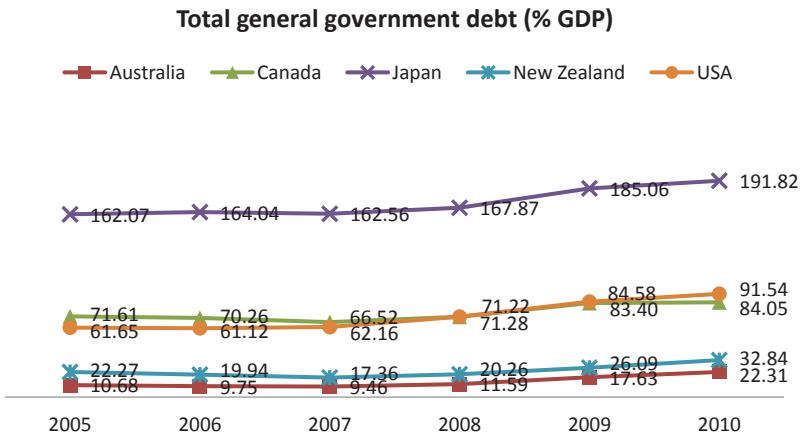


Fig. 2.2 Total general government debt (percentage of GDP) of the five advanced countries, 2005–2010

growth per capita, total general government debt percentage of GDP, unemployment rate of labor force, and consumer price inflation (CPI).

Comparisons of the Five Countries

This section presents four figures in order to examine these five advanced countries (Australia, Canada, Japan, New Zealand, and the USA) as a whole from 2005 to 2010. Figure 2.1 shows that all the five countries started to have negative *real GDP*

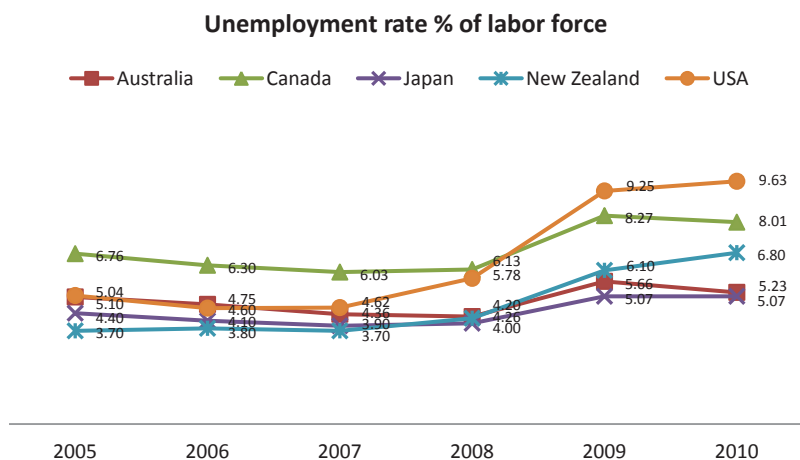


Fig. 2.3 Percentage of unemployment rate of labor force for the five advanced countries, 2005–2010

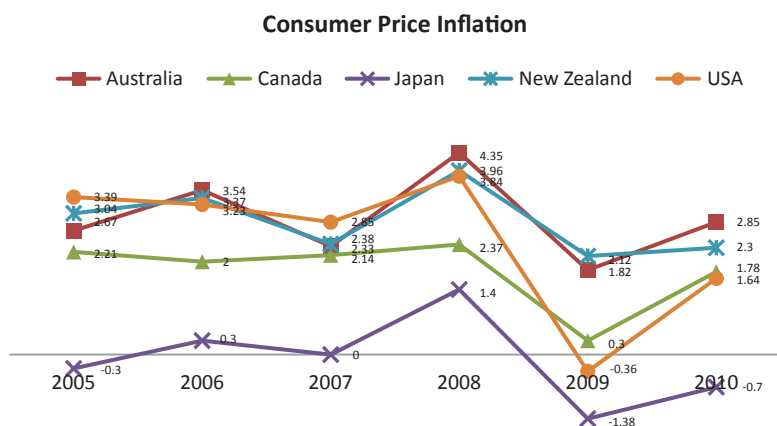


Fig. 2.4 Consumer Price Inflation of the five advanced countries, 2005–2010

growth (except Australia) from 2008, reached their deepest decline in 2009, and then rebounded to a positive growth in 2010. Among them, Australia had the least growth fluctuation, followed by New Zealand. Over the 6 years, the real GDP growth patterns of Canada and the USA are almost identical. Japan had the greatest growth decline of -6.16% in 2009, yet its upturn in 2010 was also the sharpest ($+4.07\%$).

In terms of the total *general government debt* as a percentage of the GDP, Fig. 2.2 indicates that government debts of the five countries were relatively stable for the first 3 years (2005–2007). However, their government debt increased continuously from 2008 to 2010, reflecting their increasing financial needs during and after the financial crisis. Overall, there were three debt levels in these five countries: Japan

had the highest level, Canada and the USA were in the middle, and Australia and New Zealand had the lowest levels.

Reinhart and Rogoff (2009) reported findings from their research on financial crises over the last 800 years that the aftermath of a financial crisis brings slow and halted growth, sustained high unemployment, and surging public debt—with the overhang of public and private debts being the most crucial impediment to a normal recovery from the recession.

Figure 2.3 shows that the *unemployment* rates of the five countries were relatively stable for the first 4 years (2005–2008), except for the USA. The earlier rising unemployment in the USA in 2008 explains the immediate impact being the epicenter of the financial crisis. Interestingly, its close neighbor Canada was not affected until 2009. All the five countries had a drastic increase in their unemployment rates in 2009, with the USA having the most serious unemployment situation, followed by Canada, New Zealand, Australia, and Japan. In 2010, only New Zealand and the USA had a continuous increase in the unemployment rate. Among the five countries, Australia and Japan had the least unemployment fluctuation over the period of 6 years.

Figure 2.4 shows the CPI of the five countries. Over the period of 6 years, CPI development patterns of these countries were quite similar, except for Canada. Canada's CPI was relatively stable, except for a drastic drop in 2009 that shows the impact of the financial crisis. All the countries had CPI increases in 2008, including the originally deflated Japanese economy. In 2010, most of the countries had resumed their CPI to their precrisis level, except for the USA, which showed a decrease in CPI.

In general, Figs. 2.1, 2.2, 2.3 and 2.4 indicate that the general economy of these five countries was indeed affected by this financial crisis statistically. Overall, their real GDP growth was down in 2008 and 2009 but rebounded in 2010; general government debt gradually increased after 2008; unemployment rate clearly went up in 2009; and the CPI was up in 2008 and then down in 2009.

In what follows, we briefly describe the impact of the 2008 global financial crisis on these five advanced countries. The depth of the report depends on the publicly available data (in English) for each economy. For readers to gain a general picture about the efforts that each country has put in to mitigating the negative impact of the financial crisis, we have summarized the details of the stimulus packages implemented by these countries in Appendix 1. Note that the reported package is based on publicly available data and is not an exhaustive list. In addition, the reported amounts of stimulus packages were based on the exchange rate at the time of each stimulus, and thus may vary. Readers can also refer to Appendix 2 for the important meetings conducted by key global leaders during this financial crisis.

Australia

In recent decades, Australia has transformed itself into an internationally competitive, advanced market economy, focusing on services, technologies, and high-value-added manufactured goods. However, its exports remain heavily concentrated

on mining and agriculture (Heritage 2012). Mainly due to the economic reforms adopted in the 1980s, the Australian economy grew for 17 consecutive years before this global financial crisis (CIA 2012).

With the global recession, the Australian economy was also hit hard by this financial crisis. In the last quarter of 2008, businesses ran down their stocks by US\$ 2.2 billion (A\$ 3.4 billion) (in real terms), which was the largest fall on record. Consumer confidence plummeted along with consumption (Kennedy 2009). In October 2008, the Reserve Bank of Australia Board cut interest rates by 100 basis points. The Australian government also announced that it would make a provision to guarantee all Australian bank deposits and, for a fee, the wholesale funding of Australia's banks. To mitigate the negative impact, the Australian government announced a US\$ 7.1 billion (A\$ 10.4 billion) stimulus package of around 1 % of its GDP. The package comprised of US\$ 5.9 billion (A\$ 8.7 billion) that would be provided to 4 million pensioners and low-income families in the form of cash bonuses, US\$ 1 billion (A\$ 1.5 billion) for housing construction, and US\$ 128 million (A\$ 187 million) for 56,000 new training places (Access Economics 2008; Kennedy 2009). The stimulus package was designed to rescue the housing and consumption (representing over 60 % of the Australian economy) and to be quick acting with significant cash bonuses paid to those in need within weeks of the announcement (Kennedy 2009). In early December 2008, the Australian government announced large-scale infrastructure projects amounting to US\$ 3 billion (A\$ 4.7 billion) to prepare for the possibility of a deeper and long-lasting global financial crisis than expected. In late 2008, the depreciating Australian dollar worked as an effective automatic stabilizer (Kennedy 2009).

In early February 2009, the Australian government announced its second stimulus package of US\$ 27.2 billion (A\$ 42 billion) titled the "Nation Building and Jobs Plan," designed to support up to 90,000 jobs in 2008–2009 and 2009–2010, and to boost the economic growth by about 0.5 and 0.75–1 % of its GDP in 2008–2009 and 2009–2010, respectively (Kennedy 2009; Treasurer 2009). In planning for a fast impact, 70 % of the second stimulus package comprised of infrastructure spending, focusing on quick-starting mid-scale infrastructure. The package included US\$ 9.5 billion (A\$ 14.7 billion) to be spent on school infrastructure, US\$ 4.3 billion (A\$ 6.6 billion) on social and defense housing, US\$ 2.5 billion (A\$ 3.9 billion) on energy efficiency measures (most of which will go to insulating the ceilings of existing homes), and US\$ 576 million (A\$ 890 million) on road, rail, and small-scale community infrastructure projects (Kennedy 2009). The package also included over US\$ 7.8 billion (A\$ 12 billion) to fund a range of additional one-off transfer payments targeted at a variety of low- and middle-income groups, with about half the Australian population receiving payments (ILO 2010a). There was also an additional US\$ 1.7 billion (A\$ 2.7 billion) for private business investment through a business investment tax break (Kennedy 2009). The direct cash payments to low- and middle-income households have had a significant impact on business and consumer confidence, which began recovering strongly in mid-2009 (ILO 2010a).

In addition, the Australian government quickly followed its second stimulus package with a jobs package aimed at younger persons. With the US\$ 970 million

(A\$ 1.5 billion) package provided by the federal government, the states were required to guarantee a training place to all unemployed people aged 25 years and under. The government anticipated that this package would provide up to 135,000 young Australians with higher qualifications and result in a more skilled workforce in preparation for the return of normal labor market demand. An additional US\$ 14.2 billion (A\$ 22 billion) budget for large-scale infrastructure was also announced, which helped the Australian government to outline its medium-term fiscal strategy (Kennedy 2009).

Overall, the Australian economy entered the global financial crisis with a strong base. GDP grew by 3.7% in the 2007–2008 financial year (ending June 30), and the unemployment rate stood at 4.2% (ILO 2010a). The government also had a substantial fiscal surplus for the stimulus measures introduced after the onset of the crisis. The country avoided a recession, with only one quarterly decline in GDP, a 0.9% drop in the fourth quarter of 2008. Growth was driven by the government's swiftly introduced and substantial stimulus measures, along with China's robust demand for Australian commodities (ILO 2010a). The government's stimulus took effect mainly for its effective design centered on the following three broad phases: first, one-off cash payments to low- and middle-income groups, which were rapidly disbursed and had an almost immediate impact on the consumption expenditure, retail sales, and the economic growth; second, relatively rapid investments in social infrastructure, including schools, health, and housing; and third, major new investments in economic infrastructure that were more medium term in nature (ILO 2010a).

In general, Australia weathered the world recession better than almost all other advanced economies (Debelle 2009; OECD 2010). Its GDP started to grow in the first quarter of 2009 and consumer confidence rebounded swiftly (Kennedy 2009). The Australian economy grew by 1.2% during 2009—the best performance among the OECD countries (CIA 2012).

Canada

Canada enjoys a substantial trade surplus with the USA, with three-fourths of its exports to the USA each year. Given its great natural resources, skilled labor force, and modern capital plant, Canada enjoyed solid economic growth from 1993 through 2007 (CIA 2012). During this global financial crisis, the Canadian economy dipped into a sharp recession in the final months of 2008 due to its close ties with the USA. Moreover, its strong energy and natural resources suffered as the world economic slowdown brought about lower demand and weaker prices for commodities (Bergevin 2008). As a result, Canada had an annual growth rate that slid markedly to 0.4% in 2008 and posted its first fiscal deficit in 2009 after 12 years of surplus, with the GDP contracted by 2.6% in 2009 compared to the year earlier (ILO 2010b; CIA 2012). The credit crunch and falling commodity prices caused Canada to lose more than 100,000 jobs in the last 2 months of 2008 (BBC 2009). Growth did not return until the third quarter of 2009 and accelerated to 1.2% in the fourth quarter (ILO 2010b).

To help stabilize the economy, the Canadian government announced on October 10, 2008 and November 12, 2008 that it would purchase US\$ 21 billion (C\$ 25 billion) in insured mortgage pools and would acquire another US\$ 40.7 billion (C\$ 50 billion) in securities, respectively, to maintain the availability of longer-term credit in Canada (Chossudovsky 2009; Silva 2009). Simultaneously, the government announced that it would “guarantee...more than US\$ 162.6 billion (C\$ 200 billion) to pay back new loans made to Canadian financial institutions” (Silva 2009).

In March 2009, Canada announced its Economic Action Plan, which totaled US\$ 37.8 billion (C\$ 47.3 billion) as a federal stimulus (ILO 2012b). The stimulus program comprised of public spending on goods and services, such as building homes and energy efficiency spending, boosting consumer spending through income tax cut and improved access to finance, and protecting jobs and supporting automotive, forestry, and manufacturing industries (ILO 2010b). Green investment comprised 8% of the stimulus spending and over 13% of Canada’s federal stimulus was directly aimed at labor market initiatives (ILO 2010b). Particularly, Canada’s Work-Sharing Program helped the companies and workers to continue working together productively through difficult times (ILO 2010b). The 2009 budget set out spending of US\$ 32 billion (C\$ 40 billion) over 5 years (BBC 2009).

During the crisis, Canadian banks remained profitable, mainly because they were well capitalized and well positioned to withstand economic shocks (Bergevin 2008; Porter 2010). Canada’s banking system has been ranked as the most sound in the world by the World Economic Forum; it did not experience a crisis in 2008 (Schuler 2011). In addition, with the six largest domestic banks holding more than 90% of banking industry assets, the banking industry is relatively stable.

Although Canadian financial institutions could not avoid the impact of this global financial crisis, none was excessively impacted by toxic assets and, most importantly, they continued to lend (Lynch 2010). Statistics showed that sub-prime loans accounted for less than 5% of the new mortgages in Canada, compared to 22% in the USA in 2006. By estimation, more than 75% of Canadian mortgages were held by financial institutions on their balance sheet in a more traditional fashion with an average asset-to-capital ratio of 18 (Durocher 2008; Bergevin 2008). In addition, the Bank of Canada massively injected liquidities while broadening the range of securities held under resale agreements to help financial markets run smoothly. They also reached swap agreements with other central banks, issued additional Treasury bills, and cut its key interest rates by 50 basis points to support the Canadian economy in a time of crisis (Durocher 2008). These measures have helped Canada withstand the external financial shock fairly well.

Japan

Japan’s overall real economic growth was spectacular for three decades—a 10% average in the 1960s, a 5% average in the 1970s, and a 4% average in the 1980s. However,

growth slowed down markedly in the 1990s, averaging just 1.7%, largely because of the aftereffects of inefficient investments and an asset price bubble (CIA 2012).

The Japanese financial sector was not heavily exposed to sub-prime mortgages or their derivative instruments; thus, the country weathered the initial effect of the recent global credit crunch fairly well. However, a sharp downturn in business investment and global demand for Japan's exports in late 2008 hit its export-dependent economy hard, especially since the USA accounted for 20.1% of Japan's exports in 2007 (Nanto 2009). Furthermore, Japan holds US\$ 74.5 billion in debt issued by Fannie Mae and Freddie Mac, two of the largest housing loan providers in the USA. In addition, claims by the Japanese banks and security firms against the Lehman Brothers totaled in billions of dollars (Hays 2009).

As a result, Japan's trade deficit touched US\$ 2.3 billion (¥ 223 billion) in November 2008 and reached a record of US\$ 10.6 billion (¥ 952.6 billion) in January 2009 (Hays 2011). Its GDP declined 12.1% in the fourth quarter in 2008 and crashed 14.2% in the first quarter of 2009, which was the steepest fall on record (Hays 2011). The Nikkei stood at 15,307 at the end of 2007 and fell to 6,448 in 2008, a fall of 42.1%, the largest ever percentage fall in a single year, worse than the Dow Jones (-36%) and the London FTSE (-33.1%) (Hays 2011). The main cause of the dramatic drop was the exodus of foreign investment, which had accounted for 60% of the trading volume on Japan's stock market in the recent years (Hays 2011).

Exports plunged almost 50% in February 2009 as demand for Japanese cars and electronics dropped; this was the biggest decline since the government began keeping such records (Hays 2011). Business and consumer confidence reached its lowest level in 34 years. The Bank of Japan injected trillions of Japanese yen into the money market and offered US\$ 10.9 billion (¥ 1 trillion) in loans to encourage banks to lend money and purchase government bonds to make money available for investments (Hays 2011).

The Japanese government launched stimulus packages to the total of US\$ 568 billion, amounting to 5% of its GDP (which is about the same size as the USA and above the average of 3.9% for OECD countries). The packages particularly emphasized on sustaining credit flows and stabilizing markets, encouraging lending to small and medium-sized enterprises (SMEs), stabilizing the stock market, providing emergency loans to firms, facilitating corporate financing, and lowering the policy interest rate from 0.5 to 0.1% by the end of 2008 (Hays 2011; OECD 2009). In addition, public works projects, tax cuts, programs to address global warming, and health and childcare are also on the agenda. Specifically, the package supports a subsidy of US\$ 2,718 (¥ 250,000) for people who replaced gas-guzzling vehicles with fuel-efficient ones, US\$ 10.9 billion (¥ 1 trillion) in housing subsidies and other support for temporary workers who had been discharged from their accommodation, and US\$ 130.5 billion (¥ 12 trillion) in loans and grants to banks. In addition, more than US\$ 21.7 billion (¥ 2 trillion) was given out to citizens to stimulate spending with US\$ 130 (¥ 12,000) in coupons to each Japanese resident and an additional US\$ 87 (¥ 8,000) to those under the age of 18 and over the age of 65 (Hays 2011). The package was projected to raise real growth by 2% and create around

400,000 to 500,000 jobs (Hays 2011). The International Labor Office (2010c) has provided details of the Japanese stimulus package, summarized in Appendix 1.

Despite the drastic economic downturn, Japan was one of the first countries to recover, with positive growth figures at the end of 2009 (Hays 2011). In mid-June 2009, the Nikkei rose above 10,000 and the economy grew by 3.7% in the second quarter of 2009 (Hays 2011). GDP increased by 4.8 and 4.6% in the third and fourth quarter of 2009, respectively. The trade surplus rose for 6 months in a row with a robust demand from China, which was seen as an indicator that the recession was ending and that recovery was real. In late November 2009, the yen rose to its highest value against the dollar in 14 years (Hays 2011).

To boost the economy further, in December 2009 the Japanese government announced another US\$ 80 billion (¥ 7.2 trillion) stimulus that included funding to local governments to make up for reduced taxes, support to the financial sector, subsidies to the environmental sector to continue the eco-points program, and money to homeowners for energy-savings measures (Hays 2011).

Overall, the Japanese economy began to contract in the second quarter of 2008, with continued steep declines through the first quarter of 2009; however, a small growth of an average 0.8% returned in the second quarter of 2009 (ILO 2010c). Unemployment rates rose to a high of 5.7% in August 2009 (CIA 2012). Despite some growth at the end of the year, the Japanese economy shrunk by 5.4% in 2009 (Hays 2011). Clearly, the government stimulus spending helped the Japanese economy recover in late 2009, however with a government budget deficit of around 10% in 2010 (OECD 2009).

New Zealand

Over the past 20 years, New Zealand has been transformed from an agrarian economy, dependent on concessionary British market access, to a more industrialized, free market economy that can compete globally (CIA 2012). Per capita income adjusted by purchasing power parity rose for 10 consecutive years until 2007.

In the first half of the 2000s, New Zealand's debt-driven consumer spending drove robust growth with a large balance of payments deficit. As a result, its economy fell into recession before the start of the global financial crisis (CIA 2012). The balance of the non-financial private sector deteriorated markedly as the increase in property prices and perceived wealth prompted additional household spending. The widening of the current account deficit was largely financed by bank-intermediated foreign credit, adding to the already high external debt (OECD 2011d). In addition, weak business investment and low national saving have contributed to poor growth performance (OECD 2011d).

The New Zealand economy contracted throughout 2008 and early 2009. The initial triggers of recession in early 2008 were domestic factors, including drought and tight monetary policy to combat growing inflation pressures. This domestic-led recession was escalated by the global financial crisis in mid-September 2008 (Treasury 2009). Following the intensification of the global financial crisis, the New

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