

WORLD FINANCIAL CRISIS1

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Introduction

The financial crisis from 2007- 2008 that can still be noticed in the world is considered to be the worst financial crisis since the Great Depression of the 1930s by the researchers and several economists. It was basically started by the visible deficit in the financial sectors of the United States and led the fall down of huge financial foundations, the bailout of banks governments, and recession in stock markets approximately all over the world. The failure of U.S. real estate market is worsened in 2006 and this caused the standard securities fixed to U.S. real estate costs to fall which ultimately damaged the financial sectors worldwide (Bates, 2009). This factor affected the economic conditions all over the world and the economy delayed during this stage. Not only United States, but all other countries suffered as the credit had tightened and there was a downturn in the international trade.

Causes

There have been numerous reasons that can be stated for the occurrence and busting of the economic bubble that ultimately led to the implosion of the financial markets all over the world. But there remains less doubt about the fact that US being the strongest economy of the world continues to be the epicentre of all the monetary and other economic activities that influence the functioning and operation of the global markets all over the world. It was during

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the arrival and invasion of this meltdown when one of the officials of a famous multinational said that '*when US sneeze the entire world suffers from the flu disease*'(Cooper, 2008).

US diplomatic methodology altered considerably which was reflective the way George W. Bush, at that time, confronted the whole world by saying 'either you are with us or you are with the terrorists'. The statement was within itself a sheer demonstration of the most coercive form of diplomacy witnessed. The image and perception regarding Muslims that was established within the minds of Americans was further cemented by the subsequent invasion of Afghanistan in order to eliminate the Taliban and Al-Qaeda.

A prominent result at intra-American level was the start of a slow and steady economic meltdown of the US economy. It was reported by mainstream American press that during the time of Iraq invasion in 2003 President Bush released a military package of \$80 billion from the Congress to initiate the military operation in Iraq. After this, the compensation of all this was received by imposing back-breaking taxes upon people of the country who were forced to act submissively in such circumstances.

The entire scenario has played a pivotal role in crumbling the economic foundations of capitalism upon which the financial institutions of the country stand upon. Hefty percentage of back-breaking taxes fuelled public resentment for the government and in order to provide fleeting relief, the government decided to raise the living standard of people through a poorly and hurriedly managed scheme of mortgaging property which busted in the form of collapse of organizations like Lehmann Brothers and globally established banks like Citigroup, HSBC and AIG. All these collectively led to the worst economic crisis and market crash of the US market that imposed its effects on the entire global economy in the form of massive unemployment,

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plummeting prices and eroding consumer credibility (Liang, 2012). Governments and banks act with extraordinary fiscal incentives as a response, monetary policy increase and institutional bailouts.

The deflation of assets gave way to the credit crunch, which turned into an absolute panic. To leverage each company chooses to sell. Any company that did business in a structured manner chooses to sell any risk. The guarantee funds that try to keep pace with the trend in prices also choose to sell. The case in point is that only the Federal Reserve buys. It is definitely a cause for concern and provides an answer to the question as to why recession could not be prevented.

The situation was terribly easy to analyse, and almost impossible to correct. However, in the last quarter of 2007 that ended on 31stDecember 2007, the total amount of money those banks had lent increased by 7.6% compared to the previous four months. The total number of securities held by banks had increased even more. This in itself would seem a contradiction. Unfortunately, the explanation is not easy, but fortunately is short.

To increase their profits, banks in the world - but especially in America - lent money on long term basis, paying debt with short term contracts (Clemmitt, 2008). The banks kept the partial ownership of these creations, and received a share of their profits. The subsidiaries were being carefully and cleverly hidden to the public and remained outside the audits of the banks themselves. The market had refused to give funds to these subsidiaries: once deprived of their financial oxygen, they risked collapse. In turn, the banks which were linked with a dilemma of difficult solution: thought that we should have supported these orphaned creatures, or let them fail? Both instances had occurred, but in general the banks held up their creations. This is why

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the loans granted by banks had increased so rapidly, despite the main lubricant of economic growth - credit - continued to be denied to common tasks. Among the 40 most important banks, representing about 85% of the overall system, only 7 or 8 were functioning normally. All the others had simply stopped their run, waiting to come to terms with this immediate and undeniable huge problem.

Given this, first the United States and then the whole world was directed toward a recession that would logically be much heavier and deep rooted. The collapse of housing system triggered the recession. The crisis was further expanded everywhere, prices shed even in the Midwest that had never experienced a bubble.

The housing collapse was enough to create a recession (Turner, 2008). The effects on real residential investment on health, consumption and employment, was much higher than those caused by the collapse of the technology sector in the 2001 recession. The real estate sector had directly and indirectly, for about 30 percent of employment growth in this period of expansion, including employment in retail and manufacturing of consumer products. In 2007, consumers spent about 200 billion dollar, money taken from so-called mass guarantee of their property value. With the decline in real estate, labour and lost wages in this sector was reflected in the rest of the economy. This is to emphasize that consumers were already suffering from these harmful effects escalating a major and more disastrous recession in 2007 which was heavier and more prolonged as compared to 2001.

The financial crisis resulted from the accumulation and dissemination of questionable credit in the entire financial system. It was the product of different financial stages and banking deregulation since 1980 that enabled the mixing of trades finance and uncontrollable

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development of financial innovation and securitization and a movement of short-term capital without limit. It was aggravated by new accounting rules (mark to market). It translated into uncertainty about the solvency of institutions and a deterioration of their general position.

This recession could not be prevented without the fundamental reform of the banking system certainly involving the return of state ownership of some banks, a strict separation between the businesses of banking and credit market, and a regulation of financial innovation and capital movements.

Efforts for Recovery

The subprime crisis erupted in the second half of 2006 with the crash of real estate loans (mortgages) at risk, as borrowers, often modest conditions, stopped to pay (Bardhan, 2008). Revealed to the world in February 2007, it had really turned into a global financial crisis from the summer of 2007. The non-payment of funds by individuals was provided by the banks but not to the magnitude it took. Especially since all these risky loans were made "safe" through securitization making allowances for banks to comply with the prudential rules. Each investor acquired a kind of asset portfolio securitized, on the basis of future cash flows of the assets that guaranteed the repayment of bonds.

In 2006, a total emission of securitization in Europe was €452 billion against 78 billion in 2000. The subprime crisis of August 2007 had highlighted some excesses in the use of real estate securitization. It has blamed the poor quality of securitized assets, poor liquidity in these securities, the work of rating agencies and the very principle of securitization that did not always have a clear vision of borrowers' situations (themselves misidentified) and actual risks taken.

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It is true that governments have acted aggressively in late 2008 and early 2009 to keep the banking system afloat and support the faltering economy with massive public spending plans. The activity in the housing sector has increased. Household spending was stabilized, but remain sealed by job losses, weak income growth, the depreciated value of houses and the smaller credit. Companies continue to cut investment and staff, but at a slower pace. In contrast, the stimulus and stimulation also support economic activity.

In theory, economies should take the path of growth, after passing through the hollow of 2008 and 2009. Therefore, central banks were more interested to counter inflationary pressures, leading to an increase in interest rates. Already, Australia's central bank began raising interest rates. In Canada, the Central Bank has pledged to keep rates at a low level until mid-2010. United States; the monetary authorities keep a finger on the trigger and waiting for a sign of accelerating inflation to start a movement of raising interest rates (Alfaro & Chen, 2012). This could negatively affect the recovery. Moreover, U.S. monetary authorities want to see banks raise their capital with a call for greater private saving. The Fed wants banks to increase their provisions before increasing their loans, so they are better equipped to deal with loan defaults still possible. Meanwhile, the volume of loans contracts, which could dampen the recovery.

In China, the plan of \$586 billion stimulus package centred on infrastructure investment in order to better serve the export industries and make the most of the recipe that made the success of recent years. The development of domestic consumption in emerging countries is emerging as the most promising alternative. But the governments of these countries have no stimulus plan to propose to this end. The economic recovery in these regions may run out of fuel. In addition, it is feared the speculation on commodities, starting with oil, when the pace of industrial activity will accelerate. Such an eventuality would also threaten the recovery. Finally,

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as the U.S. consumer is battered, should be another engine to pull back or new products due to technological advances, new markets, or something else. Nothing seems to break on this side. This is what compels a majority of observers and analysts to say that the recovery will be long and laborious.

The liquidity crisis due to loss of credibility of authorities in treatment of the financial crisis in the period from 15 September to 28 September was characterized by an almost total retention of cash by the players holding and the collapse of the interbank market in the short term. This situation resulted from a radical uncertainty about the economic environment that generated an absolute preference for liquidity. It threatened the entire banking and financial firms. It unfortunately could not be treated with strong policies that ensure financial commitments and guarantee continuity of payments.

Europe was experiencing its own real estate bubble, and several Member States, as Americans developed subprime, especially, Spain, the United Kingdom, Ireland and Sweden. Delinquencies have also risen sharply in the United Kingdom. The European Central Bank's mission is to protect price stability, and thus to control inflation that it must not exceed 2%. For this, it is on its rate, it generally seeks to maintain the highest possible, to limit the creation of money and thus inflation. Indeed, high interest rates, loans by commercial banks were scarce; gold lending, banks created money, which supplies the money.

At that time, the European Central Bank (ECB) puts all its energy to curb inflation, according to its mandate. It has reason to fear that inflation, which was already high, would increase in Europe, especially because of the high prices of oil and other raw materials. To do

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this it has a policy of strong rate. Its rate, then 4%, increases by a quarter point 3 on July 2008, thereby taking the market by surprise (Jagadeesh, 2009).

Although the policy proved effective against inflation, this policy carries with it negative effects, for governments which stifled the growth potential of the euro area at high interest rates, loans by commercial banks were scarce, that can seize business activity that can benefit. The rate also helped to maintain a strong euro penalizes European exports - it peaked on July 15, 2008: one euro is worth more than 1, 6 dollars (Roubini, 2010).

The financial crisis that shook the economies of major industrialized countries, has so far relatively unscathed emerging countries. In the "BRIC" (Brazil, Russia, India and China), the growth shows no signs of slowing marked. Remains very high, particularly in China where it flirts with the 10%.

Economists are unanimous in saying that we cannot stop a crisis of such magnitude acting solely on liquidity that is to say by injecting money into the financial system worldwide to enable banks to finance. Any regulation of the global financial system needs to be rethought.

The debate centres on a few key ideas: the removal of areas of non-regulation in the financial sector, the implementation of strict rules for rating agencies that assess the credit risk enterprises (methodology, transparency, etc.). easing of international accounting standards, based on the value of plan assets, which have exacerbated the effects of the crisis, the replacement of a G20 G7 involving emerging countries, even help the global economy out of the crisis thanks to their excess liquidity, in Europe the establishment of a European banking supervision modelled on the European system of central banks and supervisors interacting with other world etc.

But for now, we must find a solution to the crisis. There are two schools of thought. One advocates the pooling of losses through the implementation of systems defeasance giants, who will absorb losses. The other relies on a crisis management case by case, depending on the risk posed by a bank for the overall stability of the financial system.

An important factor that needs to be considered regarding the future prospects that are being eyed in context of devising through which the crisis can be weathered and controlled effectually is through properly managed procedure of outsourcing. It is basically the outsourcing phenomenon through which the crisis can be managed. In the post-recession scenario it is basically the Asian economies like India and China who are flexing their muscles to reignite their economic engines at light speed, but most of these economies are still overwhelmingly dependent on the income that is being generated through their sustenance on Western economies. The economic position of Asian economies like Malaysia and Taiwan are not that self-sufficient or sustainable to dictate the principles of recovery. Many economic experts also believe that in order to fill this gulf of sustainability China and India long ago started and implemented the policy of embedding their massive labour force in globally established corporations and multinationals all over the world. With the passage of time and especially in the contemporary scenario the cheap availability of Chinese and Indian labour force has turned into the most precious asset for people in United States and United Kingdom where people are already exasperated by the looming levels of inflation. In such times introduction of Chinese and Indian companies can help in fostering greater employment opportunities in multitude sectors (Gabe, 2010).

Conclusion

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There had been many reasons due to which the economic meltdown of 2007 – 2008 was occurred. An immediate reason demonstrating a rather symbiotic relation with this and which facilitated and catalysed this entire process to the brink of an obliterating ignition and consequent explosion was the real estate bubble that busted resulting in the unprecedented slump of property prices, erosion of consumer credibility, shelving of key projects and most of all the insolvency of many mortgage companies.

The entire journey in this case from riches to rags and booms to bust moves along with the events that the US was engineering in the world. As the war against terrorism in the world underwent expansion from Afghanistan to Iraq and the military expenditures began to surge at an astronomical rate, it became necessary for the US to provide relief to its people in the form of initiating realty projects for them in order to commence a venture and a full-fledged program through which an improvement in their living standard can be facilitated. It was in the midst of this venture that loans were distributed to people especially from middle class and average financial standing like hot cakes. It was during this time that economists were constantly informing about the dangers of a worldwide recession that can spark as a result of this indifference and non-regulatory policies being carried out in the real estate sector but these concerns were not provided adequate heed.

Many of the leading economists that were involved in the advocacy of the government appalling policies failed to realize the fact that the failure or crash of the market because of the housing agency would have compound effects which would ultimately manifest itself in the form of a Frankenstein monster. Things were not very different in different places of the world also. In Dubai, for instance, the realty boom was reaching its apogee in the form of the construction of sky scraping and tallest buildings of the world. Billions of dollars were being pumped from

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investors and real estate tycoons from all over the world which they viewed as a realty haven. In addition to this other places of the country like Ajman and Ras Al Khaimah also attracted a number of investors from all over the world. Inducing the rampantly taking place change other Gulf countries also decided to exercise similar policies and devised legislations that proved to be amiable and pro-investment for global investors, and then one day it happened as abruptly as it could have taken place.

Leading mortgage companies defaulted, many corporations ended in the state of total bankruptcy thus posing a serious threat to the maintenance of the pillars that were now showing rapid signs of erosion. Investors' credibility corroded, prices plummeted steeply and all pending projects were shelved because of capital shortage. All major financial corporations' stock market shares nosedived and were hence dependent on government bailouts and stimulus packages. All this collectively converged in leading and creating an extremely dismal and deteriorating economic picture through which it was the normal people who was most affected.

In order to fight back, central banks were more interested to counter inflationary pressures, leading to an increase in interest rates. Such recession could not be prevented without the fundamental reform of the banking system certainly involving the return of state ownership of some banks, a strict separation between the businesses of banking and credit market, and a regulation of financial innovation and capital movements.

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