# A QUICK OVERVIEW ABOUT THE CURRENT FINANCIAL CRISIS EFFECTS

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**Abstract**

*The global financial crisis is considered by many economists to be the worst financial crisis since the Great Depression of the 1930s. It is really started to show its effects in the middle of 2007 and into 2008. Around the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems.*

***Keywords*****:** *financial crisis, unemployment, banking sector, Lehman brothers collapse, emerging markets*

## 1 INTRODUCTION

This paper contains in the first chapter primarily on the global financial crisis of 2008, which will be divided into three subchapters. The first one discusses the credit crunch problem caused by liquidity crisis. The second subchapter explains the subprime crisis and housing bubble, as many home owners who had taken out sub-prime loans found they were unable to meet their mortgage repayments. The last one shows how the EU suffered from the financial crisis witch pitched the EU economy into recession-the deepest, longest, broadest-based recession in its history. In 2009, GDP may fall by approximately 4% in both the EU and euro area. The paper also contains in the second chapter the development of banking sector which suffered a profound and traumatic shock in September 2008 when US investment bank Lehman Brothers collapsed. This chapter divided into five subchapters as follows:

global shifts in banking

focus on emerging markets

economic growth

bouncing back

unemployment

In the end there is a conclusion refers to the impact of the financial crisis on the global economy as a whole, and recommends the procedures that must be taken to avoid such crisis again.

## 2 GLOBAL FINANCIAL CRISIS 2008

### 2.1 The credit crunch

The global financial crisis (GFC) is commonly believed to have begun in July 2007 with the credit crunch, when a loss of confidence by US investors in the value of subprime mortgages caused a liquidity crisis. This, in turn, resulted in the US Federal Bank injecting a large amount of capital into financial markets. By September 2008, the crisis had worsened as stock markets around the globe crashed and became highly volatile. Consumer confidence hit rock bottom as everyone tightened their belts in fear of what could lie ahead.

### 2.2 The sub-prime crisis and housing bubble

The housing market in the United States suffered greatly as many home owners who had taken out sub-prime loans found they were unable to meet their mortgage repayments. As the value of homes plummeted, the borrowers found themselves with negative equity. With a large number of borrowers defaulting on loans, banks were faced with a situation where the repossessed house and land was worth less on today's market than the bank had loaned out originally. The banks had a liquidity crisis on their hands, and giving and obtaining loans became increasingly difficult as the fallout from the sub-prime lending bubble burst. This is commonly referred to as the credit crunch.

Although the housing collapse in the United States is commonly referred to as the trigger for the global financial crisis, some experts who have examined the events over the past few years, and indeed even politicians in the United States, may believe that the financial system was needed better regulation to discourage unscrupulous lending.

The collapse of Lehman Brothers on September 14, 2008 marked the beginning of a new phase in the global financial crisis. Governments around the world struggled to rescue giant financial institutions as the fallout from the housing and stock market collapse worsened. Many financial institutions continued to face serious liquidity issues. The U.S. government proposed a $700 billion rescue plan. By September and October of 2008, people began investing heavily in gold, bonds and US dollar or Euro currency as it was seen as a safer alternative to the ailing housing or stock market.

What began as a relatively localized issue in the United States has had a massive flow-on effect worldwide, and it is still not known how long it will take for the world economies to recover.

### 2.3 EU suffering

In the summer of 2007, a long period of rapid credit growth, low risk premiums, abundant liquidity, strong leveraging and soaring asset prices across the globe came to an end. Many of the drivers of the expansion went into reverse and, following the fall of Lehman brothers, the availability of credit from the financial sector shrank abruptly. Economic conditions elsewhere in the economy inevitably deteriorated, culminating in a sharp contraction of global economic activity in the last quarter of 2008. This pitched the EU economy into recession-the deepest, longest, broadest-based recession in its history. In 2009, GDP may fall by approximately 4% in both the EU and euro area. In addition, the crisis is estimated to have a long lasting effect on the level of potential output and may also reduce potential growth in the future.

## 3 DEVELOPMENT OF BANKING SECTOR

The global financial system suffered a profound and traumatic shock in September 2008 when US investment bank Lehman Brothers collapsed. As market players withdrew from the financial system credit dried up and world trade collapsed, there was a real and immediate fear that the world was heading for a repeat of the Great Depression of the 1930s. Two years on and there is growing optimism that both the world economy and the banking industry are recovering from the impact of the financial crisis. But it is equally clear that the financial world has changed permanently, both in terms of who holds the balance of power within global industry and how banks will be allowed to operate in future.

### 3.1 Global shifts in banking

While the growing power of emerging markets is a long-term structural phenomenon, it has accelerated in the banking industry thanks as much to the relative decline of the west as to expansion in the east. There has been a pronounced shift from west to east – and, to some extent, from north to south – in the wake of the crisis. Banks on both sides of the Atlantic are expected to have written down more than $2.1trn of assets by the end of 2010, according to the International Monetary Fund. The equivalent figure for Asian banks is just $115bn. Banks in emerging markets are now well capitalized and well funded and big enough to be able to compete directly against their western counterparts in the global marketplace. The two largest banks by market capitalization are both Chinese – ICBC and China Construction Bank. Although third place is taken by a British bank, HSBC, it is largely an Asian operation. The Citi, the world’s largest bank, comes in at fifth, while banks from Brazil, Russia and India – the other members of the BRIC grouping alongside China – are all in the top 25.

Stephen Green, Group Chairman of HSBC, referred to this trend just a month after the collapse of Lehman, when he said there was a long-term shift towards Asia and the Middle East. ‘It is this shift that will affect financial markets most profoundly,’ he told a global financial summit in Dubai. ‘The rapid growth of emerging markets does not signal an absolute decline in the economies of mature nations. The pie will grow. But it does entail a loss of share – the developed world will have a smaller share of a larger pie. The rise of China is the most obvious feature of this shift. China's banking market is dominated by the 'big four' state owned commercial banks, of which three are listed on the Shanghai stock market.

### 3.2 Focus on emerging markets

In India, there was no financial crisis,' says K.R. Muthu Manickam, Vice-President of Finance at HDFC Bank in India. Andrew Lockhart, Head of the Banking and Finance Group at Baker and McKenzie Hong Kong, says Chinese banks were far more insulated than their western counterparts both in terms of direct exposure and in the impact on their share price. 'At the time when there was almost paralysis in the global banking lending market, the Chinese banks were still doing transactions,' he says. These sentiments are echoed in other emerging markets. Alfred Ramosedi, Managing Director of Nedbank Private Bank, part of South Africa's fourth largest bank, says: 'Banks here did not get hit by the financial crisis'. The impact of the credit crunch and on these emerging market banks was largely psychological, with many emerging market banks using the crisis as an opportunity to re-evaluate their growth plans, risk management principles and governance. Looking ahead, banks in emerging markets have a greater potential for growth because of the relatively immature development of their domestic financial markets. Consultancy firm McKinsey estimates that 2.2 billion out of the 2.5 billion people globally who do not use a bank live in Africa, Asia, Latin America and the Middle East. This offers huge potential for expansion based on innovations such as mobile phone banking and microfinance lending. As Noel Gordon, a consultant at Accenture, told The Economist, while western banks were 'fiddling with rocket-science finance', emerging market banks were innovating more productively. Even more significant is the rise of the middle class across emerging markets and a consequent increased demand for credit. As wage levels increase in industrializing countries, demand for mortgages and consumer loans for cars and household appliances is likely to increase. Furthermore, emerging market banks are well placed to exploit the marked revival in growth. According to the World Bank, developing countries will enjoy annual economic growth of 6% over the next three years, compared with 2.2- 2.6% in the OECD area. As businesses find new market opportunities they will need access to corporate finance, which will open up markets for bond and share issues. Giles Keating, Head of Global Research at Credit Suisse, says some Asian banks, which are already strong and very large but domestic focused, are likely to play a much larger role in intermediating capital flows at the global level. 'If we look ahead five years or so, the total number of major banks operating at scale on a truly global basis may be similar to that of before the crisis, but these banks are likely to be more evenly spread around the world, with the US and Europe no longer so dominant,' he says. He believes they are likely to be accompanied by rapid growth in a number of second tier banks in emerging markets around the world, active in intermediating flows into their fast growing home markets. Given their strong liquidity and high capital adequacy ratios, some analysts say these emerging market banks are now in a stronger position than their western counterparts. Chinese banks are starting to lend money to European companies for business transactions taking place solely in Europe. 'Banks in Asia have taken the opportunity to diversify and expand their business in an environment where they have enjoyed a competitive advantage', says Lockhart.

### 3.3 Economic growth

Before financial crisis Global economies growth is 5.2% at 2007 and drops significantly to 0.6% at 2009. Forecast for 2011 of Global economies growth is only 4.3% and it means Global economies growth is still below the number before the financial crisis.

**Table 1 GDP growth, percent change from one year earlier**

| Growth in percent | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| Global economies | 5.2 | 3.0 | 0.6 | 4.2 | 4.3 |
| Advanced economies | - | 0.5 | -3.2 | 2.3 | - |
| Emerging and Developing economies | - | 6.1 | 2.4 | 6.3 | - |

### 3.4 Bouncing back

Emerging markets survived the Great Recession better and recovered from it faster than advanced economies. (See Fig 1) (M .Ayhan kose and Eswar s. Prasad, Finance and Development, December 2010, vol.47. no 4 )

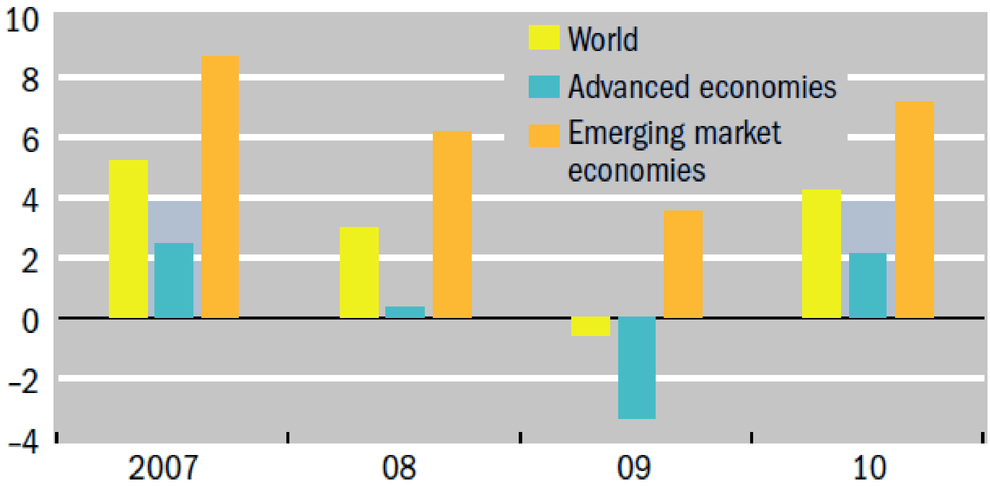


**Figure 1 Bouncing back**

### 3.5 Unemployment

The world faces an unemployment crisis. Across the globe, an estimated 210 million people are unemployed, an increase of more than 30 million since 2007. Three-fourths of this increase has occurred in the advanced economies.

(Tab. 2) clarifies the unemployment rates during the crisis and the recovery period for selected countries.

**Table 2 Unemployment Rate (% of Labor Force)**

| Unemployment Rate (% of Labor Force) | 2008 | 2009 | 2010 |
|---|---|---|---|
| Advanced economic | 5.778 | 7.977 | 8.253 |
| Brazil | 7.9 | 8.1 | 6.7 |
| Canada | 6.15 | 8.292 | 7.992 |
| China | 4.2 | 4.3 | 4.1 |
| Czech republic | 4.392 | 6.662 | 7.279 |
| Euro area | 7.56 | 9.458 | 9.983 |
| France | 7.817 | 9.5 | 9.734 |
| Germany | 7.3 | 7.492 | 6.858 |
| Greece | 7.683 | 9.375 | 12.458 |
| Italy | 6.75 | 7.817 | 8.492 |
| Japan | 3.987 | 5.073 | 5.058 |
| Netherlands | 2.75 | 3.404 | 4.467 |
| Russia | 6.4 | 8.4 | 7.5 |
| Slovakia | 9.575 | 12.05 | 14.375 |
| Spain | 11.327 | 18.01 | 20.065 |
| United kingdom | 5.551 | 7.453 | 7.841 |
| USA | 5.8 | 9.275 | 9.633 |
| World average | 4.09 | 4.79 | 4.82 |

Source: Economywatch.com

## 4 CONCLUSION

Financial crisis has had a most significant effect on the global economy as a whole. Where we note a decline in global economic development by mid-2008 and increased sharply in 2009 and then returned to recover during 2010, although he did not reach pre-crisis level, the world economic development recorded a modest but steady recovery in most advanced economies and strong growth in many emerging and developing economies.

The current financial and economic crisis is a classic bust of a credit boom, the boom having been fueled by policies whose combined effects were to increase the demand for debt to unsustainable levels.

U.S. monetary policy, taxation policy, and home ownership promotion policy were so conducive to credit expansion that the idea, understandably popular in Washington and Brussels, that preventing future such crises can be accomplished simply by waking up regulators "asleep at the switch" is dangerously simplistic. The United States in particular, given that it effectively sets monetary and credit conditions for a significant portion of the global economy, needs to put in place policies that can better discourage, recognize, and curtail a credit boom, and ensure that systemically important financial institutions can withstand its unwinding.

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