

# **Global Financial Crisis**

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## **ABSTRACT**

*The abstract of the research focuses mainly on Global Financial Crisis.*

*Throughout the history of mankind, financial disasters have occurred. Sometimes they were local and affected specific sectors of the economy, sometimes they were reflected on the welfare of the whole country in general. As a rule, the global crisis is called the continued decline in the economic power of a group of states, whose production processes directly or indirectly relate to population around the world. There have been about twenty such financial disasters in the last couple centuries. A large number of countries involved pay special attention to the development and implementation of anti-crisis measures and activities, but even in this days it's hard to predict how long the crisis will last and what character it will take. Crisis shows the reality of things, which looked forward on the continuation in the long run of the economic boom in general and the commodity boom - in particular. The crisis gives rise to impulses for mobilisation and opens up the need for political, social and economic modernisation not in propaganda rhetoric, but as well as in the reality. This is the important positive significance of the crisis for the further historical development of the world as a whole. The following point has been detailed in this work: causes of economic crises in the world; most popular global financial crisis; the impact of the global financial crisis.*

## **INTRODUCTION**

Financial crisis and a significant decline in economic activity spread across the economy in GDP, real income and employment. A disturbance to financial markets associated with falling asset prices and insolvency among debtors And intermediaries which ramifies through the financial system disrupting the market capacity to allocate capital is known as financial crisis.

Financial crisis have been generated by combination of factors such as:

- Overshooting of markets;
- Excessively bridging of depth and credit booms;
- Miscalculations of risk;
- Rapid outflows of capital from a country;
- Unsustainable macroeconomic policies;
- In experience with new financial instruments and;
- Deregulation without sufficient market monitoring and oversight.

The US is the epicenter of the current financial crisis.

Globalization contributed to the extraordinary accumulation of wealth by few individuals and created greater inequality. To reduce inequality the US government implemented policies that lead financial crisis. There are two schools of thought on this causes of financial crisis and Bank failures the first focus the macroeconomic causes of financial crisis which are beyond the control of individual financial institutions on subgroup suggest financial crisis are caused by lower loss of public trust in the ability of banks to honor their commitments which is aggravated by errors in monetary policy the loss of trust can be triggered by deterioration the quality of bank loans ,Second sub group indicates the financial crisis are an integral part of business cycles. In such a context, economic agents have insufficient liquid assets to meet liabilities and a crisis is triggered by errors in judgment by debtors and creditors.

The second thought of school focuses on causes of financial crisis related to financial system or to individual financial institutions. These authors emphasize fraud and irregularities in Bank management as major causes of bank failures mismanagement cut rate lending aggressive liability management blunders and lacks of controls are considered major causes of bank failures.

There's a crisis among financial institutions tied to decline in their value of assets and this effects their solvency in the presence of investor's profit or losses. Some financial institutions or assets lose a large part of their value by banking panics (recession), stock market crashes, bursting out financial bubbles, currency crisis and sovereign defaults. When there's financial crisis banks reduce lending companies often face bankruptcy and unemployment rises.

Consumers reduced their spending manufacturing was decreased, global trade diminished and countries adopted protectionist measures. Given the main importance of finance all aspects of globalization issues such as trade, environment, crime, disease, inequality, migration, ethnic conflicts, human rights and promoting democracy were affected. The financial crisis weakened some countries. Therefore lead significant power among countries especially between US and China

A slowdown in economic growth for a continuous period is usually called recession. A prolonged recession may be referred to as a depression. The great depression in 1930 is an example for depression similarly the recent subprime mortgage crisis in real estate bubble experience in the world starting in 2008 into recession to the USA number of other countries.

## **MAIN CAUSES OF THE GLOBAL FINANCIAL CRISIS**

Economists name various causes of a financial crisis. Often, the reasons are described on a qualitative level, and each of the crises is credited with several of them at once. Among the most common causes of financial crises are imitation of strategies, financial leverage, new technologies and uncertainty, regulatory errors, fraud and dishonesty, and financial infection. Recall that a financial crisis is considered as a situation in which financial institutions or assets (for example, shares or bonds) dramatically lose a significant part of their value. Some of the key aspects include:

### **1. Fraud and dishonesty.**

Fraud, corruption, and corporate crimes serve as examples of white-collar crime. Alone or in combination, they can contribute to the collapse of corporations or even be instrumental in a national or global financial crisis like the one that happened in 2007–2008. Fraud and corruption raise ethical issues and indicate dishonest behavior. Legislation addressing fraud should also include corruption as a criminal offense. The recent crisis in the Euro zone has focused attention on corruption. In the case of Greece, for example, corruption is endemic and has stifled development of the country's economy and the modernization of its public service for decades. Corruption of this nature on such a large scale is a malignant cancer that sinks a country ever deeper into national debt.

Many financial institutions may let themselves be on the verge of bankruptcy and may endanger partners due to the fraud. So, in addition to financial pyramids or Ponzi games in which a financial company simply finances some debts with new loans, there are situations when it may be beneficial for company management to hide the true state of affairs. Such "secrets" temporarily delay bankruptcy, but often exacerbate it.

History offers many examples of such fraud. For example the scandal with the Shell oil company, when in 2004 it turned out, that the company's oil reserves are exaggerated — and this error in reporting was a consequence of dishonesty of management. As a result, shares of the company, which was considered as one of the most reliable in the world, sharply lost in value.

### **2. Regulation errors**

There is an opinion that absence of the proper regulations of the financial organisation's activities leads to the fact that these organizations may take excessive risks, which further cannot be justified. Absence of the regulations that limits such a behavior, can cause difficulties for many companies at the same time, this can cause a financial crisis.

Interesting fact that several economists consider that an excessive regulation can also cause the crisis: US law has been criticized recently, according to which banks should increase their capital while taking greater risk, that can aggravate the situation because of the compression of lending volumes in case of a crisis.

### 3. Financial leverage

Basically Financial leverage means financing investments on an account of loans, this is when investors use not only their funds, but also borrowed funds. In case of success it is clear that the income by using financial leverage will increase, however, if the investments won't live up to expectations, then the losses will be higher. Means that a bankrupt investor will lose not only his funds, but will remain owed to creditors, which would endanger the lenders themselves.

Leverage by itself is not the cause of financial crises, however increases the risk, and consequently worsen the situation in case of problems. Several economists consider that leverage has a tendency to increase before the crisis. Thereby, the number of loans to finance investments were increased before the collapse of the Wall Street bubble in 1929.

### 5. New technologies and uncertainty

Many crisis researchers note that an important cause of financial turmoil is people's erroneous reaction when they have a deal with new and untested phenomena. Historian Charles Kindleberger noticed that most financial crisis arise shortly after the advent of new technologies or new financial instruments, for example, new types of bonds.

Until the prospect of new technologies or financial instruments, it can only be estimated theoretically, the future income from these technologies or tools may be overly optimistic. Mass optimism leads to higher prices, but when reality does not live up to expectations, prices are sharply go downwards, i.e., a financial crisis is occurring.

It is considered that mistakes in prospects estimation of new technologies caused the dotcom crisis in 2001, and an incorrect assessment of the risks of financial instruments related to mortgage loans, this became one of the causes of the global financial crisis of 2008.

### 6. Financial infection

The concept of infection in the world of investment and finance describes the phenomena when a financial crisis can be transferred from one organisation to another or even from one country to another. Thus, if an influx of depositors into one bank leads to distrust of other banks (or a monetary crisis or national default leads to other crises within the country and even abroad)

It is considered that the financial infection has started to develop.

The phenomenon of financial infection arises from the close financial relationship of companies in a developed economy: for example, companies lend to each other, and these loans, in turn, become collateral for new. When someone in the system suddenly turns out to be unable to pay - all the participants, as in a chain, begin to have problems.

It is clear that financial infection is itself is rather a mechanism by which the problems of an individual organisation turns into a financial crisis that affects the entire economy.

## OVERVIEW OF THE GLOBAL FINANCIAL CRISIS

**1. Panic of 1857.** The first Global Financial Crisis, which totally changed national economy and social life of the USA, Germany, England and France at the same time. The crisis began in the USA. It was related to a massive bankruptcy of railway companies in the United States and the fall of the stock market. Production began to decline because of the absence of a good transport supply and a well-functioning banking system. Basically steel industry (cast iron), national economy (cotton) and shipbuilding. After this crisis, bankers around the world began to pay more attention to risk insurance.

**2. Panic of 1873.** The next Global Financial Crisis began in 1873 from Austria and Germany. The crisis of 1873 is considered as a major international financial crisis. This crisis is connected with the dependence of Europe and the USA in cheap goods from Latin America. Herewith, there was a speculative lift of the stock markets in Austria and Germany. This caused a sudden increase in growth of real estate and further the

economy collapsed in many of the European countries. The Austrian-German recovery ended with the crash of the stock market in Vienna in May. Stock markets in Zurich and Amsterdam also collapsed. In the United States, the banking panic began after a sudden fall of New York Stock Exchange shares and the bankruptcy of the chief financier and president of the United Pacific Railroad, Jay Cook. The crisis spread from Germany to America due to the refusal of German banks to prolong loans. As the US and European economies fall into recession (recession), Latin American exports plummet, which led to a fall of state budget revenues. It was the longest crisis in the history of capitalism: it ended in 1878.

**3. The Great Depression, 1929-1933.** October 24, 1929 (Black Thursday) a sharp decline in shares occurred on the New York Stock Exchange that caused the beginning of the largest global economic crisis in history. The cost of securities fell by 60-70%, business activity sharply decreased, the gold standard for major world currencies was cancelled. After the First World War, the US economy was developing dynamically, millions of stockholders increased their capital, consumer demand grew rapidly. And everything collapsed overnight. The most solid shares: American telephone and telegraph company, Global electric company and Global engine company - that lost within a week to two hundred points. By the end of the month, stockholders lost over \$ 15 billion. By the end of 1929, the fall in securities prices reached a fantastic amount of \$ 40 billion. Firms and factories closed, banks burst, millions of unemployed wandered in search of work. The crisis raged until 1933, and its consequences were felt until the end of the 30s. Because of the growth of shares of banks, large companies, increase of goods production, etc., it seems that the economy simply could not stand such rapid growth.

**4. Oil Crisis, 1973.** The economic crisis that began in the USA at the end of 1973 in terms of breadth of countries, duration, depth and destructive power significantly surpassed the world economic crisis of 1957-1958. The first energy crisis was initiated by the participating countries of the OPEC (Organization of the Petroleum Exporting Countries), that wanted to increase the cost of a barrel of oil by reducing the amount of its production. Thus, the miners of black gold tried to increase the cost of oil in the world market. October 16, 1973 the price of a barrel of oil rose by 67% (from 3 to 5 dollars). In 1974, the cost of oil reached \$ 12. During the crisis period, industrial production in the USA decreased by 13%, in Japan by 20%, in Germany by 22%, in the UK by 10%, in France by 13%, in Italy by 14%. By mid-1975, the number of fully unemployed in developed capitalist countries reached 15 million. In addition, more than 10 million were transferred to part-time work or temporarily fired from enterprises. Everywhere there was a fall in the real income of workers.

**5. Black Monday, 1987.** Since August 1982, the Dow Jones Index has shown steady growth. By August 1987, the Dow Jones had doubled, meanwhile rapid economic growth in the economy after the recession of the 70s gave way to stable development. In the beginning of October, the Dow Jones began to decline smoothly, and on Friday October 16, the index lost 5 percent. On October 19, 1987, the Dow Jones stock index crashed by 22.6 percent. This collapse was even stronger than the stock market crash of October 28, 1929, which marked the beginning of the Great Depression. One possible explanation for the collapse are computer trading programs used by traders. These programs took into account market dynamics and issued purchase orders, in case if the market promised growth, or issued sales orders in case if the market declined. And as soon as these programs computed a sharp change in market dynamics the programs issued a massive order to dump shares. There was no recession neither in the US economy, nor in other countries like Australia, Canada, Hong Kong that experienced the collapse of 1987. The very next day, the Dow Jones index rose 12 percent, then there were slight fluctuations. The crisis affected mostly those people who worked in the financial sector. In America, about 15 thousand brokers, traders, etc. lost their jobs. Dow Jones reached its former heights only in 1989.

**6. Asian Financial Crisis, 1997-1998.** In July 1997, the Asian financial crisis erupted. The reason is the rapid collapse of national currencies and stock indices in the countries of Southeast Asia, provoked by overheating of the economy, as well as excessive government and corporate debts. Countries like Indonesia, South Korea and Thailand were most affected by the crisis. Before the crisis, Thailand, Indonesia, the Philippines, Malaysia and Singapore collected more than half of global investment. But in the mid-90s in the United States, in order to keep inflation, monetary authorities raise the refinancing rate. Southeast Asian

countries also raise their own rates to strengthen Asian currency, after this the competitiveness of products on the world market fell due to cost increase. At the same time, the corporate and state debt of Asian countries continued to grow rapidly. On May 14, 1997, currency speculators from Quantum to Tiger Management Corp attack Thai Baht, that collapsed on July 2. During the month, there was a collapse of the Indonesian rupee, the Philippine Peso and the Malaysian Ringgit. In Indonesia, the crisis led to riots and a change in state regime. South Korea had also been hit hard. The International Monetary Fund has allocated more than \$ 110 billion to overcome the effects of the crisis on Southeast Asia. Southeast Asian national economies overcame crisis and resumed growth by 2001.

**7. The Dotcom crash 2000-2003.** Recession caused by the massive investment of money in Internet projects. Monetization and withdrawal schemes were imperfect and showed their inefficiency. This event greatly influenced the relationship between IT and the economy as a whole. The Dotcom bubble existed from 1995 to 2001. The climax occurred on March 10, 2000, when the NASDAQ index reached 5132.52 points (daytime peak) during bidding and fell more than one and a half times at closing. The bubble was formed as a result of the take-off of shares of Internet companies (mainly American), as well as the emergence of a large number of new Internet companies and the reorientation of old companies to Internet business at the end of the 20th century. The shares of the companies offering the Internet as a platform to generate income fabulously increased in a price. numerous commentators and economists justified such a high prices as they believed that the "new economy" has come, in fact, these new business models have been ineffective, and funds spent mainly on advertising and large loans, led to a wave of bankruptcies, and sharp drop of the NASDAQ. The Dotcom collapse was about the loss of confidence in the securities of high-tech firms related to the provision of services via the Internet. It caused the third largest bankruptcy in US history.

**8. The Great Recession, 2008-2012.** The global financial crisis began on September 15, 2008 with the collapse of one of the most important banks of the United States Lehman Brothers. The onset of the crisis is associated with a number of factors: general cyclical economic development; overheating of the credit market and the mortgage crisis resulting from it; high commodity prices (including oil); stock market overheating.

The precursor to the global financial crisis of 2008 was the crisis in the United States, which began in 2006 with the collapse of the mortgage market. By August 2007, the crisis had spread to Europe. The world system began to experience a shortage of liquidity. September 15th, the sixth largest investment bank in the United States Lehman Brothers declared it's insolvency, that became a signal for the fall of stock quotes including world exchanges. In September 2008, a powerful wave of bankruptcies spread from the United States to Europe. A number of European banks were partially nationalised, or received massive government assistance. The global economy instantly responded to crisis processes in the US economy. There was a reduction in exports of the BRIC countries to the EU and the USA, export of investment goods to China and India decreases. There were a drop in world industrial production by 10-35%, an increase of unemployment by 6-15% (an average of 10%), most countries did not escape the growth of the state budget deficit to 10% of GDP. In the global economy, the global financial and economic crisis of 2008-2009, for the first time in history, required the joint action of the G20 governments and monetary authorities.

## IMPACT OF THE GLOBAL FINANCIAL CRISIS ON INDIA

### Impact on India

- India could not insulate itself from the adverse developments in international financial markets despite having a banking and financial system that had little to do with investments in subprime mortgage whose failure had set off the chain of events causes global crisis.
- Economic growth declared in 2008-9 to 6.7 percent. This represented a decline of 2.1 percent from the average growth rate of 8.8 percent in the previous 5 years.

### Impact on real estate

- In India one of the crisis is in the real estate. The crisis will hit the Indian real estate sector sector hard. The sector is witnessing a slump in demand because of the global economic slowdown.

- The recession has forced the real estate players to restrict their expansion plans. Many on-going real estate projects are suffering due to lack of capital investment from foreign investors.
- The rising interest rates which can lead to the inability of mortgage payments. Moreover if banks start investing into risky financial products as it was the case before the global crisis 2008, the financial system could collapse quickly. Also, Trump's tax reform plan plays its part in this development. As a result of the plan American households cannot take advantage of the mortgage interest deduction which could influence the net income this may lead to a decline in consumption and saving.
- Another point that critics emphasize is the possibility of an inversion of the US Treasury yield curve this means that the short term interest yields are higher than the long term interest yields which implies that investors are assuming the short-term investment environment is riskier than the long-term one. Before the recessions of 2008, 2000, 1991, 1981 the yield curve inverted which makes this variable as a strong indicator of economic health.

### **Impact on stock market**

- The financial crisis affected the stock markets even in India prospect of economic slowdown have pulled down the stocks market.
- Foreign institutional investors pulled near around \$11 billion from India dragging the capital market down with stock prices have fallen by 60%

### **Impact on India's export**

- With the US and several European countries slipping under the full blown recession Indian exports ran into difficult times.
- Manufacturing sectors like leather, textile, gems and jewelry have been hit hard because of the slump in the demand in the US and Europe Indian export fell by 9.9% in November 2008.
- When the impact of declining consumer demand in the US and other major global market with negative growth for the second month running and widening monthly trade deficit over \$10 billions.

### **Impact on market**

- The global financial crisis affected virtually of all areas including the process of globalization. Housing prices crashed fore closures became commonplace unemployment reached 10% in the US and higher levels in Europe and elsewhere manufacturing declined sharply especially in the automotive industry students were faced with higher costs as colleges suffered financial losses, finding jobs after college became more challenging a global recession created widespread hardships, On the other hand many developing countries that took a prudent approaches to finance and saved money were not as badly damaged. In five countries that did not fully embrace be financial liberalization were less affected than those that gave in to American pressure to fully engage in financial globalization. We also saw a global power shift with the US losing ground to China, India, Brazil and other developing countries.

### **CONCLUSION**

Unfortunately, modern economic science cannot accurately predict the onset of an economic crisis, but to assess its probability is quite real. The economy is cyclical, but from all economic cycles from the practical point of view, the medium-term is now the most interesting, which is also called the Juglar cycle, it usually lasts 7-12 years. There are several signs of the imminent onset of another global economic crisis. For example:

1. Recurrence. If seven to 12 years have passed from the previous crisis, then this is itself an occasion for cautious investors to reduce risky positions and withdraw capital into protective assets.
2. Slowdown of economic growth. The economy is growing more slowly in the USA, in Europe, especially in the European Union, Germany, Russia, and even China. Naturally, the global economic growth rate is also falling.

3. Less of confidence in tomorrow's day. The indicators that directly or indirectly characterize the confidence of economic entities in further economic growth are falling: PMI (Purchasing Managers Index), selling investment goods and durable goods. Firms in anticipation of the crisis are keen not to start large new investment projects and are actively completing the projects they have begun, especially in construction sector.

4. Drop of money market indicators. For example, inversion between short-term (two years) and long-term (ten years) US government securities. Normally, the yield on long-term securities is higher. If the yield on short-term securities is higher, then there is a clear sign that investors are waiting for a crisis. This rule has worked well over the past three decades.

5. Debt overload. The crisis of 2008 was overcome not due to the bankruptcy of insolvent businesses (which would be right), but due to the huge infusion of money into the economy. The result is strong growth in both corporate and public debt in developed countries. The symptoms of the crisis were removed, but its strategic reasons remained largely.

6. Contradictions generated by globalization. The transfer of production from developed countries to developing countries, mainly to Asia, allowed developed countries to significantly reduce consumer inflation, which pleased the population, but had to pay with a negative trade balance. And the most obvious result of this discontent is the trade war and the increase of customs duties. It effectively slows down international trade, and after that the economic growth.

All these reasons are strong arguments in favor of a radical review of their portfolios for most reasonable investors. It makes sense to reduce risky instruments, for example primary stocks and vice versa it makes sense to increase conservative and currency instruments. Avoiding of risky assets towards low-risk foreign exchange - it worked well before 1998 and before 2008, and it can be quite good these days.

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