Comparison of the Governmental Actions undertaken in response of the Financial Crisis in Europe

Economics of European Integration

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Final Paper

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Introduction

The year 2009 will always be remembered as the worst economic downtown since the second world war. Every day, the news inform about new insights and scope about the financial crisis. Nearly every country and every business sector is affected. The first shocks came unexpectedly and slowly. The real estate market in the US showed huge price overestimations. Bad debts, which were given out by banks even worsen the situation. Nowadays, the consequences of the financial crisis even express their effects in the real economy. The labour market is harmed and the unemployment rate is steadily increasing. The consumer index is still stable but will decrease in a long run as well and this, without doubt, it will have significant implications for the financial world. Although, it is a global crisis the countries need to cope with the effects individually. In Europe however, the countries are tightly bound to each other through the European Union. Therefore, the countries depend on each other comparatively more than on other continents. In this paper, the governmental actions in Europe are reviewed. Next to a global overview, which is given about international actions within Europe, four countries with varying importance, different influence and integration level within Europe are compared. Germany was chosen as a candidate for being one of the biggest Economies in Europe. The United Kingom (UK) is taken into account for the comparison as well. UK is one of the few countries which did not introduce the Euro as a common currency. Traditionally, Switzerland follows a rather autonomic policy. Switzerland does not actively participate in the procurement of the European Union. It is interesting to see whether Switzerland is equally affected by the crisis. This comparison will show whether the different actions which were undertaken, showed the desired effect, to stabilize the economy.

The first part is going to discuss the European effort to abandon the financial crisis. In the second part the governmental actions in Germany, UK and Switzerland and going to be analysed individually. The third part is concerned with the comparison of the governmental actions. At final, a conclusion is drawn about the most effective action.

1.0 The financial crisis in Europe

The financial crisis which started in the United States has hidden Europe long ago. The

consequences of the global financial crisis in Europe are only partly the same as they are in the US. In Europe, we observed as well a squeeze on credit, a sharp decline in house prices and tumbling stock markets, which led to a further decrease in consumer confidence. This in turn reinforced the slump in consumption and investments. Until now, we have seen economic conditions that have even degraded further. Especially in the financial sector, conditions have worsened and are likely to stay fragile for still some time. Also the exporting sector has suffered from the financial crisis. All these factors have triggered a European wide recession. However, the real problem in Europe is a political one.

1.1 Consequences for the European economy

There are many different consequences for Europe that are resulting from the financial crisis. First of all, there is the banking crisis. This crisis, and the financial crisis as well was the result of a global failure of banks and it supervision. The banking crisis is especially affecting Europe, since the banking sector stands for nearly one quarter of the one hundred European listed firms with the highest market capitalization. Furthermore, it is undoubtedly the main sector when looking at value. Since banks are playing the mayor role in the financial sector, which is the connection of lenders and borrowers, it is no surprise that Europe had and will have to grapple with the banking crisis until now and in the near future (more on this subject will be presented below). As a consequence of the dramatic financial situation, we have also observed a dramatic drop in share prices of companies and especially of financial institutions. The share prices decreased due to several factors. The capital expenditures which create future benefits decreased, since they are postponed because of uncertainty. Furthermore, huge amounts of asset sell offs have taken place. The crisis led also to a decrease of working capital. However, the main reason for the drop in share prices is the humongous decrease in sales, which reduces a company‘s Earnings Before Interest and Tax (EBIT). All these factors just mentioned reduce the free cash flow from a firm. The low free cash flow together with the increased cost of capital resulting from uncertainty and the sharp drop of money supply reduces the number of positive net present value projects. In other words, many companies are unable to find profitable investment opportunities. Additionally, many companies even became unable to finance their day to day operations. This led to a European wide decrease in demand and triggers a higher unemployment rate. The European average unemployment rate of that rose to an unexpected high level of almost 8,5 percent did not only increase this much due to lower demand within Europe, it is also affected by the decrease in exports. Exports are

decreasing because of lower demand from abroad but this already low demand is even more diminished because of the appreciation of the Euro that was caused by the weak dollar. An appreciation of a country's own currency, in this case the Euro, makes imported goods and services from other countries cheaper. Note though that at the same time it becomes more expensive for countries from abroad to buy European goods and services. Thus, European exports decreased dramatically and are expected to decrease even further. The GDP of the Euroland is likely to fall by 1,9 percent, which is 0,1 percentage points lower that the expectations for the GDP of the 27 EU member states (European Commission, 2009).

1.2 European plans to combat the effects of the financial crisis

Since the crisis has started within the banking sector, Europe aims to restructure the financial system in order to form international institutions that are able to perform in such a way people want them to perform (Brown). Furthermore, it is planned to isolate the bad assets and to back up the financial system by means of financial support to make loans start again to businesses and households. In addition, the heads of many European governments ask for a European wide stimulus package. However, it is going to be very difficult to put these plans into action. The reason for this, as already said, is a political one and it lies in the structure and the characteristics of Europe. Different from the US, Europe consists of many countries with unequal numbers of inhabitants and unequal size. The countries vary in their economic systems and in their economic strength. In addition, most European countries have different languages and historical backgrounds, which make it even more complicated to reduce the countries to a common denominator. In case of the financial crisis it is even more difficult for the EU to find unity, since the countries are affected in variably ways. The countries are not only facing different problems caused by the financial crisis; even if some financial problems are the same in all of Europe, their magnitude might vary greatly between countries.

As mentioned above, the banking crisis is not yet over. According to Zanny Minton-Beddoes, the main European banking crisis is yet to come. She argues that eastern European countries, for instance, are facing huge deficits. These emerging countries were borrowing large amounts of money mostly from their strong European neighbors that implemented the Euro in 2001. The borrowing countries let the deficit rise to an almost suicidal level, as they acted on the assumption to be assisted by Europe during harder times. These huge deficits explain why the emerging eastern European countries are much worse off than their stronger European neighbors, since they are not only hit by the financial crisis and the European wide recession

that reduced their exports, these countries have a much greater problem - the balance sheet crisis. As their own currency has depreciated against the Euro, they are facing much higher payments. At the moment, it seems that the already existing gap between stronger and weaker European countries is getting even bigger. Obviously, a European wide stimulus package seems to be almost impossible at this point in time, since economically stronger countries are not willing to spend a great fraction of the European cash injection to help eastern European counties getting out of the balance sheet crisis. However, Minton-Beddoes cautions against a failure of the "European Economic Recovery Plan", since an illiquidity of eastern European banks and governments would most likely cause a western European banking problem. The reason for this is the fact that the eastern European counties were borrowing from west European bankers. This connection would turn a default of eastern European countries into a serious crisis of western European banks (Public Broadcasting Service, 2009).

But even a EU or a Euroland wide solution is not easy to find. In December 2008, the EU prepared an European Economic Recovery Plan that aims to increase the purchasing power of the European citizens. The member states have agreed to spend up to €200 billion in order to boost demand within the EU. This immediate budgetary impulse is approximately equal to 1,5 percent of the European Gross Domestic Product (GDP). €30 billion of this cash injection will be financed by EU funding, the remaining €170 billion are supposed to be financed by the European member states (European Commission, 2008). However, until not it is still unclear which country is to contribute how much. Although many questions about this stimulus package remained open, the two major objections are clear. This package should increase consumption and recreate confidence in the European economy. Public spending and tax cuts should yield to more investments and consumption of private households. Moreover, parts if the cash injection is aimed to be invested in the „right skills for tomorrow‘s needs“(European Commission, 2008). These investments are going to be spend on research & development. The resulting increase in know-how and a further progress of environmentally friendly technologies should lead to a higher employment rate and to a dynamic economy with low CO2 emissions (European Commission, 2008).

Nevertheless, we have to bear in mind that the European member states have not even agreed on the distribution of the contribution of money that is needed for an implementation of the recovery plan. Additionally, regarding the fact that these plans were already made in October

2008 and should have been implemented on the 11th of December 2008, it is questionable if a European wide stimulus package will at all be carried out.

1.3 European Reactions on the financial crisis

In case of a global recession, one would expect the central banks to cut the prime rate. By doing this, they allow people to borrow money at a lower rate, which stimulates investments and might result in a cyclical upturn. Such a cut is again not that easy in Europe. Not only countries within Europe differ from each other, but also the member states of the European Union have different economic structures and the economic dynamics are also varying between members. But this is not the only reason why the ECB did not cut the key interest rate in the beginning of the crisis when a recession had already hidden the US. The main reason, why the ECB has difficulties with cutting this rate is the fact that the bank‘s focus lies on price stability rather than economic growth, social protection, or the maintenance of a high employment level. In other words, its primary objective is to keep inflation below but close to two percent.

Although a low interest rates give rise to an increase in inflation, the ECB had to react to the ongoing financial crisis and it’s negative impacts on the economy. The ECB, together with the Fed, the Bank of England and three other central banks, cut the key interest rate by 0,5 basis points in the beginning of October 2008. As economic conditions degraded even further, the key interest rate was cut five more times. On 2nd of April, the interest rate has achieved its lowest level since the implementation of the Euro and, according to Jean-Claude Trichet (The president of the ECB), the lowest limit might not yet reached.

Date	Cut in key interest rate	level of key interest rate before cut	level of key interest rate after cut
08.10.2008	0,5 basis points	4,25%	3,75%
06.11.2008	0,5 basis points	3,75%	3,25%
04.12.2008	0,75 basis points	3,25%	2,50%
15.01.2009	0,5 basis points	2,50%	2,00%
05.03.2009	0,5 basis points	2,00%	1,50%
02.04.2009	0,25 basis points	1,50%	1,25%

If the interest rate will decrease even further will depend on the improvement of the real economy. In other words, as there is already enough liquidity in the market, the interest rate

will only be decreased further if the real economy does not show evidence of a confidence building.

2.0 Economic Performance in Germany

Germany can be explained with many superlatives. According to GDP, Germany is the biggest country in economic size in Europe. Even in the world, it holds the third place after US and Japan. Next to that, Germany has the highest population in Europe although it is a comparatively small country in dimension. 82 Million people share 350,000 km2 and therefore it is a country with one of the highest population density. The key industries of Germany are mainly the automotive, engineering and pharmaceutical industry. However, the country is highly dependent on imports of raw material to process the products further and sell technological advanced products throughout the world.

2.1 Germany and Europe

In 1951/57 the precursor of the European Union was established. Together with France, Belgium, The Netherlands, Luxembourg, and Italy, Germany belongs to the founding members of the European Union. Therefore, a major interest is shared among those countries to achieve a maximum level of integration within Europe. Germany promotes heavily the engagement of European countries in European politics. Since today, the poorer countries receive money from stable economies to adjust economic performance in the long-run. Germany however, is paying the largest amount into the common cash box due to its superior economic performance. Because the actual financial crisis effects every country within Europe it is questioned whether a close integration and interlocking could harm the performance of the individual countries. It is considered whether Germany faces a disadvantage due to its liabilities within Europe and it´s close trade relationships. This question will be discussed in a later paragraph.

2.2 Germany’s Economy

Germany itself does not command about raw material aside from few resources such as coal. Therefore, it depends heavily on imports of resources. However, those resources are then transformed into products and exported throughout the whole world. This leads to Germany’s

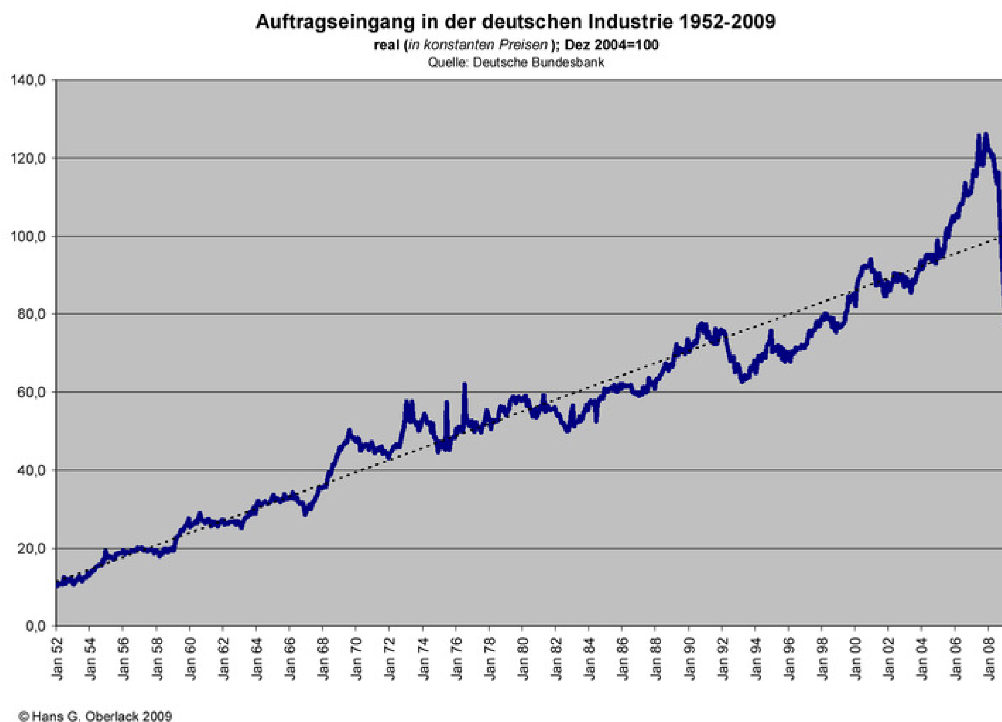
reputation of being the world’s biggest exporter. Conducting an annual GDP of 2,4 Billion, companies in Germany are mainly active in technological and High-Tec industries. For instance, Germany supplies superior solar constructions and highly advanced equipment. Next to the technological focus, the country as well is active in the service sector. The services, however, are mainly linked to technological industries as well. For instance, SAP provides EDV solutions and consultancy for companies.

2.3 Devolution of the crisis in Germany

As it was mentioned before, the actual financial crisis started of in the United State due to an overestimation of real estate. Through the tight incorporation between the US and Europe, the European countries were torn into the crisis as well. Due to the global decrease in demand, the companies were forced to decrease their production quantity as well. The effects of the global crisis were gently observable in autumn 2008. Companies lost contracts and cancelled production. A major change in the devolution was the insolvency of the several banks. The IKB, Bayern LB, and West LB had to write of billions from their financial statements due to losses in market value. This was the first indicator for Germany that the financial system is in a crisis. The consumer however, did not perceive the situation as critical at this stage. The consumer index remained stable and even increased during the Christmas time.

Nevertheless, in spring 2009, the crisis also swapped over the German real economy. Due to the droop in world demand, companies reduced their production level. In sake of adjustment, fewer workers were necessary, which could have resulted in surge of lay-offs. The backbones of Germany’s economy were highly affected by the crisis as well. Automotive companies experienced a heavy drop in sales and accumulated stocks. Some companies even fully stopped the assembly lines in order to prevent overproduction. Due to the trouble of famous German automotive companies, the sub-suppliers, which provide the industry with small components, faced insolvency. Since the first glance of the economic crisis, 12% of medium-sized enterprises had to shut down.

Although, the crisis did firstly not touch upon the employment market, the recession shows their effects today. The unemployment rate increase by nearly 1% in the past month. It is expected that 50,000 workers are lay-off every month, although government undertook action to prevent dismissals. The graph below displays the decrease in production demand in the period of 1952 till 2009. As one can see, the slum in economic activities is dramatic and at it worst level since World War II.



2.4 Governmental actions to weaken the effects of the crisis

Due to the global decrease in trade, the German economy experiences a recession and a steady increase of the unemployment rate. To stabilize the economy, government realized in autumn 2008 that the country requires financial aid in order to avoid a drain of resources and economic power. After the insolvency of states banks, West LB and Bayern LB, government assured the outstanding liabilities to the public and initiated a public acquisition limited on time. In October 2008, government provided the financial market with the so called "Finanzmarktstabilisierungfond" to stabilize the liabilities. The maximum expenditure amounts to 400€ Billion.

In order to prevent the employment market to collapse, government promoted reduced working hours among German producing companies. This action stopped extensive lay-offs in all businesses. The outstanding wages are paid by the “Bundesagentur fuer Arbeit” a public institution of the employment market. The companies profit from this regulation as well, because it leaves them with some lack of time for the upcoming month. Through reduced working hours, companies can adjust their production level to the existing demand.

In total, the German government has released two financial aid packages, namely “Konjunkturpaket I” and “Konjunkturpaket II”. Both economic stimulus packages amount to 400,000€ Billion. However, it is criticized that the economic stimulus can only lessen the effects of the economic crisis but does not prevent Germany from o deep and long lasting recession.

2.6 Outlook

Although, government invested a large amount of money, the German economy will suffer from the global crisis. It is expected that Germany will experience a negative growth of 6% by the end of the year 2009. This would be a major drop in economic performance. Since the recovery of the recession in 2002, the economic growth add up to 2,8% in 2007. Experts expect that a similar economic performance will not be achieved before 2013 again. Although Germany is the world’s biggest exporter, exports will decrease by 5,2%, as it is presumed. Firstly, the service sector will be affected before the crisis cutback is observable in other sectors as well.

As an economic law predicts, the unemployment rate will remain high if the global demand does not increase. In Germany it is expected that the unemployment rate will rise up from currently 3,5 Million to 5 Million. This will draw upon the financial resources of the state again. This in turn will also lead to the disdain of the 3& rule of new indebtedness stated in the Maastricht treaty. Peer Steinbrueck, the financial minister, is expecting a new indebtedness of 4% in the coming year.

3.0 Consequences of the Financial crisis for the United Kingdom

Just like on almost every other developed country, the global financial crisis has been hard on the British economy. In 2008 the UK entered into a recession after 16 years of consecutive growth in every single quarter. Most recent figures demonstrate a GDP decline of 1.6% in the last quarter of 2008, just to be followed by a further decline of 1.9% in the first quarter of 2009. This is the sharpest GDP drop since 30 years. The manufacturing industry suffered most, noting a decline of 4.9% in the last three months of 2008 and another 6.2% since the beginning of 2009, which is the industry's worst drop in history. In total the British GDP has decreased by 4.1% over the last twelve months and forecasters expect them to be not even half way through, as the recession is anticipated to last at least twelve more months.

As a further consequence of the crisis, the Pound Sterling's value dropped sharply on international currency markets. Having been worth $2.00 in mid 2008, it hit a 23-year low of $1.35 in April 2009. Against the Euro the Pound Sterling fell from €1.25 in 2008's summer to €1.10 just recently and against the Yen it hit an all-time low of ¥119.25 after the latest GDP growth figures had been published.

Mainly as a result of the gas and oil prices, which were rising until mid 2008 and started falling sharply afterwards, the inflation rate was rising quickly during 2008 and is decreasing at an accelerated level now. Although the UK's inflation rate currently still is above the European average it is feared that it might turn negative, leading to deflation.

Another major problem at this time is the rapidly rising unemployment rate, which has never been growing faster before. Generally speaking, the unemployment rate and the number of unemployed people have constantly been rising, whereas the number of vacancies and the growth of average earnings have been falling since the crisis kicked in. Current figures confirm an unemployment rate of over 6.5%, which is an increase of more than 1.5 per cent points over the last 12 months. The UK has not experienced higher unemployment rates since 1997. These rates correspond to roughly two million unemployed people, while some forecasts predict the numbers to exceed three million people by the end of the year, resulting in an unemployment rate of more than 10%.

3.1 Government Actions

The British government started intervening quite early when they had to nationalize the troubled mid-size bank Northern Rock in February 2008. During the five months before that,

Northern Rock nearly collapsed due to the subprime mortgage crisis and was granted a loan of almost £27 billion by the British central bank (Bank of England). When the broad public learned about the bank's situation, many customers were afraid to lose their savings and started withdrawing money from their accounts. This run finally led to the bank's nationalization after two takeover attempts by private buyers had failed because of the prospective inability to pay back the government loans within the following three years. A temporary nationalization, so the British government declared, would be the only way to ensure that the taxpayers' loans would be repaid. This decision was heavily criticized and shareholders who lost their investments even sued the government, although finally losing the case in January 2009. Due to heavy downsizing of the bank's workforce and the renewed confidence in its state-owned status, Northern Rock was able to already pay back some two thirds of its 2007 outstanding debt by March 2009 – meaning they are way ahead of schedule in paying back their loans.

In April 2008 the Bank of England launched a so-called Special Liquidity Scheme in order to overcome the liquidity problems most banks had to cope with. The problems associated with the sub-prime mortgages in the US housing market had led to a massive lack of confidence in banks' assets consisting of mortgage-backed securities. As the markets in which these assets were usually traded had closed due to this lack of confidence, many banks were facing major problems in liquidating their assets. With the Special Liquidity Scheme the Bank of England offered financial institutions the possibility to swap these kinds of assets for highly liquid Treasury Bills for a specified time span, after which the swap would be reversed, thereby ensuring the banks' short-term liquidity without taking over their losses. Originally, it was planned to limit the swaps to a total of £50 billion but due to higher than expected demand, it resulted in a total lending of £185 billion by the end of January 2009, as the central bank published in February.

In another rescue attempt of the banking sector, the British government was heavily involved in the takeover of HBOS (Halifax Bank of Scotland) by the London-based banking group Lloyds TSB. Starting in March 2008, HBOS's share prices fell rapidly, which was connected to short-selling and false rumors about the need of emergency funding. When Lloyds TSB stepped in to rescue the bank by acquiring it in September, the British government brokered the deal with the aim to escape another nationalization like it was the case with Northern Rock. The joined banks would have significantly high market shares in the mortgage market,

in financial services for small businesses, as well as in personal current accounts and therefore, the government had to overrule competition law in order to make the deal go through. Furthermore, a £37 billion bail out plan was introduced, of which £17 billion were pumped into the newly combined Lloyds TSB and HBOS, whereas £20 billion were invested in the likewise troubled Royal Bank of Scotland, taking over 58% of the bank's shares.

Resulting from the short-selling incident, which is believed to have caused HBOS's downfall, the Financial Services Authority introduced a ban on short-selling of several securities in September 2008 for the upcoming four months in order to attain some financial stability.

In late September then the second bank after Northern Rock were to be nationalized. One of Britain's biggest mortgage lenders', Bradford & Bingley's profits were adversely affected by the credit crunch and their share prices dropped by 93%, which left them unable to continue operations. The only options left were selling the bank to another private entity or to the state. With the intention of stabilizing the banking system and the financial markets as a whole, as well as to protect savers and depositors, the government stepped in and acquired the bank's £50 billion mortgage and loan portfolio, whereas its £20 billion savings business was sold to the Spanish bank Grupo Santander. Similarly to the Northern Rock case, former Bradford & Bingley shareholders tried to take legal action against the government, as they had not been properly compensated for the shares that were taken over.

In November the government formed the UK Financial Investments Limited company to manage their shares in Lloyds Banking Group, Royal Bank of Scotland, Northern Rock and Bradford & Bingley. The company's objectives are the protection and value creation for the taxpayer as shareholder as well as maintaining financial stability and promoting competition.

Over the last six months the Bank of England had to cut the interest rate six times. It all started in October with a cut from 5% to 4.5% when the world's central banks acted together in a coordinated 0.5 percent point reduction to decrease the cost of borrowing with the purpose of avoiding a financial meltdown. It was hoped that the global rate cuts would release some pressure from the stock exchanges but they failed on that aspect, as investors were not convinced about the ability of these cuts to solve the crisis. It was the first time since the aftermath of 9/11 that the British government had to take emergency actions on the interest rate. Just one month after the initial cut, the Bank of England took action again, cutting the rate by another 1.5 percent points to only 3%, which was the most dramatic reduction since 18

years. The aim was that banks would pass on the lower interest rates to their customers, but due to the unexpected size of the cut, banks were rather hesitant. With prospects getting worse and worse, a long-time recession getting more and more likely and the inflation rate dropping further, the Bank of England cut the bank rate four more times over the next few months until it reached an all-time minimum of 0.5% in March 2009. The extremely low interest rate is expected to make saving unattractive and therefore will motivate borrowing and spending, which is desperately necessary to revive the economy. Rates in Britain had never before fallen below 2%, not even during the Great Depression in the 1930s.

Alongside this latest cut, the central bank issued a statement that it would increase the money supply of the country by an initial amount of £75 billion, which could be extended to £150 billion if needed. The idea is the same: the increased amount of money is believed to boost lending and investments, which would help the economy. Whether both measures, cutting the interest rate as well as increasing the money supply, will be successful in its purpose of boosting investment and lending will be seen in the upcoming months but it almost is standard procedure when expecting a long-time recession.

In January 2009 the British government announced a second bank rescue plan, in which the Bank of England would set up an asset purchase program, which allowed them to buy up to £50 billion of high-quality private sector assets in order to get cash flowing freely again. It was hoped that this second rescue plan would have positive effects on perceptions at the stock exchanges, but all hopes were shattered when the Royal Bank of Scotland released their trading statements on the same day. Despite the receipt of £32 billion of government and shareholders funds only three months before, the bank had to record the biggest loss in British corporate history when they published estimated losses of up to £28 billion due to write-downs over the foregone year. Almost all their losses were associated with the sub-prime markets and their acquisition of the Dutch bank ABN Amro the year before. Following the publication, the bank's shares collapsed again and moreover the share prices of almost every other British bank fell significantly as well. The government had to step in again, increasing its interest in the Royal Bank of Scotland from 58% to 70%, but still the government's second rescue package had failed in its attempt to restore confidence in the financial sector.

3.2 Outlook

Of course forecasts vary, but over the whole year of 2009 the UK GDP is generally expected to decline by slightly more than 3% and then to be roughly flat on average during 2010 with a

slide recovery becoming evident over that year. The recession however is broadly believed to last at least until the end of 2009. Furthermore, the inflation rate is expected to drop further and below its target rate of 2% as the economy slows down and past energy and food price rises are reversed. As already mentioned before, the unemployment rate might rise above 10% as several further layoffs are likely. Finally, the positive effects of a lower interest rate on spending behavior will have to be awaited, but if it does not work out as hoped, the recession might even last longer than until the end of this year.

4.0 The financial crisis in Switzerland

At first sight Switzerland seems to be among the only economies that got their act together fast enough to help their economy not slip into the disaster which the other countries are now in. Furthermore, its specific circumstances can be seen helpful from the start.

The Swiss industry is completely open to unconfined global competition. As a result, Swiss firms have been whipped into shape. In the past six years Switzerland opened their labor market to their neighbors from the European Union. It is now possible for Swiss firms to draw on a vast pool of workers from neigh boring countries like Germany and France which are highly skilled. By opening the market the Swiss raised their average rate at which their economy can expand throughout the cycle to over 2% from a previous value of less than 1.5%.

The bank thought of belonging to one of the best managed central banks in the world, the Swiss National Bank (SNB), was one of those that were well prepared for the turmoil. As compared to other central banks the SNB did not focus on an interest rate they could control and set directly by themselves. Instead, the SNB targeted the three month rate at which commercial banks lend to each other. This rate can be considered as being important. It is the rate that influences the rate of interest at which a bank can lend money to households and businesses, because it is the rate that determines how much banks have to pay to fund themselves in the money market.

As trust was lost at the beginning of the crisis, the interest rate at which banks were willing to lend skyrocketed. The SNB has always had to keep a close watch on this rate, as the rate set by the SNB is targeted at the rate in which banks lend to each other, and so the SNB was able to see earlier than most other countries that counter actions needed to be taken. They set the

interest rate at an aggressive 1 percent, with the result that the market was flooded with money. As a consequence the banks now seem to even be rich on money as they see no need to hoard the money anymore. The most positive effect of getting their monetary response right from the start, however, is that the Swiss have less need for a fiscal stimulus than other countries, and thus run less risk of wasting resources by i.e. spending too much money in a rush.

Furthermore Switzerland had the benefit that its real-estate market was not exposed the price bubble that faced many of the economies. Prices had been reasonable, and before the crisis there was a limit to potential buyers from a foreign country that could buy property within Switzerland. During the crisis this turns out to be a great advantage. This is the case because the country is attractive for foreigners in many ways. It attracts many rich tourists as well as many foreigners that wish to enjoy the low taxes which are present in the country. So even in case local demand decreases there is still the large foreign demand, even in this time of economic turmoil, as potential buyers.

However, the view that Switzerland is not as deeply hit by the crisis as other countries has been questioned by recent events. The largest Swiss banks previously believed to be secured are under severe economic pressure and financial difficulties. UBS and Credit Suisse, the two largest of the banks, are the most prominent examples. The major reason why they have been sucked into the crisis is because these banks have businesses that reach an international scale as Switzerland has always been a place attracting huge amounts of foreign customers.

4.1 Current Situation and Problems

This story begins with the Swiss franc having to suffer under the consequences of deflation. As the Swiss market has always been considered a safe haven, people have bought the Swiss franc in a storm. This led to a sharp increase of the value of the franc and has caused relative consumer prices to fall sharply. This is dangerous. Exports have sharply dropped as the result of a rise in the exchange rate. Swiss goods are simply becoming too expensive abroad, leading to an intervention of the SNB. The SNB has deviated from its previously rather passive path to force down the exchange rate.

By forcing down the exchange rate Switzerland is trying to export its deflation, which is dangerous as well. The best example here is taken by looking at what has happened to Japan.

Western countries are trying to keep their exchange rates low in order to stimulate exports in this time of economic turmoil. Switzerland is one of these countries and is one of many countries toying with devaluation, whereby these countries are mainly exporters with surpluses. Japan has had to suffer the consequences and exports were deeply affected as western countries devalued their currency against the Yen. Nowadays Japan is actually thinking of devaluing their currency as well, creating a domino effect that will backfire on the countries pursuing a strategy of devaluation. Eventually, if these countries refuse to let their imbalance correct, world demand will implode.

A further threat emerges because the SNB has already cut its interest rate to near zero (as previously mentioned to be a good thing). This means that as people continue to buy the franc and continue to tighten monetary conditions the SNB cannot easily offset this by monetary policy. Interest rates cannot be lowered further.

The next problem facing Switzerland is that of the banking secrecy. UBSs step to hand over data of US citizens to the US have changed the view on the previously thought safe Swiss banks. The fact that a Swiss bank would rather give away bank secrecy information and pay a fine shocked many of the worldwide clients. It can be considered a sign that the Swiss bank UBS is in deeper financial difficulties than previously suspected. Had the bank not given away the information the US threatened it with a lawsuit. In case UBS was found guilty they would have had to pay an enormous sum of money, much larger than the small fine they paid now. The fact that the largest Swiss bank was in such financial difficulties shows that there are more problems present in the Swiss financial sector than previously expected. The end result of the UBS giving the client information away led to the overall dropping of the banking secrecy. This means that countries can now look into the financial records of clients easier than they used to. Tax fraud issues are now easier to resolve with clients of Swiss banks. Over the long run, however, this could have a seriously negative result for the banks. Investors will not find the Swiss bans as attractive as they used to, and rich foreign investors could look for other locations to save their money. Thus, in the future it might become necessary for banks in Switzerland to attract clients in another way.

4.2 Counter Actions and Results

Attempts by the government to counter the crisis have been made. As previously mentioned, the SNB changed its interest rate quickly. This can overall be considered to have been a good

move, however, as also mentioned; the move came at the cost of using the interest rate as a fiscal tool to battle deflation. Furthermore the Swiss government has engaged in numerous other acts to counter the crisis, and they have done so with quite some success in comparison to other countries, including the US and most of Europe in general. On October 16, 2008 a special purpose company was created by the SNB and was announced to take on illiquid assets of the UBS. The aim of this measure was to relieve the UBS from these illiquid securities and thereby secure financial stability within the country. The new company is able to use a different time horizon to operate than a typical commercial bank and is therefore in a better position to keep the illiquid securities for a longer period of time than normal. So far this special purpose company can be considered a success. Even though the illiquid assets have continued to lose value, this only underlines just how important the removal of these assets from the UBS's balance sheet actually was. Further contributing to its success is that the company was initialized early on in the crisis. Also, expressed as a percentage of the GDP of Switzerland, the size of the package lies in the international average. By helping UBS the SNB can be considered to have contributed to the stability of the financial system.

So, what does the real economy of Switzerland look like at the moment? It can be said that in the Swiss economy grew solid through 2008, having responded to the help of the government (like the special service company previously mentioned). However, at a closer look it can be seen that the economic growth of Switzerland has steadily declined. The annualized quarterly growth fell from +1.3% in the first and second quarter to +0.1% in the third and -1.9% in the fourth quarter. Yet these numbers are actually better than those of the US and the Euro area where the economy already started shrinking in the third quarter of 2008.

The fact that consumption in Switzerland has decreased was inevitable, no matter how good the actions of the state have been. But even here there is a sign that consumers are regaining confidence. A glimmer of hope is that consumer confidence has for the first time since the beginning of the crisis slightly recovered in January. One of the parts of the economy having the most influence on consumption is of course the situation on the labor market.

All the actions taken by the government have not been able to stop a rise in the unemployment rate. In the past year the Swiss unemployment rate was at 2.5%. Still, in the short period that has passed since autumn last year it has steadily risen. While originally it was primarily the export sector that was affected, layoffs and short-time work are now rising. One of the main reasons for this is that Swiss banks have responded to their heavy losses by restructuring and job cuts. Switzerland simply cannot deal with the decreasing consumption

and production of the foreign markets. Since their exports and Imports are decreasing, especially those of their biggest trading partner Germany, they are being sucked down with the other countries, no matter how good the actions taken have been.

So the question that remains is what we can expect for Switzerland in the future. Here it has to be predicted that the development in the real economy will be grim. In 2009, the Swiss economy, along with that of the rest of Europe, will shrink. While private and government consumption will probably continue to be supporting forces, investments and trade will continue to decline and unemployment will rise. Overall recovery seems to be dependent on the development of the American economy. In case the government actions taken in the US are successful and lead to a recovery of the financial sector and if they help restore confidence of consumers and investors, the upswing of the country will be transmitted to the rest of the world and international trade will pick up again. Here it has to be made sure that protectionism, national solos and a turn away from globalization are avoided.

Even though the current crisis is global, it is and was not a crisis that was caused by globalization. The crisis should rather be seen as being the result of an absence of discipline of the industrial nations. The high indebtedness of households in the United States has contributed tremendously to the emergence of the financial bubble. Additionally, a loose monetary policy led to a lack of discipline of financial institutions. The risks of non-crisis-tested assets with high yields were largely underestimated, and many commercial banks behaved pro-cyclical, partly due to poorly designed incentive structures.

The crisis has lead central banks and governments to massive stabilization measures in the banking sector and the real economy. Although the reactions are justified in their size, it is important not to ignore the discipline this time. The flexibility in the short-run may not threaten the long-term credibility of the fiscal and monetary policy. The actions taken by Switzerland seem to be pointing into the right direction, and encouraged by the fact that they were implemented so quickly they seem to already show small signs of improvement. Still, if Switzerland wants to find a way out of the crisis it has to rely on the other European countries as well as the US. The Swiss economy is simply not large enough to be able to influence the world economy enough by itself to lead out of the crisis.

5.0 Comparison of the Countries

	Effects	**Gov. Actions**	**Outlook**
Europe	•Lay-offs higher unemployment rate •Decreasing share prices •Increasing cost of capital •Reduction of investments and consumption •Bankruptcy of banks and firms •Decreasing growth rate	• ECB cut key interest rate • Recovery plans	• Unemployment rate remain low • Stock markets will re[illegible] slowly • Cost of capital will dec[illegible] again • More and stricter regul[illegible] for the banking sector
Germany	•Bankruptcy of three major banks •Decrease in production level •Lay-offs	• Financial aid for banks and transfer of liabilities • Promotion of reduced working hours • Financial support to stabilize the economy, 400€ Billion	• Unemployment rate will increase up to 5 Million • Consumption level will remain low • Civil disturbance is expected
Switzerland	•Large losses and write-offs •Fewer lay-offs than in other European countries •Decreasing growth rate •UBS and Credit Swiss announced large losses and write-downs	• Quickly cut in interest rate •Creation of new company that announced to take on illiquid assets of the UBS	• Creation of liquidity •Faster recovery than most European countries •Possible ending of banking secrecy
United Kingdom	•Increasing unemployment rate •Fewer investments •Decrease in consumption •Banks announced losses and write-downs •Depreciation of the Pound	• Temporary nationalization of banks •cash injection package increase in money suply •Cut of key interest rate	• GDP is expected to decline slightly •Inflation rate will drop below 2 percent •unemployment rate might rise above 10 percent

6.0 Conclusion

To find a European wide solution for the financial crisis and its impacts, is far more complicated than expected. The differences between European countries and even between EU member states are still very large and the affect of the financial crisis on the different economies vary fundamentally. For that reason, the plans made for all European countries, as well as the recovery plan of the 27 EU member states were not yet carried out. At this point in time, the only European wide reactions to the crisis were cuts of the key interest rate. As the economy is still struggling, the sixth interest cut within five months was made on the 2nd of April. If this sixth cut does not show significant improvements of the real economy, a further reduce in the interest rate will probably follow in the near future.

As the degree of impacts of the crisis on the different European economies were varying notably, and a European wide solutions is still rather unrealistic, the different European governments were looking for their own specific way out of the crisis.

From the time when Germany experienced a thread of a coming recession, the government tried to counteract the crisis by promoting reduced working hours, to decrease the number of lay-offs. It also assisted banks that struggled for existence by assuring outstanding liabilities to the public and initiating public acquisitions that are limited in time. Furthermore, the government introduced the so called "Finanzmarktstabilisierungfond" with a market capitalization of around €400 billion which should stabilize the liabilities. In total, the German government has released two financial aid packages, namely "Konjunkturpaket I" and "Konjunkturpaket II". However, compared to other countries, the German governmental actions were rather conservative regarding the degree of the financial aid, as well as its timing. Therefore, the entire effect of the stimulus packages on the real economy can not yet be foreseen.

For the case of Switzerland it can be said that accurate measures were taken and they were taken quicker than in most other countries. Still the crisis was not without any consequences. The banking crisis of USB and Credit Suisse were caused by the crisis and eventually lead to the loss of the banking secrecy. Furthermore Switzerland could not help the fact that their economy also shrank. Yet, it did not shrink as much as in other nations and there are already small signs of relievement present, i.e. in consumer spending. Overall, however, it is clear that the Swiss economy cannot fully recover from the crisis if the economies of the other nations, especially the US and European countries like Germany, does not recover as well.

Summarizing the British government's actions in response to the crisis, the most notable interventions were two massive bank rescue plans, the nationalizations of Northern Rock and

partly of the Royal Bank of Scotland, as well as the central bank's immense interest rate cuts in line with an increase of the country's money supply. Although both rescue plans for British banks could not convince in their aim to restore confidence in the financial market, at least it made sure that all troubled banks could continue operations so far, thereby preventing the markets from complete collapses. Whether the extremely low interest rate and the increased money supply will assist in curtailing the country's recession remains to be seen in the upcoming months.

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