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Is the Financial Crisis Over?

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I. Introduction

The sharp economic downturn and turmoil in the financial markets throughout the recent wave of globalization has resulted in history’s worst global financial crisis. As a result, the financial crisis has caused a fall in commodity prices, declines in exports, lower foreign direct investment inflow, stock price crashes, and an increasing unemployment rate in the world (Adamu, 2009). Therefore, Taiwan’s economic system has been impacted by the global financial crisis since it struck the US in 2008.

1.1 Research Motivation

According to CNN News (2011), Stock markets in the United States, Europe and Asia dropped sharply on 4th and 5th August, 2011 amid fears about a global economic slowdown. In addition, Economic Daily News (2011) reported that Greece will face a total financial crisis because their national debt is so huge, resulting in foreign exchange receipts and payments will not be able to cover the national debt. Taking the global financial crisis and Greece as an example attracts me to explore the cause and effects of the financial crisis both in Taiwan and abroad. For considering the effects of the global financial crisis, it is important to understand how the economic system in Taiwan was impacted by the global financial crisis. In light of these concerns, this paper analyzes the major causes and effects of the financial crisis in 2008, and the European debt crisis in 2010 to provide possible policy for the Taiwan’s government as well as references for further research.

1.2 Research Questions

In view of the preceding research objectives, three major sets of research questions are to be addressed in this study as follows:
1. What are the causes of the financial crisis?
2. How has the financial crisis made an impact on Europe, Taiwan and the rest of the world?
3. Does the financial crisis come to an end?

It is hoped that answering these questions will not only provide significant information for financial institutions in Taiwan, but also contribute useful information to the government.

1.3 Research Framework

For these objectives to be achieved, this paper is structured as follows: Section 2.1 introduces the cause of the financial crisis, and 2.2 presents the effect of the financial crisis in Europe, Taiwan and the rest of the world. Section 2.3 discusses urgent policies in Taiwan’s financial system. Finally,
conclusions and suggestions are discussed on section 3.

1.4 Methodology

This paper adopts exploratory studies to find out the major effects of the financial crisis in Europe and Taiwan. In terms of the exploratory studies, the paper uses inductive methods to illustrate the recent situations of the financial system and its tendencies. The research primarily relies on information gathered from secondary material, such as journals, books, newspapers and websites. First, the internet will be used to find suitable materials. Second, relevant books will be obtained. Third, these books will be read and summarized into notes. Fourth, the causes and effects will be analyzed, especially in Europe and Taiwan. Fifth, the urgent policies of the government will be described. Finally, the conclusion and suggestions will be presented.

II. Thesis

The financial crisis was caused by major market failures in the US, especially in relation to the housing bubble and massive defaults on the mortgage-backed security (MBS) (Rogers, 2010). Due to the US financial crisis extending to European and Asian countries, global financial markets experienced significant losses in the twenty-first century, resulting in a worldwide credit crisis since Sep, 2008. (Wang, 2009) In order to address the causes and effects of this financial crisis, as well as policy responses in Taiwan, this paper is discussed as follows:

2.1 The Cause of the Financial Crisis

The financial market had been in a terrible mess since the subprime mortgage crisis in the US in July, 2007. After that, the US Wall Street financial crisis broke out in September 2008. First, Countrywide Financial Corporation went into bankruptcy in January, 2008. Second, Fannie Mae and Freddie Mac began to experience serious financial problems. As a result, many financial institutions broke out in the financial crisis. For example, Lehman Brothers declared bankruptcy on September 15, 2008. Merrill Lynch was merged and acquired by Bank of America and American International Group (AIG) applied for emergency finance from the Federal Reserve (Fed). These huge financial institutions going into the bankruptcy or forced into mergers and acquisition was a rarely seen disaster, unlike anything in the previous ten decades (Foster & Magdoff, 2009).

The major reasons of the US 2008 financial tsunami could be divided into five categories. First, the US housing price speculative bubble and its bursting resulted in massive defaults on the mortgage-backed security (MBS). Second, the global savings glut crowding into the US provided the sources of bubbles. Third, the financial institutions did not base on the self-regulatory belief.
Fourth, credit ratings agencies did not fulfill of their responsibility. Fifth, the internal and external financial supervisions were lax with the financial regulatory system (Foster & Magdoff, 2009).

2.2 The Effect of the Financial Crisis

To understand the consequences of the financial crisis, this paper discusses the impact on Europe, Taiwan and the rest of the world respectively.

2.2.1 Widespread

The crisis resulted in a serial problem in the international financial market such as a credit crunch with exchange rate markets in turmoil, international stock markets crashing and unemployment rates rising.

A. Credit Crunch

After the subprime crisis, the US banks and mortgage industries have learned a lesson from it. As mortgage bad debts and operating costs have increased, these situations have decreased their ability to provide credit. Thus, they have adopted a conservative and cautious approach to examine mortgage cases as well as a substantial increase in credit standard. Moreover, lower points of a credit rating are no longer available to mortgage borrowers, or to suspend certain loans. However, a stable income and good credit of prime customers were be raised their interest rate. Therefore, many house buyers gave up mortgages to purchase houses, and abandon to own houses (Wang, 2009).

Due to the price of the mortgage-backed security (MBS) fall down, the investors were caused huge losses for investment in the derivative financial instrument. Moreover, many investors requested to redeem their funds resulting in the problem of fluid insufficiency of financial markets. Therefore, these have withered MBS in the market, and caused a credit crunch since July, 2007 (Wang, 2009).

The effect of the credit crunch has been extensive. Many banks have revised the term of consumption loan and mortgage loan to change to stricter than before. People borrow money from banks for repairing the house, paying tuition, buying cars, or purchasing real estate those are now much more difficult than before. Moreover, the credit crunch is also a disadvantage in developing business, and it leads to reduction in productions and unemployment. As a result, many people were unable to pay back their loans (Wang, 2009).

B. Exchange Rate Markets in Turmoil
The subprime mortgage crisis set off investors selling Japanese yen (JPY) carrying out trade unwinding, and the impact of fluctuations in global currency markets. The bank of Japan has adopted the zero interest rate policy since 2001, and the central bank discount rate was 0.1%. Due to the relatively low Japanese interest rates, investors borrowed JPY and invested in a large number of other more lucrative assets (Wang, 2009).

Investors were worried about asset deflation from the subprime mortgage turmoil. The JPY could not repay the debt, so investors rushed to sell the high interest rates, high-yielding currencies of investment assets, and sell USD, and also to sell the EUR, AUD, NZD but buy JPY. The JPY against USD rate was in continuous appreciation from August 10, 2007. The JPY rose to 112.66 against USD and rose up to 4.79% on August 17, 2007. In the same period, the high interest rates of NZD, AUD, GBP and EUR depreciated, and the depreciation range was 9.66%, 7.45%, 2.14% and 1.62% respectively. After that, the US Federal Reserve announced a reduction in the discount rate to 2 yards on August 17, 2007, and then JPY depreciated to 115.14 against USD (Wang, 2009).

C. International Stock Markets Crash

The subprime mortgage crisis hit the US and global stock markets in 2007. With investor confidence shaken, New Century Financial Corporation was out of the New York Stock Exchange on March 13, 2007, and the Dow Jones Industrial Average Index fell 242 points, or 2%. This has been the second worst one-day point drop in four years. After the subprime crisis happened in July 2007, the rapid decline in the US stock prices began in July and August, 2007 causing the US stock prices plummeted (Wang, 2009).

Because the profit of mainly financial companies sharply dropped or they went into bankruptcy, the deterioration of fundamental issues remains to be resolved. For example, due to borrowers being unable to pay loans, houses were seized and foreclosed. Moreover, the prices of derivatives linked with the subprime mortgage were in a decline, so that the amount of loss was difficult to estimate.

The subprime mortgage crisis caused liquidity problems and the credit crunch situation still exists, so the credit market conditions deteriorated and banks profitability eroded. As a result, the stock price of banks fell; global stock markets and economic growth dragged down (Wang, 2009).

D. Unemployment Rate Rising

The labor market has been deeply impacted by the subprime crisis and economic recession since 2008. Especially in the US, the average rate of unemployment was 5.8% in 2008, and 9.5% in June,
2009. The unemployment rate was increased by 3.7% (9.5%−5.8%) from 2008 to June, 2009. The unemployed population was 14.5 million, and it has reached a new high since December, 1983, it’s previous worst (Wang, 2009). Moreover, Commercial Times (2011) has pointed out that the unemployment rate was still high at 9.1% in August, 2011 and that the employment rate in the non-agriculture sector has rarely increased in the US.

2.2.2 Europe

The global financial crisis has seen concerted policy adopted by each country since 2008. The impact period is longer than originally expected. The US and Europe’s economies have fallen into negative growth since the fourth quarter of 2008. After that, the economic growth has trended to recover in the fourth quarter of 2009. Although the global economic is in recovery, each country boosts economic policies and relief for financial institutions resulting in fiscal deficits and increasing negative impact of public debt rapidly (Lee, 2010).

Europe is the first large-scale outbreak of a sovereign debt crisis after the global financial crisis in the developed countries. The debt crisis in Europe started in the fourth quarter of 2009. When Greek Prime Minister George Papandrou took office, the Socialist Party announced the budget deficit substantially increased in 2009 resulting in a shock to people. According to CNN News (2010), Greece’s deficit could not cut and pay down its debt causing three major credit ratings agencies, the S&P, Fitch and Moody to downgrade the rating of Greece to junk status (BB+) in 2010. The Greece debt crisis was serious in first half of 2010. The International Monetary Fund (IMF), the European Union (EU) and other international aid organizations have had to discuss the resolution of the crisis. Greece along with the IMF and the EU reached a consensus for reducing the budget deficit on May 2, 2010, so that Greece will receive 110 billion euros in fiscal relief for next three years. However, other European countries are worried about the spread of the crisis to other European countries and not in fact (Lee, 2010).

According to Asymptotix (2010), 27 Finance Ministers of the EU announced for eurozone countries to implement 750 billion euros for the European Financial Stability Facility (EFSF) on May 10, 2010. European members will provide the guaranteed period of 3-years of 440 billion euros in order to raise funds in the financial market. At the same time, the European Central Bank (ECB) announced to acquire the government and private bonds in the secondary market. Moreover, the US Federal Reserve was also joint in multinational central banks in order to restart the Lehman crisis SWAP mechanism for cross-border (Lee, 2010).

In October, 2010, the EU discussed the establishment of a permanent mechanism for crisis management. Germany claimed that private creditors must share the loss of non-performing debt
rather than fully pay by the relief funds. This resulted in a further round of European debt crisis. For example, bond yields of PIIGS countries (Portugal, Ireland, Italy, Greece, and Spain) soared. In order to avoid the spreading crisis, EU Finance Ministers agreed to give aid of 85 billion euros on November 28, 2010 (Lee, 2010). So far, the European debt crisis is still not yet over, people fear that the crisis will spread to other European countries. For instance, CNN News (2011) points out that “the EFSF still needs additional ‘leverage’ to address both the sovereign debt and banking crisis simultaneously.”

2.2.3 Taiwan

The impact of the global financial crisis, economic recession and the consequences of the international financial market turmoil turned Taiwan’s economy to negative growth. Furthermore, the crisis also caused Taiwan’s industrial production, consumption, investment, exports, and a massive stock market to decline. Besides that, it resulted in NTD depreciating and unemployment rate rising.

The Financial crisis’ impact on the Taiwan stock market is obvious. Since the US subprime mortgage crisis, it has caused the Taiwan stock market to panic, and has immediately reflected in the stock price index decline. According to Taiwan Stock Exchange Corporation (TWSE), Taiwan Stock Exchange Capitalization Weighted Stock Index (TAIEX) has declined from 8,919.92 points on April 30, 2008 to 4,247.97 points on January 21, 2009. Thus, the stock market has declined by 4,671.95 points (See Figure 2-1).

![Figure 2-1 Tendencies of Stock Index in Taiwan](http://www.twse.com.tw/ch/trading/indices/MI_5MINS_HIST/MI_5MINS_HIST.php)

2.3 Urgent Policies in Taiwan

Because of the grim economic situation, the government must rapidly undertake urgent policies.
For instance, it has been enforcing a variety of long-range strategies, including; cutting interest rates, implementing full security deposits, payment consumption coupons to all citizens, expanding public construction investment, providing preferential mortgage, reduction of taxes, promoting employment, promoting new industries, and executing commodities price stability (Wang, 2009). The following of the loose monetary policy, improving the economic policy, enhancing employment policy, and developing new industries are discussed, respectively:

2.3.1 The Loose Monetary Policy

Because the inflation pressure was significantly subsided, continued interest rate cuts have helped to boost private consumption and investment. According to the Central Bank of the Republic of China (2011), there was a 7 times reduction in the discount rate and mortgage rate on September 26, 2008, October 9, 2008, October 30, 2008, November 10, 2008, December 12, 2008, January 8, 2009, and February 19, 2009, respectively. The total reduction in the discount and mortgage rate was 2.395 percent.

2.3.2 Improving the Economic Policy

The stimulus economic policy has been divided into two phases. First, the government provided 10 items policies on September 11, 2008, including care for the vulnerable, encouraging consumption, rising the employment rate, processing for preferential mortgage, investing in public construction, improving private investment, and stabilizing the financial market, strengthening SME financing, expanding exports, and tax reform. The second phase of economic stimulus started on October 10, 2008, including issuing consumption coupons, subsidizing car sales and expanding public construction (Wang, 2009).

2.3.3 Enhancing Employment Policy

The government implemented the ‘promoting employment’ program, and provided job opportunities in the public services from 2008 to 2009. Moreover, the government also enhanced vocational training to improve employable, expanded university-industry cooperation, provided wage subsidies and enhanced the employability of matching success rate in November 6, 2008. After that, the government subsidized the full training costs of business groups or organizations. In addition, agreements were made between employers and employees to reduce working hours using the original implementation of the normal working hour from February 2, 2009 to January 2010 (Wang, 2009).

2.3.4 Developing New Industries
In order to guide domestic economic restructuring, the government developed 6 key industries and established funds on March 26, 2009. For example, the government established 60 billion biotechnology venture capital funds; set up 30 million for a tourism industry fund to enhance the domestic tourism industry. The government further developed a new energy and industrial development plan; quality agriculture; the cultural and creative industries; and the health care service (Wang, 2009).

Due to implementing above the economic policies, people have had a stable economic situation in Taiwan since the US financial crisis in 2008. However, considering the debt crisis in Europe, the government needs to carefully assess the impact on industry and the economy in Taiwan.

III. Conclusion

3.1 Conclusion

The US financial tsunami caused the global financial crisis in September 2008. The crisis resulted in the US and Europe falling into economic recession, and lead to a decrease in tax revenue. This study found that the reasons for the US financial crisis and the European debt crisis can be summarized as follows:

The US financial crisis was caused by several factors: the housing bubble and its bursting with massive defaults on the mortgage-backed security (MBS), high leverage financial manipulation, and the global savings glut crowding into the US provided the sources of bubbles. Moreover, the financial institutions were not based on self-regulatory belief such as Fannie Mae and Freddie Mac; credit ratings agencies did not fulfill their responsibilities, and financial supervision was lax.

The main reason for the eurozone crisis is as follows: first, its direct cause is the reduction of tax revenues stemming from the 2008 financial tsunami. This lead to an increase in government expenditure for economic revitalization and the bailing out of troubled of financial institutions, resulting in increased fiscal deficits and public debt. Second, the structural causes include problems of financial regulation and disparities of competitiveness in the eurozone, as well as low employment and a population ageing problem faced by Europe as a whole.

The European debt crisis has not only impacted the eurozone, resulting in depreciation of the euro, but also a wider contribution to the global financial market turmoil. Moreover, it has lead to a poor financial situation for the EU member states who are extremely nervous such as Germany, France, and the UK. The nervousness is due to fear of causing a chain reaction, and even forcing the
disintegration of the eurozone, negatively affecting the global economic recovery.

3.2 Suggestions

Even though Taiwan has adopted several policies since the 2008 global financial crisis, the government must cautiously face the impact of the European debt crisis. If Taiwan wants to avoid the European credit crisis which may be brought about by a drastic change in the situation and wants to avoid the impact, Taiwan needs to make efforts and strengthen cross-strait economic cooperation with China. In addition, the government must face its own debt issues in order to avoid the debt snowball being left behind for the next generation. Finally, this paper suggests that the topic of Taiwan’s public debt is an important issue to be explored in future research.

IV. References

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V. Appendix

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