A Study on Global Financial Crisis and Its Impact in India

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Abstract: The recent global financial crisis has had a significant impact on economies across the world. The purpose of this study is to investigate the origins, effects, and mitigation strategies of global financial crises. The goal of the study is to improve our comprehension of the underlying causes and dissemination mechanisms of financial crises via the examination of historical case studies and analysis of existing literature. The study will investigate several triggers for financial crises, including as excessive risk-taking, weak regulatory systems, and macroeconomic imbalances. The study will look into the systematic effects of financial crises, including economic downturns, unemployment, and social unrest.

1. Introduction

Due to post-war influences, real GDP grew quickly during the 1960s (the post-World War II era), which led to low unemployment rates, higher inflation rates, and increases in asset prices. As a result, there was a protracted era of decline, fear, and political and economic turbulence. Newspaper headlines were rife with information about inflation, recession, unemployment, depression, bankruptcies, losses in business, declines in finances, and the financial and economic standing of enterprises, all of which demanded immediate attention from the public and government.

The global financial crisis (GFC), commonly referred to as the "great recession," is basically a prolonged period of stress within the banking and financial sectors that results in a significant decline in value. GFC started sometime between the middle of 2007 and beginning of 2009. It is a situation that closely mimics panic and compels investors to sell off their holdings while also requiring them to withdraw cash because of the asset's decline in value. In the end, this led to a freeze in the credit markets. The global recession that resulted in extensive company downsizing, an increase in unemployment, and decreased tax revenues for governments is slowly beginning to come to an end. GFC contributes higher quality assurance in manufacturing efficiency among employees. The crisis began with borrowing and lending money in a negligent manner that resulted in the increase of prices of housing which is fuelled demand, careless spending, investment in assets with risk of loss which led to a collapse of the economy.

2. Objectives

- It helps to know how it contributes in ensuring monetary stability.
- It aids in avoiding leverage and accelerating growth.
- It makes simpler for financial funds to move internationally for trading and investment purposes.
- To lay out the causes of Global Financial Crisis.

3. HISTORY OF GLOBAL FINANCIAL CRISIS

Stocks of US technology companies were soaring in 1996, driving up interest rates on the stock market. There was a stock market bubble that burst between 2000 and 2002, resulting in a dramatic drop in stock prices and a subsequent outflow of investor capital. The US interest rate has decreased to just 1% by 2001. As a result of that, the individuals were searching for profitable investment options. As bank loans at the time had low interest rates, even the US government encouraged people to buy homes during that time when real estate interest rates were rising. This way the demand for houses and rate for properties were increasing. Instead of stock markets, investors opted to invest in real estate. They could make an enormous amount of money this way. Even investment banks sought to benefit from this increase in real estate prices.

Investment banks started acquiring loans from banks and pooling a number of those loans to form a complex derivative product. It was referred to as a Collateral Debt Obligation (CDO). The credit rating for these CDO was obtained by the investment banks from Credit Rating Agencies (CRA), and these investment banks would offer those CDO to investors with a credit rating of AAA (the highest rating). As soon as investors realised the CDO had a AAA rating, their interest in them increased. 70% of CDO were given AAA rating. Now because there was no assurance that the borrowers would return the loans, even the banks started to give home loans to those individuals. Sub-prime loans are known as low quality loans. The banks used to provide these sub-prime loans in order to increase loan sales and commissions. From 2000 through 2007, Amerequest Mortgage Company and Countrywide Financial Corporation began offering subprime loans.

Investment banks earned profit after selling CDOs for millions of dollars. Investment banks and credit rating companies both benefited as a result. According to data given by Moody's, the largest credit rating agency in the US, during the period 2000–2007, earnings were about 4 times that amount ($36 trillion). Additionally, the largest insurance business in the world, American International Group (AIG), began offering insurance on these CDOs. Investors ultimately purchased these financial derivatives as a kind of loss protection. This eventually led to more people purchasing real estate. Initial bank interest rates were modest, but they subsequently started to rise. Both the banks and the sub-prime borrowers were unaware of the unexpected increase in interest rates. Loan default and payback followed as a result of this.

Banks started selling investor's houses to recover its money back. The reason why this occurred was because the banks was giving loans without proper checking, inspection and understanding of the borrower's capability. Most of the borrowers did not

have regular income. These very reasons led to the global financial crisis which caused total abrupt to the entire economic system throughout the world including India

Due to India's banking system's poor economic integration, we were able to absorb significant harm done to other regions of the world. The banks were undoubtedly unaffected, although this mild effect only persisted during the early stages. The second stage of the global financial crisis, which India was unable to avoid, created an emergency. Trade rates, exchange trends, and the banking industry were all impacted by three aspects of the global financial crisis in India. Multiple factors contributed to the collapse of India's gross domestic output to a subrange by 2008–2009, which resulted in an inversion of capital inflows.

In order to strengthen our financial situation, the Indian government and Reserve Bank of India devised plans and strategies that once again used strong countercyclical measures to sustain domestic interest. In any case, this study argues that in order to restore Indian GDP growth to its likely rate of 8 to 9 percent, measures should focus on satisfying the key prerequisites that discourage private venture interest due to the country's extremely restricted financial mobility and the weak grounding of money-related strategy.

India was compelled to implement several changes in response to the crisis brought on by the balance of payments at the beginning of the 1990s. Changes in exchange, interest, and speculative activity are some examples. By assisting in removing the disconnect the Indian economy had with the global economy, business, and innovation sectors, these improvements genuinely revolutionised and reformed the economy.

Every bank must be ready to handle loan losses. The bank determines the projected loan loss and maintains a matching provision to counteract this credit risk. When a provision is recorded, the bank expects to suffer a loss on the loan. The banks use their capital to cover these misfortunes: By making a reservation, the bank incurs losses, forfeits money it cannot recover from the customer, and sees a reduction in its funding. The RBI's rule for a greater provisioning requirement for business bank loans to the real estate area stopped the demand-driven, speculative-fuelled, excessive spending-fuelled rise in housing prices that would have caused them to collapse. A housing bubble often starts with a rise in demand in the face of a constrained supply, which takes some time to refill and increase.

This is one of a few numbers of circumstances where a national bank needs countercyclical capital overall. To ensure that the macroeconomic context in which banks operate is taken into consideration when calculating their capital requirements, the countercyclical capital buffer was created. The main purpose is to employ a capital buffer to help accomplish the broader macroprudential goal of preventing times of excessive banking sector-wide aggregate credit expansion, which have been associated with the build-up of systemic risk.

In general, subprime lending had less of an impact on Indian banks. For the most part, only ICICI Bank, one of the more carefully guarded regional banks, was found. Nevertheless, it devised a strategy to avert a catastrophe because of safe spaces for its sheet and supportive acts done by the public authority, which effectively guaranteed its stores. The total balance sheet of the banking sector has not changed. In actuality, Indian banks reported good results in the second to last quarter of FY2008, which was a nightmare for many major financial institutions around the world. Despite an absolute fall in the profitability of non-financial corporate enterprises, the banking sector recorded a 43% gain in profitability.

The RBI's strict supervision of acceptable lending criteria and banning of complicated arrangements like synthetic securitization also served to assure a greater quality of banking assets.

4. Literature Review:

1. *"Global Financial Crisis and Its Impact on India's Growth" by Subho Mukher*

The review, "Worldwide Monetary Emergency and Its Effect on India's Development," by Subho Mukher provides an analysis of what the global financial crisis means for India's monetary development. Mukher emphasises that while the emergency had a negative impact on many countries, including India, it did so less severely than on a few high-level economies. The study looks at how the crisis affected India in a variety of ways, including a decline in exports, a reduction in capital flows, and a slowdown in domestic demand. The estimates of the plan the Indian government and the Hold Bank of India tried to implement to lessen the consequences of the emergency and encourage financial development are also covered by Mukher. In general, the paper clarifies the unique difficulties India encountered during the global financial crisis and the solutions that were implemented.

2. *"The Global Financial Crisis: Impact on Asia and Emerging Consensus" by Ruiz Brunschwig, Sonia Carrasco, Bruno Haysashi, Tadateru Mukhopadhyay and Hiranya published on February 2011*

The authors talk about how the situation spread to Asia through channels like lower exports, decreased money flows, and disruptions in the financial markets. When describing how the crisis affected Asian economies, they place emphasis on the relevance of financial and trade links. The authors emphasise the importance of both domestic and international cooperation efforts in reducing the effects of the crisis and fostering Asian financial recovery. The assessment includes the emerging consensus regarding strategy measures to investigate and recover from the emergency and provides an overview of Asia's effect on the global crisis.

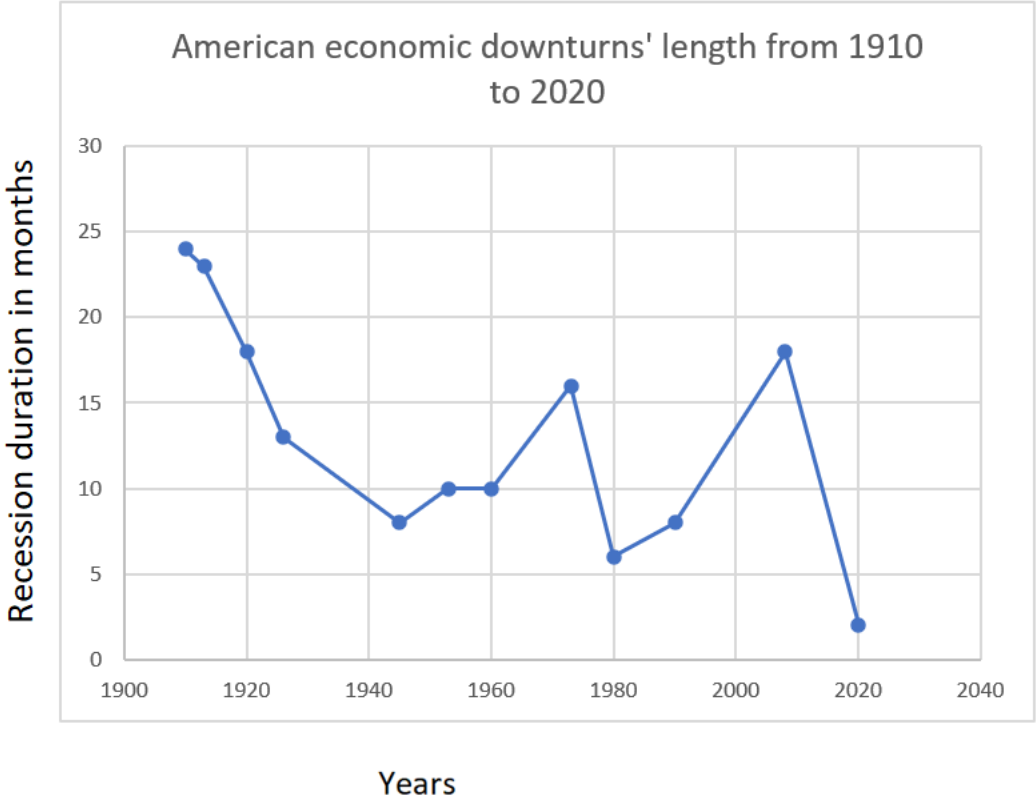
3. *"Understanding Financial Crises: Causes, Consequences, and Policy Responses" by Stijn Claessens, M. AyhanKose, Luc Laeven, and Fabián Valencia published on 2013*

The report emphasises how serious financial crises' effects are on the economy and society. It talks about how financial crises cause economic downturns, elevated unemployment, decreased investment, and a drop in standard of living. The report also discusses the domestic and international financial crises' ripple effects, highlighting how they can spread via worldwide financial markets.

Regarding policy responses, the report offers information on the steps that decision-makers can take to address and lessen the effects of financial crises. It focuses on the value of proactive and well-coordinated policy initiatives, such as monetary, fiscal,

and financial sector policies. In the financial sector, the report emphasises the need for strong regulatory frameworks, efficient oversight, greater risk management, and increased transparency and disclosure.

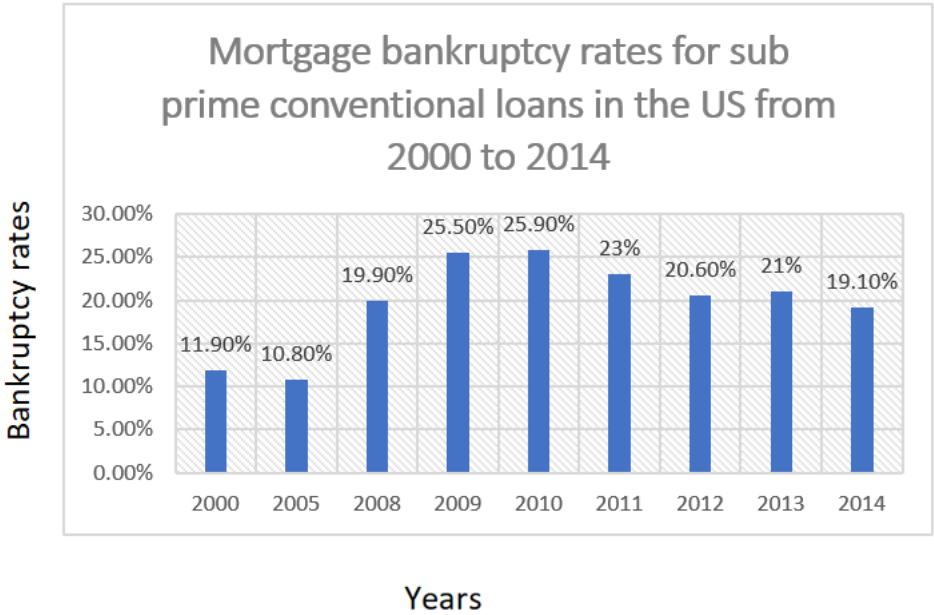
5. Data analysis:



The above data shows the recession period from the year 1910-2022.

The recession happened due to various reasons. In the year 1910-20 speculative markets led to the crash in the stock markets causing recession in the economy. Followed by 1920-40 there was a tight monetary policy adopted by the central bank of America (stock market crack of 1929) and led to great depression and decrease in severity.

1. In the year 1940-60 federal reserve increased the interest rate from 1.75% to 4% and tightened the monetary policies.
2. In the year 1960-1980 there was an oil crisis and an attempt to close the budget deficit of the Vietnam war (fiscal tightening).
3. In the year 1980-2000 interest rates increase led to collapse of dot com bubble, the combination of banks unable to provide funds to businesses and homeowners paying down debt rather than borrowing and spending.
4. In the year 2000-2022 AI was introduced where it took most of the jobs leading to unemployment and covid 19 had a huge impact causing inflation.



The percentage of subprime conventional loans borrowed overall from 2000 to 2014 is shown in the graph above.

We can see from the graph that 11.90% of people purchased subprime loans in the year 2000. Later in 2005, there was a 1.1% decline. This demonstrates the investors' lack of interest. The year 2008 shows a subsequent increase of 9.1%. The bankruptcy rates increased from 5.6 to 6% in the fiscal year 2009–2010. Eventually, in 2011, it dropped to 2.9%. Later, as a result of people's lack of interest and the investment banks' failure to inform them of the higher interest rates, it started to decline daily.

6. **Findings:**

1) Following the crisis, the global economy revived gradually, with several nations experiencing protracted periods of weak development.
2) The worldwide economic downturn significantly impacted household wealth and widened income inequality in many nations.
3) Researchers continue to dig into the reasons behind the crisis and its effects, concentrating on macroeconomic modelling, risk management, and the function of financial institutions.
4) Financial institutions gave loans to people with bad credit (subprime borrowers), which led to an increase in mortgage arrears and foreclosures.
5) The crisis was brought on by the bursting of the U.S. housing bubble, which resulted in a sharp drop in property prices and an increase in mortgage default rates.

7. Suggestions:

a. Before offering subprime loans, lending institutions and investment banks must thoroughly investigate the backgrounds of the investors. Due to this, debt repayment and default rates increased.
b. The banks need to have alerted loan debtors in advance of the interest rate rise. This might have lightened the load on loan debtors.
c. Examine if regulatory changes made in the wake of the global financial crisis have been successful in promoting financial stability.

8. Conclusion:

The Worldwide Monetary Emergency, which occurred in 2008, was a significant event throughout modern finance's history. It uncovered the worldwide monetary framework's profound defects and weaknesses, bringing about serious worldwide financial outcomes. This emergency serves as a clear reminder of how interconnected and delicate the global economy is. The United States housing bubble burst and major financial institutions collapsed prior to the crisis's onset. The all over use of confusing financial instruments and dangerous crediting practices exacerbated the situation, achieving an infection influence that spread across borders. Businesses and individuals faced enormous challenges as financial sectors seized up, credit disappeared, and the economy crashed.

The worldwide monetary emergency had expansive impacts. There was a severe downturn in many economies, which resulted in lower jobless rates and slower growth of gross domestic product. In order to bring their economies into balance and prevent future crises, states implemented extensive boost measures and administrative changes. Central banks used unconventional monetary policies like quantitative easing to support financial institutions and add liquidity to the system.

Additionally, the crisis demonstrated the greater than ever need for international cooperation and coordination in financial regulation. Systemic risks were reduced, early warning and crisis management mechanisms were established, and financial market transparency and oversight were enhanced. The Basel III design was familiar with strengthen banks' capital and liquidity necessities, hoping to make a more grounded monetary region.

Even though significant progress has been made in mitigating the effects of the emergency, there are still obstacles. The global economy continues to be impacted by financial shocks, and emerging risks like the effects of climate change and rapidly evolving technology require attention. Financial regulations are being tightened up, risk management techniques are getting better, and inclusive, sustainable economic growth is being encouraged.

All in all, the global financial crisis was an essential occasion that uncovered central defects in the framework. It brought about significant shifts and reshaped the global money scene. Policymakers, regulators, and market participants all need to remain vigilant and collaborate in order to ensure a more resilient and equitable global economy and avoid future crises.

9. Reference:

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