FINANCE
VERTICAL

STUDYING FINANCIAL CRISIS

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2008 Global Financial Crisis: An Overview

The global financial crisis of 2007-2008, often referred to as the "Great Recession," was a severe worldwide economic crisis that had its roots in the United States housing market. Here's a brief case study of the crisis:
- The crisis was triggered by the bursting of the housing bubble in the United States, which was fueled by a combination of factors including subprime mortgages (high-risk loans to borrowers with poor credit), low interest rates, and a housing market speculation boom. - Financial institutions had bundled these risky mortgages into complex financial products called mortgage-backed securities (MBS) and collateralized debt obligations (CDOs), which were sold to investors worldwide.

Key Events

Housing Market Collapse: As housing prices began to decline in 2006, many homeowners found themselves unable to make mortgage payments, leading to a surge in mortgage defaults and foreclosures.

Financial Institution Failures: The exposure of major financial institutions to these toxic mortgage-backed securities led to concerns about their solvency. Lehman Brothers, a prominent investment bank, filed for bankruptcy in September 2008, sending shockwaves through the global financial system.

Credit Freeze: The fear of exposure to bad debt caused banks to stop lending to one another, resulting in a freezing of credit markets. This lack of liquidity severely impacted businesses and consumers who relied on credit for day-to-day operations and investments.

Stock Market Decline: Stock markets around the world experienced sharp declines as investor confidence plummeted.

Government Interventions: Governments and central banks intervened to stabilize the financial system. The U.S. government implemented the Troubled Asset Relief Program (TARP) to inject capital into struggling banks and provided guarantees for money market funds.

Impacts of Crisis: Globally

Macro Level:

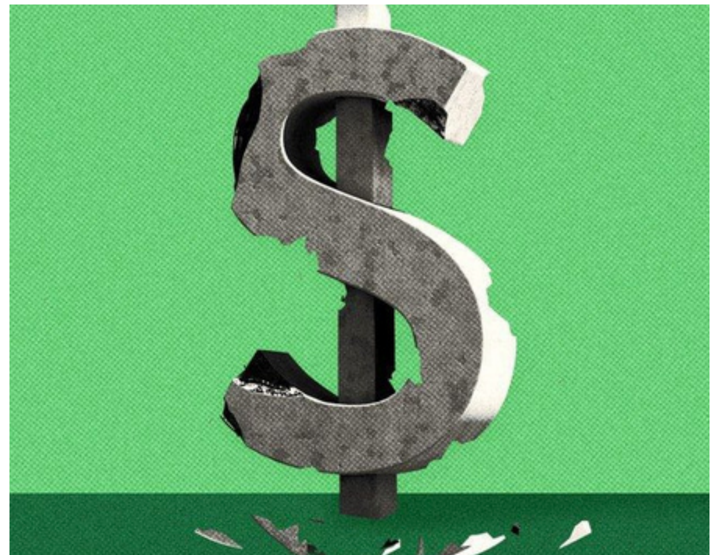
After the 2008 financial crisis, advanced countries implemented various policies to mitigate its impact on their economies. European countries like Italy, Spain, and Greece implemented austerity measures to reduce their budget deficits. Central banks injected significant liquidity into the capital market to prevent a collapse similar to the 1930s Great Depression. The crisis led to declining GDP, increased public debt, and rising borrowing costs, while households experienced financial insecurity due to job loss, reduced salaries, and falling house prices. Unemployment increased to 9%, while exports dropped by 20% and stock market prices decreased by about 45%.

US Households Net Assets worth Decline:

The 2007 subprime mortgage loan crisis significantly impacted the US economy and people, leading to a significant decrease in the average net value of US citizens from $126,300 to $77,400 between 2007 and 2010. This decline was largely due to a decrease in home prices, which had not stopped since the housing bubble burst in 2007. The average net worth of US families dropped by about 40%, wiping out savings of most households for about 16 years. The average wages also decreased, affecting the income of the working class. However, the net worth of the top 10% of the rich class increased from $.18 million to $1.20 million between 2007 and 2010. The decline in income led to over 46 million
people seeking food stamps, costing the US government $75.7 billion in 2011. Half of these were small children whose parents had no money to feed them properly.

Unrest in Middle Class:

Declining incomes and net worth have angered ordinary people in the US and Europe, sparking protests demanding an end to capitalism and a fair distribution of income. Activists formed groups in Europe and the United States, leading to the "Reclaim the Dream Conference" in Washington. They believe that high corruption fails to fail the US economy and the corruption system threatens the economic improvement of ordinary citizens.



Globally Violent Protests:

'In US' ,Protesters occupied the Park in New York City, demanding the end of exploitation, income inequality, and job provision. The protest was against the growing inequality and concentration of wealth, and the dominance of Wall Street brokers in the national economy and politics. The New York Administration instructed the protestors to vacate the park due to security issues for those working in the New York Stock Exchange building. Despite the New York Police Chief's warnings, hundreds of protestors were arrested, with most being arrested under the law of trespassing. The protest campaign spread to other US cities, including Oakland and Chicago. There were other countries as well who did protest such as Spain, Italy and Germany.

Impacts on India:

India's economy faced challenges in 2008-09 due to the subprime mortgage crisis, which led to a global crisis. Economic growth fell by 2.1% to 6.7%, with GDP growth per population of 4.6%. The crisis intensified and spread to developing countries, creating a supply-demand imbalance in the foreign exchange market. The Indian government responded with fiscal stimulus packages, increasing the fiscal deficit from 2.7% to 6.2% of GDP. The RBI is the most important political interest rates marking the state of exchange of contraction.

Timeline of the Events

Figure 1 and Figure 2 depict the US financial crisis timelines, highlighting key events such as the spike in subprime mortgage delinquencies, the Troubled Asset Relief Program, and the American Recovery and Reinvestment Act of 2009. The timelines are divided into two parts, labeled "September 1" and "October 1," and emphasize the seriousness and urgency of the situation. The color scheme is muted, emphasizing the importance of the events and the gravity of the situation. Both timelines convey a sense of urgency and instability as financial institutions collapsed.

Figure 1 Shows

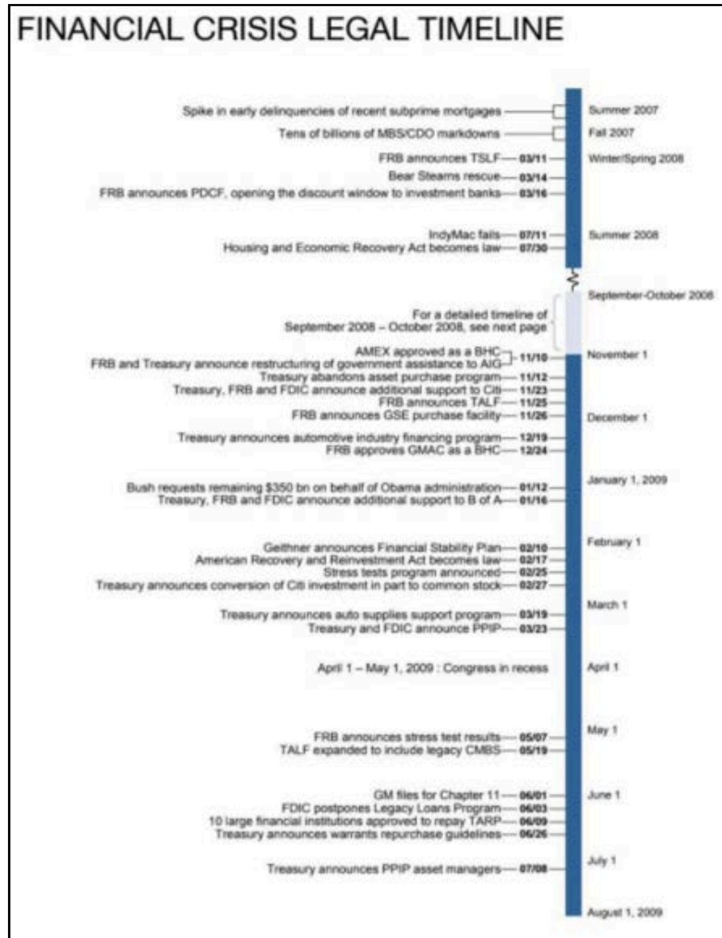
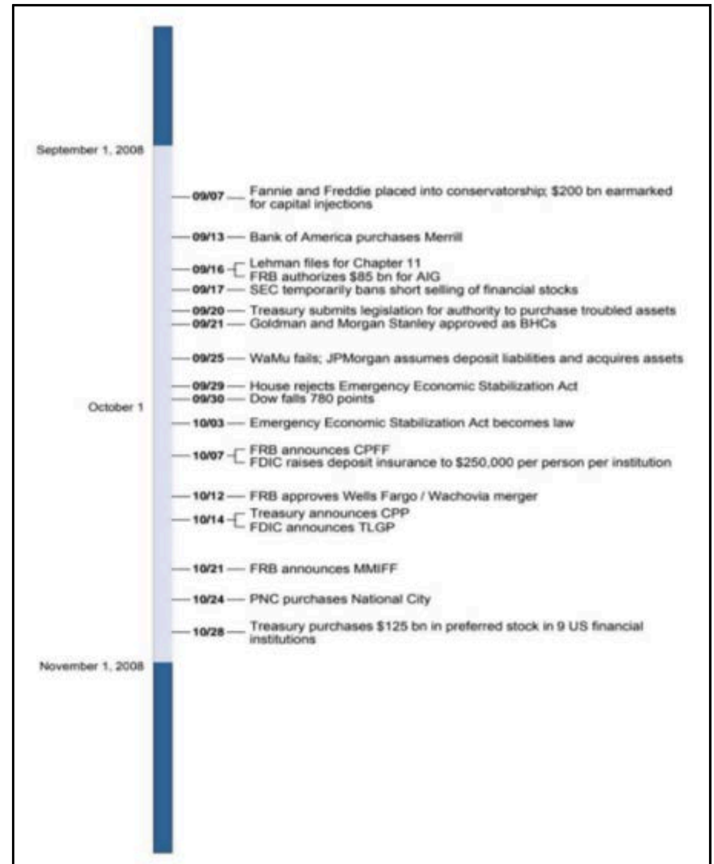


Figure 2 Shows



Government Policies

The 2008 global financial crisis had a significant impact on the world economy, including India, although its effects were not as severe compared to some Western countries. The Indian government's response was a combination of monetary and fiscal measures to safeguard the economy from the crisis. Here are the key policies implemented by the Indian government:

Monetary Policy Measures by the Reserve Bank of India (RBI):

- Reduction in Interest Rates: The RBI significantly reduced key interest rates to infuse liquidity into the financial system and boost credit availability.

The repo rate, which is the rate at which banks borrow from the central bank, was reduced from 9% in July 2008 to 4.75% by April 2009 . The reverse repo rate, at which banks park excess funds with the RBI, was also reduced to encourage lending.

- Reduction in Cash Reserve Ratio (CRR): To further improve liquidity, the RBI cut the CRR from 9% in August 2008 to 5% by January 2009 . This measure released substantial funds into the banking system, allowing banks to lend more freely.
- Special Liquidity Facilities: The RBI introduced various liquidity facilities, such as special refinance facilities for banks and non-banking financial companies (NBFCs), to ensure that there was sufficient liquidity for sectors like mutual funds and NBFCs, which were severely impacted by the crisis .

Fiscal Policy Measures by the Government:

- Stimulus Packages: The government of India announced three fiscal stimulus packages between December 2008 and March 2009, amounting to approximately ₹1.86 lakh crore (around 3.5% of GDP at that time) . These packages focused on increasing public expenditure in infrastructure projects, reducing excise duties, and providing tax reliefs to stimulate demand.
- Increase in Public Investment: As part of the stimulus, the government increased public investment in sectors such as infrastructure, rural development, and education to boost employment and domestic consumption. Investments in projects like the National Rural Employment Guarantee Scheme (NREGA) were scaled up .
- Support for Export Sector: To support the export sector, which was hit hard by the global recession, the government introduced measures like interest subvention (interest rate subsidies) on export finance and increased the duty drawback rates (rebate of duties on export goods) to make Indian exports more competitive in global markets .
- Relaxation of Foreign Direct Investment (FDI) Norms: The government liberalized FDI norms in various sectors, including telecom, insurance, and retail, to attract more foreign capital. This helped provide much-needed liquidity and increased investor confidence in the Indian economy .

Impact and Outcome:

These coordinated efforts helped stabilize the Indian economy and limited the adverse effects of the global recession. India's GDP growth, which had slowed to 6.7% in 2008-09 from 9% in 2007-08, started to recover in the following years and reached 8.4% in 2009-10. Although India was not immune to the global financial crisis, the swift policy response of the government and the Reserve Bank of India helped mitigate the impact and allowed the economy to recover faster than in many other countries. Protect yourself from the worst effects of the financial crisis.

Comparison with Other crisis

The 1991 Indian economic crisis was a significant turning point in India's economic history. It marked a period of severe economic turmoil that compelled the Indian government to undertake far-reaching economic reforms. Here's an overview of the crisis:

Background:

- In the late 1980s and early 1990s, India was facing multiple economic challenges, including high fiscal deficits, balance of payments problems, and stagnant growth.

- The country was heavily reliant on foreign loans to finance its deficits, leading to a mounting external debt burden.

Triggers:

- Balance of Payments Crisis: A balance of payments crisis emerged due to the combination of high import bills, declining export growth, and reduced foreign exchange reserves. India was struggling to meet its external obligations.
- Currency Depreciation: The Indian rupee came under pressure, leading to its depreciation against major foreign currencies.

Key Events:

- Liberalization and Reforms: In response to the crisis, the Indian government, under Prime Minister P.V. Narasimha Rao and Finance Minister Dr. Manmohan Singh, initiated a series of economic reforms in 1991.
- LPG Reforms: The reforms were often referred to as the "LPG" reforms, standing for Liberalization, Privatization, and Globalization. They aimed to liberalize the economy from decades of strict government control and open up to global trade and investment.
- Devaluation of Rupee: As part of the reforms, the Indian rupee was devalued to improve export competitiveness and reduce the trade deficit.
- Trade and Investment: The government eased trade restrictions, reduced import tariffs, and encouraged foreign direct investment (FDI) to boost economic growth.
- Industrial and Financial Sector Reforms: Industrial licensing requirements were relaxed, and the financial sector underwent significant changes to encourage competition and efficiency.

Consequences:

- The reforms led to a transformation of India's economic landscape. They helped accelerate economic growth, boost industrial productivity, and attract foreign investment.

- India's GDP growth rate, which had been hovering around 3-4% prior to the reforms, saw a significant uptick in the following years.

Long-Term Impact:

- The 1991 crisis and subsequent reforms marked a shift away from the planned economy model towards a more market-oriented approach.

- The reforms laid the foundation for India's economic growth in the following decades, contributing to the country's emergence as a global economic player.

The 1991 Indian economic crisis served as a wake-up call that prompted the government to recognize the need for drastic economic changes. The reforms undertaken during this period had a profound and lasting impact on India's economy, steering it towards a path of liberalization, privatization, and globalization.

1997 Asian Financial Crisis:

The 1997 Asian financial crisis began in Thailand and quickly spread across Southeast Asia, leading to the collapse of currencies, stock markets, and economic output. India remained relatively unaffected due to its limited financial integration with East Asia at the time and prudent capital controls. The Indian rupee did not undergo the massive devaluations seen in Southeast Asia, though India's export growth slowed.

Key Differences:

Currency Stability: In the 1997 crisis, the rupee remained relatively stable, while during the 2008 crisis, it depreciated sharply due to capital outflows.

Capital Controls: India's capital controls in 1997 limited the inflow of short-term capital, preventing the type of speculative attacks seen in Southeast Asia.

COVID-19 Economic Shock (2020)

The COVID-19 pandemic led to one of the worst economic contractions globally and in India since independence. In 2020, India's GDP contracted by 7.3% compared to the 2008 crisis's milder impact on GDP. Unlike the financial contagion of 2008, COVID-19 caused supply chain disruptions, widespread job losses, and a collapse in domestic demand due to lockdowns.

Key Differences:

Supply vs. Demand Shock: COVID-19 was a supply-side and demand-side shock, with restrictions on production and movement. The 2008 crisis was more of a financial sector issue.

Contraction Severity: The contraction in 2020 was sharper, highlighting the pandemic's extensive reach across all sectors, compared to the selective impact of 2008 on banking and exports.

Conclusion: Lessons Learned from 2008 Crisis

Strong Regulatory Framework: The RBI's conservative policies and regulation of financial institutions helped insulate India from the worst effects of the crisis.

Diversified Economy: India's relatively large domestic consumption base acted as a buffer during the global slowdown.

Global Interdependence: The crisis revealed India's increasing integration with global markets, especially in terms of capital flows and exports.

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Introduction

One of the questions I ask my parents most often is: how did their lives change after 1991? They often pause to reflect on a time when India was on the brink of economic collapse. The economic crisis of 1991 is not only a turning point for India, but a reminder of what happens when financial systems collapse under pressure. There was a time when financial crises were not just stories from the outside, but a harsh reality for millions of people in the country.

But what exactly is a financial crisis? Simply put, a financial crisis is a time when the financial system, built on trust and stability, begins to collapse. Prices collapse, institutions fail and panic spreads, affecting everyone from the wealthiest investors to ordinary workers. These crises often arise from deep cracks in the financial structure, and their consequences can cripple economies and societies for decades to come.

What Causes a Financial Crisis?

A sudden breakdown of trust in financial institutions that have operated smoothly for so long is typically triggered by a combination of factors. Key triggers include excessive debt, risky lending practices, or speculative bubbles where asset prices—like housing or stocks are driven far beyond their true value. When these bubbles burst or debt becomes unsustainable, banks and institutions face losses, leading to a loss of confidence in the financial system and panic or a bank run during which investors sell off assets or withdraw money from savings accounts because they fear that the value of those assets will drop if they remain in a financial institution.

Why are Financial Crises So Significant?

The study by Carmen Reinhart and Kenneth Rogoff, published in This Time Is Different, notes that the world has faced 147 banking crises since 1970. The IMF notes that the average output loss during the first year of a financial crisis is about 6.5% of GDP, and that it usually takes eight years for GDP per capita to return to pre-crisis levels. As global connections have deepened, the impact of these crises has increased, often resulting in significant losses for ordinary citizens. Therefore, it is essential to study the financial mistakes of the past to build a moreresilient financial system to prevent future crises..

Lessons From The Past

The Great Depression (1929-1939)

The Great Depression stands as one of the longest and deepest economic downturns in modern history, lasting from August 1929 for nearly a decade. Imagine a time when families, once secure and thriving, suddenly faced empty kitchens and lost jobs. Millions struggled to make ends meet, experiencing firsthand the harsh reality of economic collapse.

Causes

Multiple factors contributed to this crisis, with the 1929 stock market crash often highlighted. A significant reduction in the money supply, overproduction during the "Roaring '20s", and subsequent declines in spending led to widespread bankruptcies and defaults. As incomes fell, banks faced liquidity crises, prompting a wave of consumer withdrawals.

Impact

The Great Depression had a profound impact, shrinking the U.S. economy by nearly a third and driving unemployment to 25% by 1933. Millions faced poverty and hunger as 7,000 banks failed, eroding public trust in financial institutions.

Lessons

The Great Depression illustrated the critical roles that money, banks, and the stock market play in the economy. Many countries abandoned the Gold standard, embraced regional trade blocs, and increased government intervention through fiscal policies, paving the way for the rise of Keynesian economics.

Balance of Payments in India (1991)

Thinking back to the question I often ask my parents about how life changed after 1991, the financial crisis during that time played a pivotal role in ushering India's economic reforms. It also set the stage for a new era of growth and global integration.

Causes

In 1991, India faced a severe financial crisis due to high government spending, subsidies, and a trade imbalance, with imports exceeding exports. The fiscal deficit reached 8.4% of GDP,
and the current account deficit hit 3.1%, leaving the country with only two weeks' worth of oil imports in foreign reserves.

Impacts

To address the crisis, the Indian government sought an emergency loan from the IMF, pledging 67 tons of gold as collateral and agreeing to implement economic reforms. This led to the Liberalization, Privatization, and Globalization (LPG) policies, which spurred GDP growth to 5.3% in 1992-93, compared to a decline of 1.1% in 1991. Foreign reserves also increased significantly, reaching $20 billion in a few years.

Lessons

The 1991 crisis highlighted the need for sound fiscal management and the importance of opening up the economy to reforms that could enhance growth and stability. Now, all thanks to the LPG policies, I need not take a flight to the U.S., everytime I crave McDonald's—who knew that a financial crisis would eventually lead to such convenience?

Balance of Payments in India (1991)

Asian economies emerged as attractive investment destinations in the '90s but soon faced a severe financial crisis that even affected countries in Latin America and Eastern Europe.

Causes

This increase in foreign investment, combined with the lack of policies and institutions, especially the protection of the financial sector, led to an overvaluation of stocks. International investors underestimated the risks, seeking higher returns at a time when investment opportunities appeared less profitable in Europe and Japan, due to those countries' weak economic growth and low interest rates. The lack of effectiveness in the implementation of reforms in these countries has also led to an increase in consumer panic and economic losses..

Impacts

To address the crisis, the IMF provided $36 billion to help Indonesia, Korea, and Thailand, a part of nearly $100 billion in international support. India was less impacted due to its relatively closed economy and stable monetary policies, which helped keep confidence in its financial markets.

Lessons

The crisis showed the failures of financial institutions in East Asia and emphasised the need for strong policies and regulations to avoid risky speculation and maintain economic stability.

Global Financial Crisis (2008)

As they say in *The Big Short*, "It's like a giant game of musical chairs, and there are not enough chairs." The Global Financial Crisis of 2007-2008 illustrated this perfectly.

Causes

The crisis began with a housing bubble in the United States, where rising housing prices led to risky lending. Many people try to take advantage of the resale of houses, and banks lend to subprime borrowers, those who are more likely to default. This weakness in lending, combined with fierce competition between banks, created a dangerous situation. When the housing bubble burst, many borrowers could no longer repay their loans, leading to widespread defaults.

Impacts

On September 15, 2008, Lehman Brothers, a major financial services company, filed for bankruptcy, the largest bankruptcy in US history and a pivotal moment in the global financial crisis, causing panic and a sell-off. massive in the markets. Advanced economies experienced their worst recession since the Great Depression, which led to the loss of millions of jobs. In contrast, India's banking sector remained largely unscathed due to its limited exposure to risky foreign investment, although the crisis was felt through financial markets, trade and exchange rates. ICICI Bank, the only Indian bank directly affected, managed to stay afloat thanks to strong finances and government support.

Lessons

The crisis highlighted the importance of sound lending practices and strict oversight of financial institutions. It showed how interconnected global markets are and the need for better risk management to prevent future financial disasters.

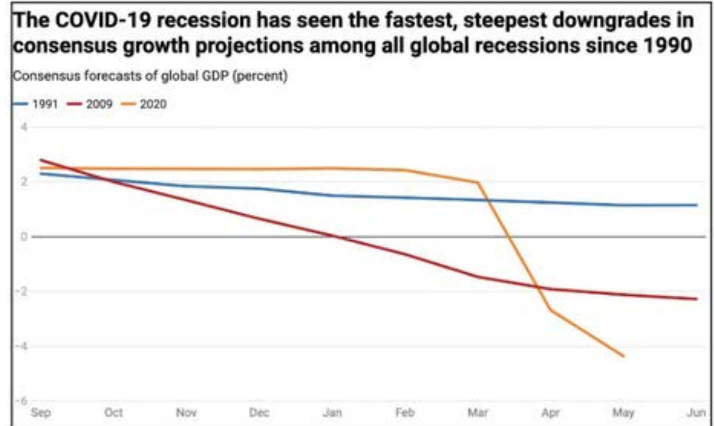
Turbulence Today: An Overview

Having reviewed the lessons from the past, it's crucial that we apply these insights to evaluate the current situation. The current global economy faces significant challenges, including aftershocks from the COVID-19 pandemic, the ongoing Russia-Ukraine war, and escalating global debt. These factors contribute to rampant inflation and a looming recession, particularly affecting emerging markets with unsustainable debt. As crises are interconnected, their impacts are on a global scale.

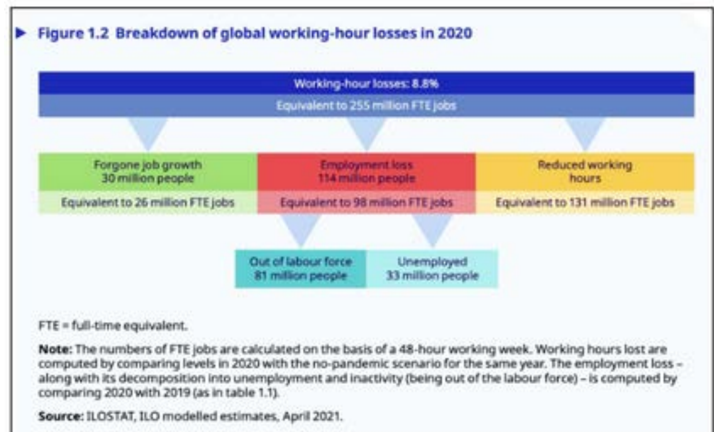
Fallout from the Virus (2020 - Present)

The COVID-19 pandemic created the largest contagious global recession since the Great Depression across economies worldwide.

- *Global GDP Impact:* The global economy contracted by 3.1% in 2020, resulting in the largest single global economic contraction in 70 years. Despite some resuming economic recovery beginning in 2021, a full return to economic stability has certainly not returned. According to the World Bank, global growth reached only 2.4% growth in 2022, as inflation increased and supply chains remained disturbed.



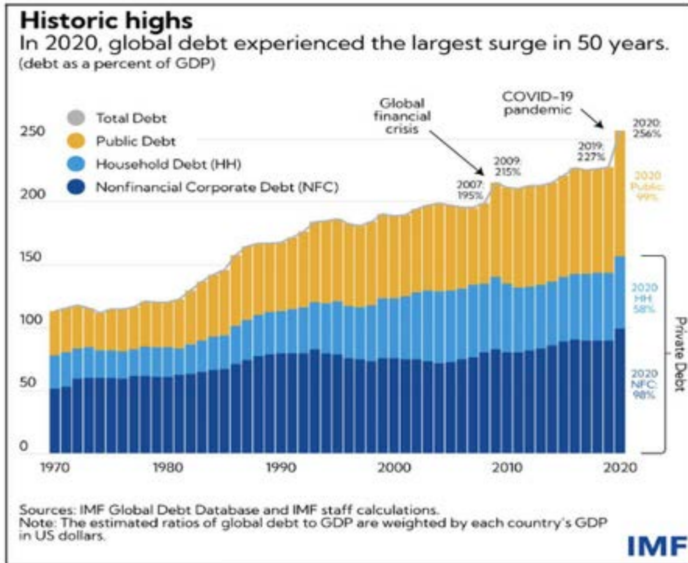
- *Unemployment:* The International Labour Organization (ILO) estimated there was a loss of 114 million jobs in 2020. Furthermore, loss of income was estimated at $3.7 trillion. Unemployment rates remain volatile, especially in Latin America, where joblessness remains high.

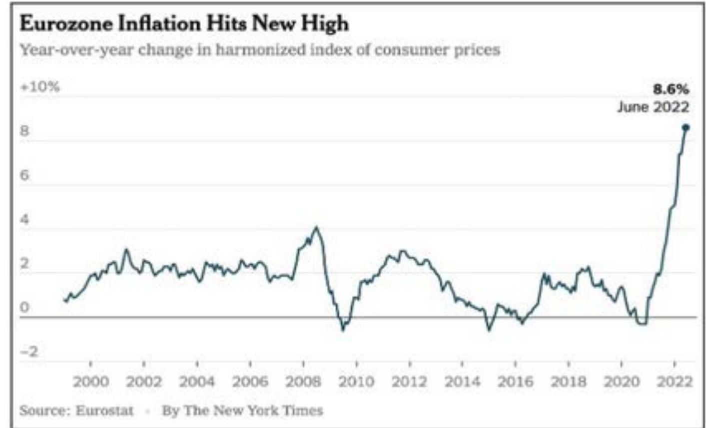


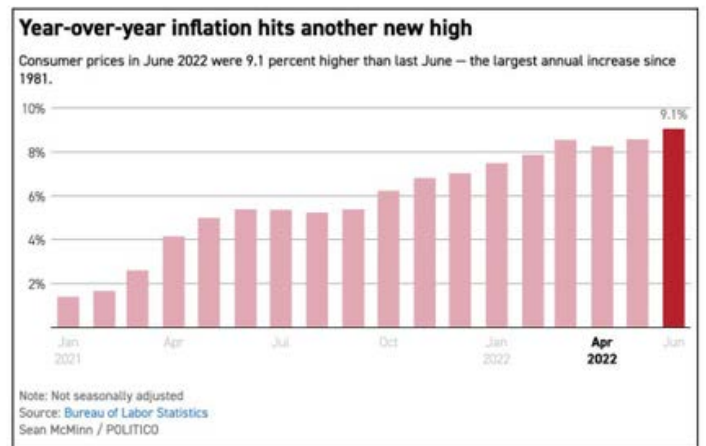
- *Supply Chain Changes:* The pandemic brought light to weaknesses in global supply chains and certainly highlighted resource commodities upon further inspection, especially in crucial sectors such as electronics, and medical supplies. Even today, the shipping sector is constrained with bottlenecks, spikes in prices, globally strained supply, and delayed deliveries which continue to impact the efficiency of economies.

- *Public Debt:* Global spending decreased as many economies took on debt at "unprecedented levels." By October 2020, global debt growth surged, reaching over $226 trillion, about 256% of global GDP, according to the IMF.

While we hoped for some recovery and stabilisation in the world economy, inflation continues to create challenges. It is thus creating doubts regarding our earlier optimism.





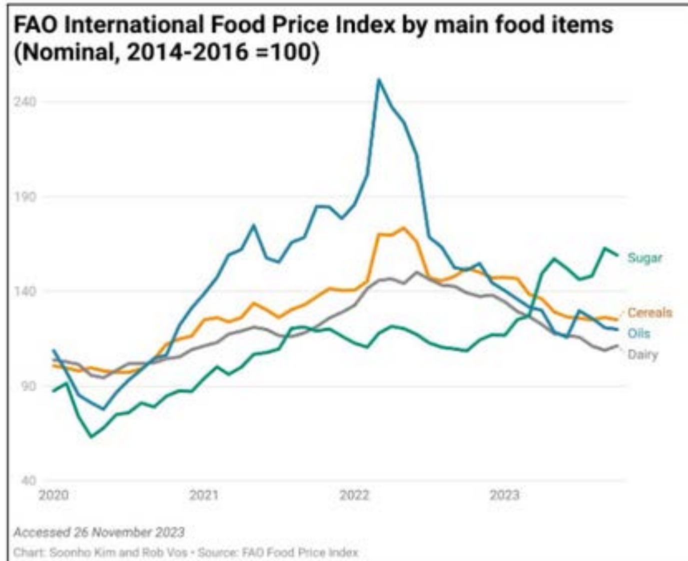


Russia-Ukraine War: Disrupting Global Markets (February 2022 - Present)

This ongoing military conflict has only worsened the global financial landscape, particularly in the energy and food markets.

- *Oil & Natural Gas Prices:* Russia provides substantial amounts of oil and natural gas on the international market, particularly to Europe. Following sanctions on Russia, the price of oil dramatically increased and reached a high of $130 a barrel in March 2022, subsequently stabilising at around $80-$90 per barrel in 2023. The energy crisis in Europe led to increases in natural gas prices to about 400%, leading to inflationary pressures across Europe.

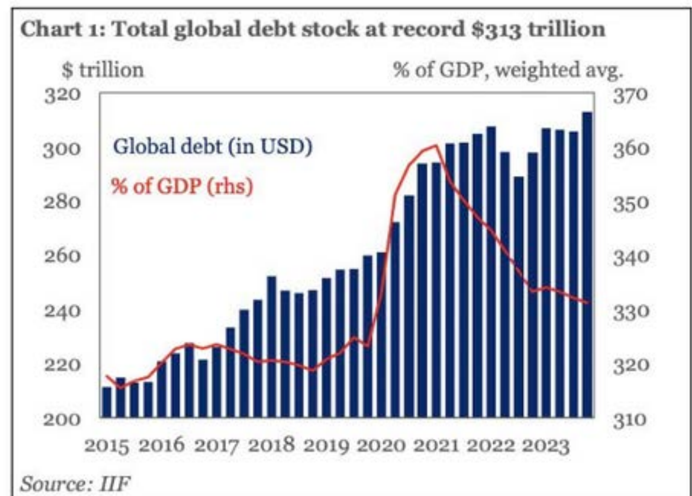
- *Food Prices:* Ukraine is a major exporter of wheat, barley, and corn throughout the world. The war has significantly disrupted food exports, lifting global food prices to record highs. The UN Food and Agriculture Organization (FAO) indicated that the global food price analysis had increased by approximately 30% during 2022, pushing many low-income countries into the food insecurity zone.



- *Inflationary Pressures:* Inflation across the world has been fuelled with it surging in the Eurozone to a rate of 8.6%, and the United States registering a 40-year high price increase at 9.1% inflation rate, both in June 2022. The rising price levels resulted in the central banks increasing interest rates to help stabilise prices.

Global Debt Crises and Vulnerabilities in the Financial Sector (2022 - Present)

The levels of global debt have reached unsustainable levels, especially for low-income and emerging market economies, which are struggling to service their debt due to rising interest rates and tighter financial conditions.



- *Global Debt:* Global debt reached a staggering $313 trillion as of 2023, an increase of 45% since 2019 from the pandemic-infused spending and slower growth in the post-COVID world, according to the Institute of International Finance (IIF).

- *Developing Economies Buffeted by Debt Crises:* Many developing economies are under heavy debt pressure. Countries such as Sri Lanka, Zambia, and Ghana have stopped servicing specific sovereign debts. The World Bank reports that currently 60% of low income countries are experiencing or are at high risk of debt distress.
- *Intensified Strain on Banking Sector:* Global banks are facing growing vulnerabilities, with the Bank for International Settlements reporting increased stress, particularly in regions with high inflation and rising interest rates. This has led to bankruptcies and an expected rise in non-performing loans.

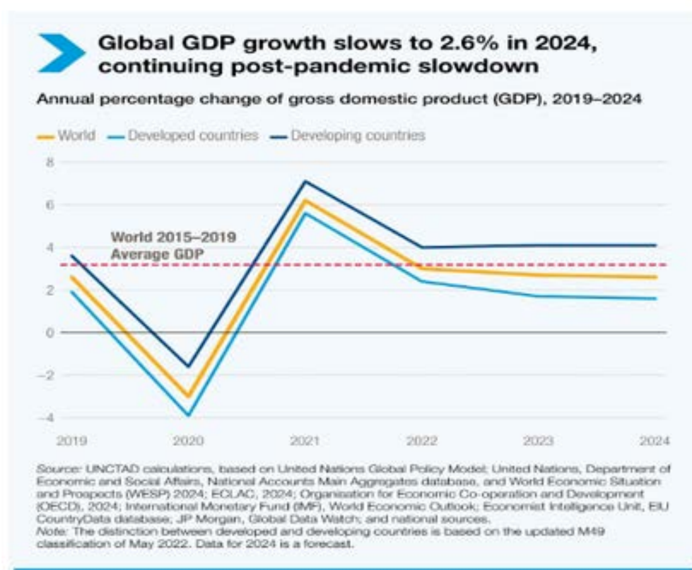
The global economy faces major challenges from COVID-19, the Russia-Ukraine war, and rising debt. High inflation and interest rates are straining low-income and emerging markets, while banking sector vulnerabilities highlight financial fragility. Global cooperation is essential for stabilisation.

Tomorrow's Uncertainty: Anticipating the Next Financial Crises

Anticipating future financial crises requires analysing a range of emerging risks and vulnerabilities in global economies, such as climate change, technological disruption, geopolitical tensions, and rising global debt.

Climate change can disrupt industries like agriculture, energy, and insurance through natural disasters, while technological disruption, like the rise of cryptocurrencies and cybersecurity threats, may challenge traditional financial systems. Let us focus on the ones that may have an impact in the foreseeable future.

Anticipating a financial crisis in the near future is challenging, but several warning signs suggest potential risks. Taking previously mentioned factors into consideration, economists are cautiously forecasting a recession, with a heightened risk of economic slowdown but significant uncertainty about its severity and duration.



Predicting Recession

Bruce Kasman, Chief Global Economist at J.P. Morgan, notes that while hiring in the U.S. is slowing and manufacturing is underperforming globally, strong service sector activity is offsetting these trends. Since typical recession warning signs are currently absent, J.P. Morgan has raised the near-term recession probability to 35% and projects a 45% chance by the end of 2025, despite ongoing political uncertainties.

The US stock market has hinted that fears over possible recession have gripped the sentiments across. But is this fear justified?
Here's what the data reveals:

- *US GDP Growth: Most recessions are driven by significant declines in economic output, but current GDP growth remains strong, at 2.8% in the second quarter—double that of the first quarter and in line with pre-pandemic levels. Additionally, final sales to private domestic purchasers have stabilised at 2.6%, consistent with averages from the past 18 months and pre-pandemic figures.*
- *US Inflation: At the start of the year, rising inflation made the Fed hesitant to cut rates. However, on 18th September 2024, it slashed rates for the first time in four years by 50 basis points as inflation is nearing its target of 2%.*
- *US Unemployment:* The interest rate cut comes in response to the rising unemployment which climbed up nearly 1% from its record low in April 2023, reaching 4.2%. Once the unemployment rate heads upward with that kind of momentum, it does not typically stabilise until the Fed cuts interest rates.

The Sahm Rule: Rising Unemployment can spark a recession and this is because of the Sahm Rule. Named after former Fed economist Claudia Sahm, this rule says that if the three-month average unemployment rate rises by 0.5% from its lowest point in the past year, a recession is probably already underway. It's actually been a reliable indicator for every US recession since 1970. So, to prevent a bigger slowdown, the Fed cut rates by 0.5%.

Claudia Sahm herself believes the economy is probably not currently in a recession, but "we are getting uncomfortably close."

What's at Stake in the Upcoming U.S. Elections?

The 2024 U.S. elections are impacting stock markets, currencies, and trade, with recession fears among investors. Goldman Sachs warns that a Trump victory could lead to significant economic downturns, projecting GDP growth to peak at just 0.5% in 2025 due to his proposed tariffs and immigration policies. In contrast, a Harris win could slightly boost GDP through new spending and tax credits, despite higher corporate tax rates. Additionally, 16 Nobel Prize-winning economists cautioned that Trump's fiscal policies could reignite inflation, while they suggested Biden's continued presidency could support economic recovery through measures like the Inflation Reduction Act.

How are things looking for India?

RBI Governor Shaktikanta Das stated that a global recession is unlikely due to the resilience of individual economies, despite concerns following COVID-19, the Ukraine war, and rising inflation. He noted that while growth has slowed, inflation is decreasing globally, which is positive for central banks. Das highlighted that India's retail inflation is within the target
range, moving towards 4%, and projected GDP growth of around 7% for FY 24-25. He indicated that average inflation for the next financial year could be about 4.5%. However, he emphasised the need to monitor food inflation closely due to potential external risks.

Conclusion

In summary, the landscape of financial crises highlights the need for sound economic policies, rigorous financial supervision and global cooperation. Reflecting on events such as the Great Depression and the global financial crisis of 2008 highlights these lessons. Currently, the world is facing the challenges of the COVID-19 pandemic, geopolitical tensions related to the war between Russia and Ukraine, and the growing global debt, which threaten economic stability. While the US may see a slowdown due to the upcoming elections, India is showing resilience and positive growth. The way forward depends on learning from the past, adapting to new risks and encouraging cooperation for a more sustainable global economy..

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Financial crises have long been a defining feature of global economies, bringing to light the fragility of financial systems and the complexity of human behavior in the face of uncertainty. From the Great Depression of 1929 to the Global Financial Crisis of 2008, these catastrophic economic events do more than just disrupt markets—they reshape societies, economies, and individual lives. As I reflect on my own family's experience during economic downturns, these crises are not abstract events—they're lived realities that leave lasting scars on 'real people'.

Like many, I grew up hearing stories from my grandparents about the hardships they faced during the 1990s liberalization era in India. As inflation surged and unemployment rose, they had to make difficult choices to keep food on the table. Even today, I see those echoes of past crises in the lives of people around me—job instability, rising costs of living, and an uncertainty about the future that mirrors the past. It's this humanly aspect that makes understanding financial crises not just an academic exercise, but a deeply personal one.

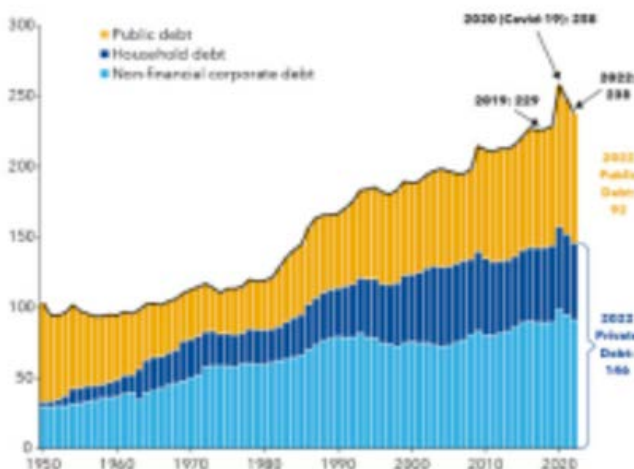
The Echoes of the Past: Lessons from History

History, as they say, repeats itself. The Great Depression of 1929 and the subsequent market crash left deep scars on the global financial system, leading to widespread unemployment, poverty, and social unrest. The root of these crises often lies in speculative bubbles—overvalued assets that are unsustainable and destined to collapse. The stock market crash of 1929 was driven by unchecked optimism, over-leveraging, and lax regulation.

Fast forward to the Asian Financial Crisis of 1997, where the interdependence of global economies became even more evident. A speculative frenzy in the housing and stock markets across Southeast Asia resulted in currency devaluation, capital flight, and a liquidity crisis. The ripple effects were felt worldwide. Both these events, though decades apart, reveal the dangers of excessive risk-taking, poor governance, and lack of transparency—lessons that policymakers still grapple with today.

These historical events underscore a critical point: financial crises are never purely about numbers and theories. They involve human emotions—fear, greed, and panic—that amplify downturns and complicate recovery. The history of financial crises teaches us that effective regulation and the strength of institutions are as important as market forces in maintaining stability.

Today's financial landscape feels like a delicate balancing act, teetering between hope and despair. The COVID-19 pandemic—an event that shook the world—led to an infusion of over $16 trillion into global economies. This monumental effort was meant to shield us from catastrophe, but it also laid bare the vulnerabilities of our systems. The staggering rise in global debt, now exceeding $300 trillion, raises a critical question: at what cost are we striving for stability?



Navigating the Present: A New Age of Uncertainty

As I reflect on this, I can't help but think about the families in my community who struggle with the ramifications of rising costs. With inflation peaking at 9.1% in the U.S., many are faced with tough decisions: Should they buy groceries or pay the rent? The data paints a stark picture, but behind each statistic is a story—a mother juggling multiple jobs, a student burdened by loans, a retiree watching their savings dwindle. The wealth gap has grown so wide that during the recovery, the richest 1% accumulated two-thirds of all new wealth. This isn't just an economic issue; it's a moral one that challenges our sense of justice and community.

Compounding this is the geopolitical turmoil we witness daily. The conflict in Ukraine serves as a poignant reminder of how interconnected and interdependent our world is. What happens in one corner of the globe ripples through markets and affects lives far away. It's a sobering thought, underscoring the need for unified global action. Yet, as I observe the responses, I often feel a sense of frustration. Are we merely putting band-aids on systemic wounds rather than addressing the deeper concerns?

Examining the rise of cryptocurrencies and decentralised finance, these offers both promise and peril. For many, these innovations symbolize hope—a chance to escape the constraints of traditional banking systems. However, the volatility seen in these markets, like the collapse of FTX, can be devastating. I think of those who invested not as a gamble but as a lifeline, only to face financial ruin. The risks are real and often overlooked, and they remind us that every financial decision carries human consequences.

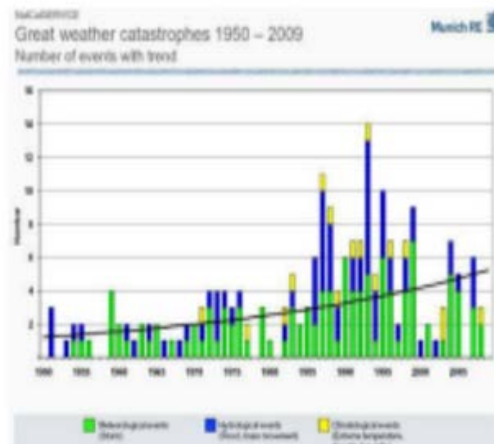
Critically analysing our financial systems, I feel compelled to ask: Are our policies truly designed to uplift everyone, or do they serve a privileged few? It's a question that demands our attention. We must push for reforms that prioritize equity and sustainability, fostering an environment where every individual can thrive. As we navigate these turbulent waters, we must remember that financial crises are not just abstract concepts; they are lived experiences. Each crisis affects lives, families, and communities. It is our collective responsibility to advocate for change, ensuring our financial systems work for everyone.

The Future: Emerging Threats and the Next Financial Crisis

Looking to the future, a new breed of crises looms on the horizon, shaped by emerging global challenges. The interconnected nature of modern economies means that local crises can easily escalate into global disasters.

Climate Change: The Unseen Financial Risk

Climate change is an often-overlooked catalyst for financial crises. Extreme weather events, rising sea levels, and resource shortages threaten billions in economic losses and could destabilize industries from agriculture to real estate. Financial institutions are increasingly recognizing climate risk, but current mitigation strategies remain fragmented. As the world warms, so too does the potential for climate-induced financial collapse, particularly in vulnerable regions that lack the resources to adapt.



Geopolitical Instability and Trade Wars

The global political landscape is becoming more polarized, with trade wars and geopolitical conflicts posing severe risks to financial stability. The ongoing U.S.-China rivalry and the Russia-Ukraine war have already disrupted supply chains, caused energy crises, and pushed inflation to multi-decade highs. As these tensions escalate, they may trigger deeper financial disruptions, particularly in emerging markets reliant on global trade. In a hyper-connected world, political conflict anywhere can have financial consequences everywhere.

Digital Currencies and Central Bank Policies

Digital currencies—both cryptocurrencies and central bank digital currencies (CBDCs)—are reshaping the future of money. As more countries experiment with CBDCs, the global monetary system could face disruptions akin to the transition from the gold standard to fiat currency. This transition, if mismanaged, could lead to volatility in currency markets, destabilize traditional banking systems, and give rise to new forms of speculative bubbles.

The Road Ahead: Can We Prevent Future Crises?

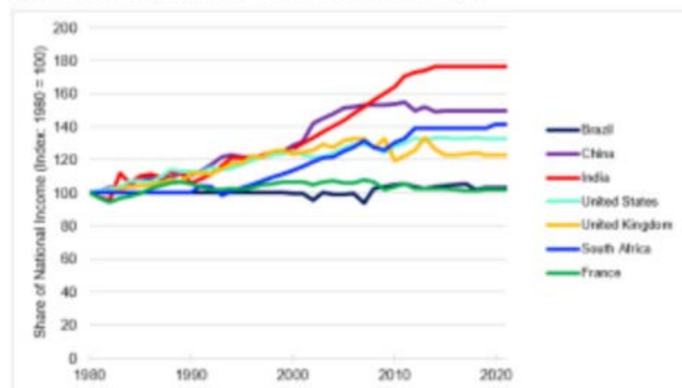
The future of financial crises is uncertain, but one thing remains clear: they are inevitable. The inherent volatility of financial markets, combined with human behavior, makes periods of boom and bust almost cyclical. However, predicting when and how these crises will occur remains elusive.

Emerging threats like climate change, cybersecurity vulnerabilities, and the rise of artificial intelligence (AI) in financial services pose new risks. Climate change, for instance, has the potential to destabilize entire industries, disrupt economies dependent on fossil fuels, and create mass migration, all of which could trigger financial crises. On the other hand, AI has introduced new complexities in the market, where algorithmic trading and decision-making processes can accelerate market movements, potentially leading to unforeseen consequences.

Preparing for future crises requires a proactive approach. Policymakers must prioritize long-term financial stability over short-term gains. This means increasing transparency, strengthening institutions, and, most importantly, understanding that the key to stability lies in balancing human needs with market dynamics. While technology and data can aid in forecasting trends, they cannot substitute the nuanced understanding of human behavior.

Are We Ready to Turn Financial Turbulence into Opportunity?

Figure 8: Share of National Income of Top 10% (1980-2021)



The journey through financial crises reveals them as more than mere economic downturns; they are profound human experiences that shake the very foundations of society. As we grapple with the lessons of the past and the challenges of today, we confront a stark reality: our financial systems are rigged, favoring the few at the expense of the many.

Globally, total debt has skyrocketed to over $300 trillion, an alarming figure that highlights our precarious dependence on unsustainable borrowing. In India, the pandemic's fiscal response amounted to ₹29.87 lakh crore (approximately $400 billion), yet this relief has largely enriched the already affluent. According to the Oxfam India report 2022, the wealth of India's billionaires increased by ₹4,900 crore daily during the crisis, while millions fell deeper into poverty. The richest 1% now control over 40% of the nation's wealth, a statistic that screams injustice and demands action.

As we stand at the precipice of another potential crisis, the rise of cryptocurrencies and decentralized finance—valued at a peak of $2.9 trillion globally—poses both a challenge and an opportunity. In India, the Reserve Bank's concerns echo the need for urgent regulation in a landscape that could otherwise devastate countless lives, as evidenced by the collapse of exchanges like FTX. This is not merely about market fluctuations; it's about safeguarding the dreams and savings of ordinary people from the whims of speculative greed.

The International Monetary Fund highlights that over 1.7 billion adults worldwide remain unbanked, a staggering number that reflects systemic failures. In India, where many are still denied access to basic financial services, this reality is intolerable. We must rise against a system that perpetuates inequality and exploitation. It is time for a financial revolution that prioritizes equity, transparency, and accountability. We must demand an economic framework that not only addresses the symptoms of crisis but uproots the underlying injustices that breed them.

The path ahead requires collective action, innovation, and a fierce commitment to change. Let us channel the lessons of history into a new vision for our financial future—a future where prosperity is not a privilege of the few, but a shared reality for all.

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Financial crises akin to economic earthquakes - they are spasmodic in nature, destructive in their strength and have the potential to wield a great deal of influence on global socio-economics in the period that is to follow. Whatever the cause of these downturns, be it overextended investments, failure of the banking sector, or exogenous factors, their effects are always the same- economies are stagnated and recessions are felt worldwide. Such phenomena highlight the underlying vulnerablities in 'strong' economies that are usually concealed during the 'good' times of economic expansion.

A financial crisis is more than just an event in the economic timeline. It is a manifestation of deeper rooted imperfections in structural systems, whether policy, market or inter systemic relations. When a crisis strikes, it transcends borders, affects employment rates and consumer engagement levels, government support, as well as peace in society. The difficulty in predicting these crises arises from their complex nature and the often-hidden internal weaknesses within economies.

The evolution of these problems in time is rarely straightforward and clear, since they result from internal weaknesses of the economy, which are masked at the initial stage. The following is a perfect showbook of some of these major financial crises like the crisis of 1991, which jerked all the national systems but left a remarkable change for the 21st gens to cherish. By examining such historical events, we can gain valuable insights into the causes, consequences, and potential solutions for future financial crises.

The 1991 Indian Economic Crisis:

The 1991 Indian economic crisis was a watershed moment in the nation's history, marking a turning point that forced India to re-evaluate its economic policies and adopt a more open and market-oriented approach. This crisis was primarily triggered by a balance of payments deficit, exacerbated by excessive reliance on imports and other external factors. The seeds of the crisis were sown around 1985, when India's economy began to falter. Despite the country's long-standing socialist model, which was intended to make India self-reliant, the cracks in the system had begun to show by the late 1980s. Imports surged during this period, leaving the country with a twin deficit: a trade deficit at the same time the government was grappling with a significant fiscal deficit. During this time, it became evident that this inward-looking strategy had led to economic stagnation, with growth rates faltering and productivity remaining low.

Several factors contributed to the economic crisis of 1991. One of the most immediate catalysts was the Gulf War of 1990-91, which led to a spike in global oil prices. This further exacerbated India's current account deficit, which was already reeling under the strain of excessive imports. The government's fiscal deficit had ballooned during the 1980s, due to a combination of populist welfare programs and inefficiencies in public sector enterprises. High inflation, hovering in double digits, added to the instability, eroding purchasing power and making economic conditions more volatile. By June 1991, India's foreign exchange reserves had dwindled to alarmingly low levels, barely sufficient to cover two weeks' worth of imports. Political instability also contributed to the crisis, as the late 1980s and early 1990s saw a series of short-lived governments, which created uncertainty and delayed necessary policy actions.

By early 1991, India's economic situation had deteriorated significantly, with foreign exchange reserves plummeting below $1 billion. At this point, international financial institutions, including the International Monetary Fund (IMF) and the World Bank, were reluctant to lend to India without stringent conditions attached. Facing the real threat of default, the Indian government were compelled to seek a bailout from the IMF. However, the IMF's financial assistance came with a caveat: India had to implement sweeping economic reforms to liberalize its economy. Under the leadership of Prime Minister P.V. Narasimha Rao and Finance Minister Dr. Manmohan Singh, the government embarked on a comprehensive reform agenda that aimed to pull India out of the crisis and set the stage for long-term economic growth.

The reforms were twofold: structural and fiscal. On the structural front, one of the most significant steps was the devaluation of the Indian rupee by nearly 20%. This move aimed to boost Indian exports and reduce the balance of payments deficit. The government also initiated trade liberalization measures, lowering tariffs and lifting import quotas.

This decisive shift towards integrating India with the global economy, as it opened its markets to foreign goods and services. Another critical aspect of the reforms was the dismantling of the License Raj, which had stifled industries with excessive regulation. The removal of these restrictions allowed businesses greater freedom to operate and grow, spurring industrial development in sectors such as steel, cement, and telecommunications. Privatisation and disinvestment of inefficient public sector enterprises were also encouraged, reducing the state's role in non-essential industries. Furthermore, foreign direct investment (FDI) restrictions were eased, and the government actively sought to attract foreign capital to boost economic development.

On the fiscal front, the government made efforts to consolidate the fiscal deficit by reducing subsidies and cutting back on public sector spending. Tax reforms were introduced to simplify the tax system and broaden the tax base, making it easier for the government to raise revenue.

One of the most memorable aspects of the 1991 crisis was India's decision to pledge its gold reserves as collateral for emergency loans. In an extraordinary move, the government shipped 67 tons of gold to the Bank of England and the Union Bank of Switzerland in exchange for loans that temporarily stabilized the country's foreign exchange reserves. This bold step allowed India to avoid an immediate default, providing the government crucial breathing room for implementing necessary reforms.

The reforms undertaken in 1991 had a profound and lasting impact on India's economy. The shift from a protectionist, socialist framework to a more open and market-driven economy laid the foundation for India's economic transformation. Growth rates surged in the years following the reforms, with India emerging as one of the fastest-growing economies in the world by the late 1990s and early 2000s. The liberalization of trade and investment policies attracted significant foreign direct investment, and India's foreign exchange reserves began to climb steadily. In addition to higher growth rates, the private sector experienced a boom, particularly in industries such as information technology, pharmaceuticals, and services. These sectors flourished in the new liberalized environment, contributing significantly to India's economic resurgence. While fiscal discipline remained a challenge, the reforms did lead to a temporary reduction in the fiscal deficit. However, challenges persisted, and the fiscal deficit crept up again in subsequent decades.

The 1991 economic crisis is a pivotal moment in India's modern history as it marked the country's departure from Nehruvian socialism and its embrace of market-driven policies. While the reforms ushered significant economic growth and global integration, they also sparked debates on issues such as inequality, labor rights, and the impact of globalization on local industries. Critics argued that the benefits of liberalization were unevenly distributed, with urban areas and the wealthy reaping more advantages than rural populations and the poor. Reduced government intervention also affected the public sector and social spending, which disproportionately impacted vulnerable groups.

Despite these criticisms, the legacy of the 1991 reforms continues to shape Indian economic policy. Successive governments, regardless of their political affiliations, have largely maintained the path of liberalization as recognizing the reforms initiated in 1991 were essential for India's growth and development. However, after a smooth period of 17 years, the world witnessed the 'Great Recession'.

The Global Economic Depression of 2008:

The Global Economic Depression of 2008, or the Great Recession, is probably one of the largest financial crises that the modern world has ever experienced. It originated by the collapse of the US housing market and was drastically heightened by the collapse of large financial institutions, thereby causing widespread economic unrest that created shocks across the very foundations of the entire world.

The early 2000s witnessed an unprecedented housing boom in the United States. It was actually founded on low interest rates and very lenient lending regulations. That was the precursor of the financial crisis of 2008. Subprime mortgages-high-risk loans to borrowers with bad credit histories-increased because banks and mortgage lenders began lending money to homebuyers without regard for their ability to repay. Assuming that house prices would always appreciate, these loans were packaged into complex financial instruments referred to as mortgage-backed securities and sold to investors worldwide. Now, in 2006, when housing prices had actually peaked and became due for their downtrend, homeowners defaulted on many of their loans, sending the value of MBS plummeting. The ripple effects of the implosion in housing-related assets spread rapidly around the world, leaving banks, investors, and financial institutions shaken to the core for being as interlocked as the financial markets of this world. The crisis reached a tipping point when the big investment bank Lehman Brothers filed for bankruptcy in September 2008. The financial industry got shocked by the failure of Lehman, which reduced trust in the soundness of other significant banks and organizations. The stock and credit markets collapsed. This led to the so-called "credit crunch," wherein banks became reluctant to lend money to businesses or even other banks, which worsened the situation further. The crisis quickly spread beyond American shores and gave rise to severe contractions in the economies of Europe, Asia, and other regions. The governments had to bail out major banks in the UK, Iceland, and Ireland on the brink of collapse. Millions of people around the world lost jobs, homes, and savings due to the skyrocketing unemployment rates.

Governments worldwide had to intervene and take unprecedented steps so as not to let the economy crumble completely. In this respect, the US government came up with the plan of a Troubled Asset Relief Program (TARP) worth $700 billion so as to stabilize banks that bought toxic assets, while interest rates cut by the Federal Reserve became almost zero in the country. The rescue plans were widely implemented in other major economies as well, such as in Europe. Central banks, in turn, focused on quantitative easing (QE) programs, pumping large amounts of money into the economy to encourage lending and investment. In due course, the measures undertaken even stabilized economies, recovering confidence in the financial system, and slow but steady recovery ensued.

The Great Recession's effects persisted for years despite its official end in 2009. The crisis exposed the risks associated with speculative bubbles, unregulated financial markets, and the interdependence of world economies. To prevent a repeat of the same collapse, governments responded by enacting stricter financial regulations, such as the Dodd-Frank Act in the United States. Thus, the Great Recession of 2008 serves as a sobering reminder of the vulnerability of the global financial system and the need for prudent lending practices, risk management, and regulatory supervision to avert future crises. After the 2008 crisis , economies learnt their lessons and played their level best to avoid financial traps that would lead to a state of disaster. However, history repeated itself in 2020 with the COVID-19 pandemic, presenting new challenges and requiring a different set of responses.

The COVID 19 Pandemic:

The COVID-19 pandemic, which originated in China in December 2019, rapidly spread across the globe, causing widespread fear and economic disruption. This global health crisis caused markets to fall and credit to the financial system to grind to a halt. A global stock market crash began in February 2020. This was a result of the COVID-19 pandemic, which caused widespread panic and uncertainty about the future of the global economy. The stock market crash began on February 20, 2020. From February 24–28, the stock market declined the most in a week since the 2007–2008 financial crisis. On March 12, 2020, there was a global stock market crash known as Black Thursday. Stocks in North America and Europe fell more than 9%. The pandemic caused a sharp contraction of economic activity and huge job losses in early 2020. At the beginning of February, the S&P 500 Index was making a new all-time high above 3,300, by the third week of March, the index had slumped all the way down to around 2,200 – in short, losing approximately one-third of its value in just a few short weeks. However, by the first of May, the index had recovered more than half of its decline, rising back up to the 2900 level. But till date, economists and market analysts remain uncertain as to whether the crash has been weathered, and if a recovery, at least in the stock markets, has begun, or whether there will be a secondary down wave in stock prices.

Conclusion:

Financial crises are an inevitable part of the economic landscape, acting as both disruptors and catalysts for change. But there is a lesson to be learned from every financial crisis- a warranty of sorts or illustrations and often, a guidance on how reforms should look like. In that aspect, the age of financial crises is also the age of economics in the sense that it is about how institutions, markets and states learn how to defend themselves from the next crisis. It is not merely an issue of the past: it is a way of looking at economies, how they get distressed, how they can be equipped to deal with the storms of the future.

To sum up, economic recessions are a clear signal of the instability present in the worldwide economy. However, every problem is an opportunity. They reinforce the necessity of watching over and being flexible in the control of the financial systems, and overcoming challenge calls for development. No economy can ever be impenetrable to crisis. However, lessons should be held from all downturns to pave a way towards achieving the future that is much more stable, where weaknesses are not crumbled over with bust but arise stronger and better with possibilities.