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MSC Fintech with Business Analytics (Core)

GLOBAL IMPACT: SUBPRIME CRISES

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1.THE SUBPRIME FINANCIAL CRISIS (AUGUST 2007- JUNE 2009)

INTRODUCTION

The housing market bubble that started to emerge in 2007 served as the foundation for the global financial collapse. Due to their cheap mortgage interest rates, banks and other lending organizations persuaded many homeowners to take out loans that they were unable to repay. Lenders, overloaded by the volume of mortgages coming in, created new financial products known as mortgage-backed securities (MBS). These were simply bundles of mortgages that could be marketed as securities with low risk since they were backed by CDSs, or credit default swaps. (federal reserve bank, 2016)

Banks started lending money carelessly to people and families who lacked the resources to repay the mortgages they had been given. Then, it was inevitable that these high-risk (subprime) loans would be packaged and transferred up the chain. Lending institutions started to have financial difficulties as the number of subprime mortgage packages increased to an alarming degree and a significant portion of them went into default. It resulted in the dire financial circumstances that persisted for years after the 2008–2009 global financial crisis.

They used QE and it has led to high inflation, Not only was the housing industry cause the financial crisis, but it also took the lead in the decline in overall economic activity. Both residential investment and employment in the construction industry reached their peak in 2006. (Corporate Finance institute, 2023)

2.LITERATURE REVIEW

At a certain point, crises are severe expressions of the relationships between the financial sector and the actual economy. As a result, comprehending macro financial linkages—a very difficult task in and of itself—is necessary for understanding financial crises. This study aims to provide focused analysis on specific two macro-economic variables namely Unemployment and Inflation and its effect before during and after financial crises domestically and globally. *(IMF WORKING PAPER, 2023)*

Some of the reasons of crises have been made clear by the literature, but determining their underlying origins is still difficult. Over time, several hypotheses have been proposed to explain the fundamental causes of crises. Even though basic elements like macroeconomic imbalances and external or internal shocks are frequently seen, there are still a lot of unanswered concerns about the precise causes of crises. There are instances when it appears that "irrational" reasons cause financial crises. *(federal reserve bank, 2016)*

Workers in specific industries are also being disproportionately affected by the downturn, one of the industries most impacted by crisis is construction. where, in relation to drastically rising residence prices, there had been a significant boom in residential development. employment losses are also occurring in industries that were not directly involved in the housing bubble or the ensuing financial market crisis. (*Organisation for economic cooperation and development, 2023)*

Between 2007 and 2009, there were almost 7.5 million job losses, which doubled the unemployment rate, which in 2010 was close to 10%. *(kirstin hubrich and robert j Tetlow, 2012)*

3.MACRO ECONOMIC VARIABLES

A. UNEMPLOYMENT

Following the financial crisis, the collapse of the property market and the ensuing unrest in the banking sector had a cascading impact on the whole economy. In 2009, the unemployment rate in the United States reached a high of 10%, indicating the depth of the economic crisis. Particularly heavily impacted were the financial services and construction industries, where job losses and layoffs were commonplace. (jon, marcela,ilknur zer, 2016)

Reduced consumer spending and a drop in company investment contributed to a wider economic recession, which in turn had an impact on other industries. The labour market had difficulty rebounding, and many people had extended periods of unemployment. Even while employment gradually improved in the years that followed, the effects of the subprime mortgage crisis persisted, affecting long-term employment trends and changing the makeup of several businesses. The statistics from this time frame highlights how deeply the crisis affected the American labour market and how difficult it is for policymakers to support a strong and long-lasting recovery.

Figure 1 Unemployment rate USA recession

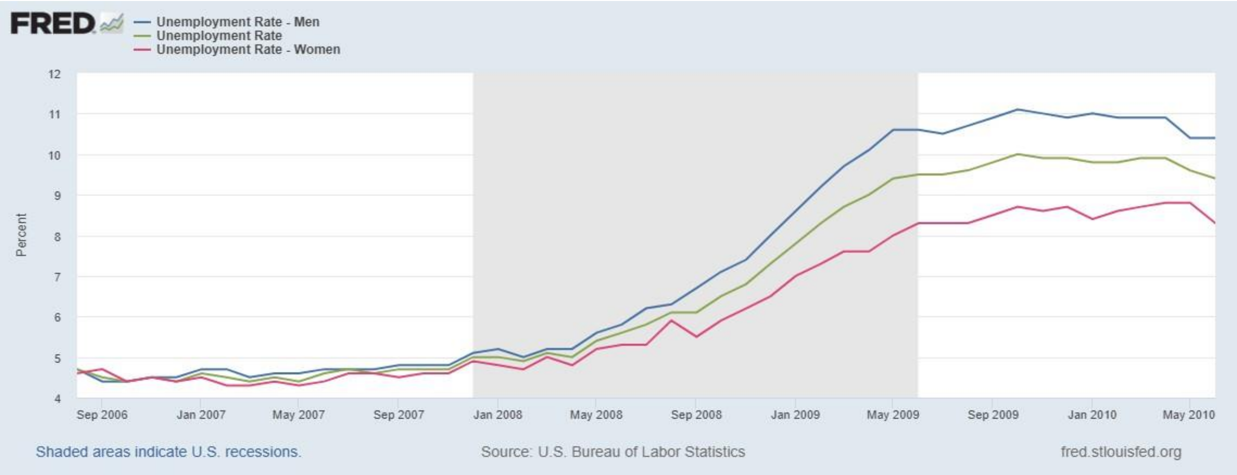
(Fred Economic research data, 2023)

The graph indicates that the rate of unemployment started to rise in 2007 and peaked in 2009 at 10%. The 2006 start of the subprime mortgage crisis was the cause of this rise in unemployment.

The housing bubble started to burst in 2006. When home values began to decline, many people found themselves in arrears on their mortgages. Home values were further lowered because of the subsequent wave of foreclosures. It resulted in a steep rise in unemployment.

According to the graph, the unemployment rate started to drop in 2010. But it took a few years for the number of unemployed people to get back to what it was before the crisis.

Figure 2 Unemployment rate Men and Women comparison



(U.S.Beuro of labor statstics,FRED, 2023)

According to the data, in 2009, the unemployment rate for women was between 5% and 9%, although it was greater for men, reaching 11%. This suggests that there is a noticeable gender gap in unemployment rates, with males being disproportionately impacted by job losses during the crisis. Because certain industries may have been more strongly filled by men than others, it is crucial to consider both sector-specific implications and the complex dynamics of this gender-based variance in unemployment.

B. INFLATION

Global financial crises have complex effects for the dynamics of inflation there. Because of the uncertainty in the market and the decline in demand, these crises frequently cause the first disinflationary forces. In response, unconventional monetary policies like cutting interest rates and implementing quantitative easing are used by central banks, most notably the U.S. Federal Reserve, to boost economic activity and avoid inflation.

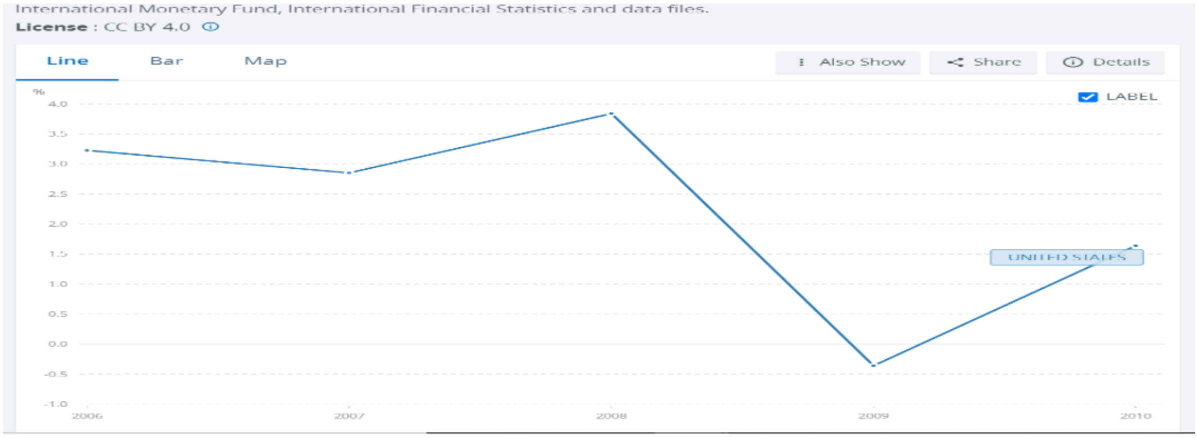
Inflation has frequently increased when central banks, most notably the U.S. Federal Reserve, used quantitative easing (QE) as a monetary policy instrument. In periods of economic recession. (The Reserve Bank of Australia, 2012)

Figure 3 Inflation (CPI) index USA-2006 to 2010

(FRED economic data, 2023)

The Consumer Price Index (CPI) had subdued growth and even negative inflation rates in several quarters. In response, the US Federal Reserve implemented before unseen monetary policy initiatives, such as cutting interest rates down to zero and launching massive asset purchases (also known as quantitative easing) to boost the economy. The slow pace of the inflationary rise despite these attempts was indicative of the lengthy nature of the economic recovery.

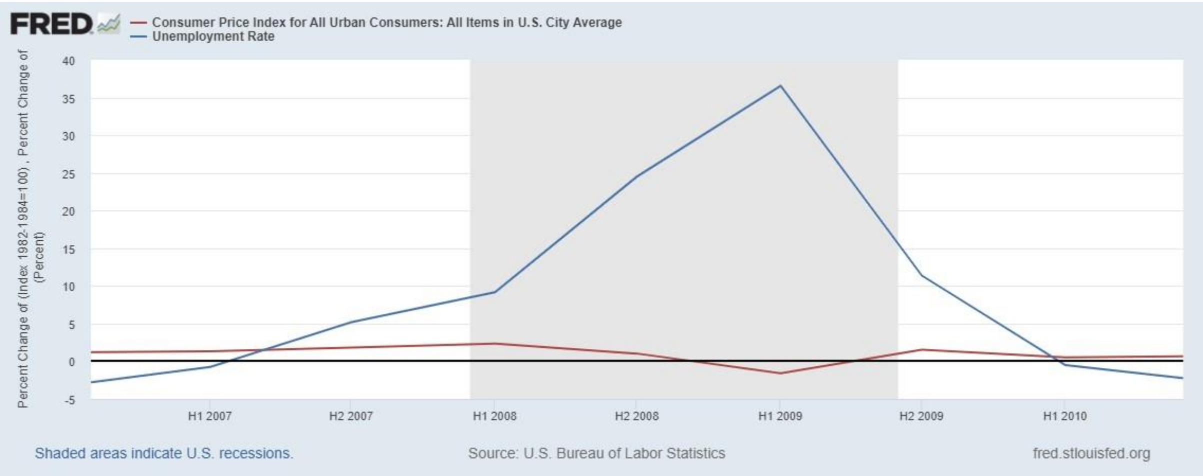
Figure 4 CPI Index % rate from IMF-World Bank



(The World Bank Data, 2023)

The United States' inflation rate peaked in 2008, which was a significant turning point in the country's economic history. The weakening value of the US dollar and rising commodity prices, especially in the food and energy sectors, were two of the many reasons that contributed to the inflation increase. To stabilize financial markets and combat deflationary forces, the Federal Reserve reacted swiftly, using both conventional and unconventional monetary policy instruments, such as interest rate changes and quantitative easing.

Figure 5 Unemployment and Inflation relation during Recession



(Inflation consumer prices, 2023)

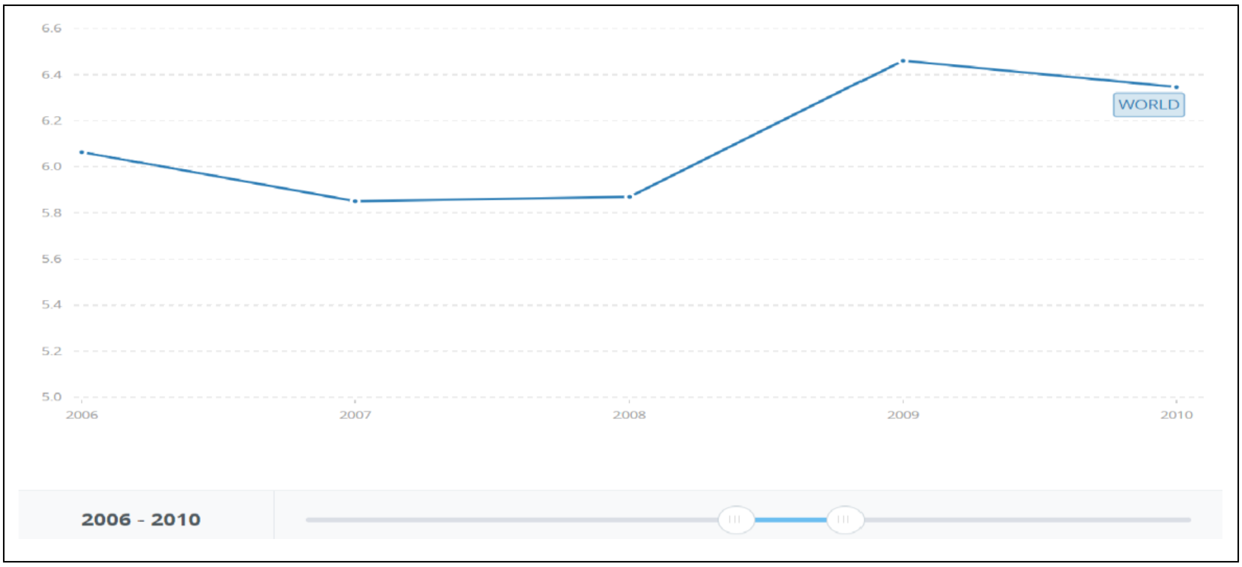
The inverse relationship between unemployment and inflation, as indicated by the CPI's rate of change, appears in the graph. The CPI had a sharp decline during the Great Recession as the unemployment rate rose to around 10%.

4.RESULTS

GLOBAL IMPACT

The International Labour Organization (ILO) reports that throughout the crisis, the number of unemployed persons worldwide increased by almost 30 million, reaching an all-time high of 212 million in 2009. This resulted in a notable rise in the unemployment rate worldwide, impacting both developed and developing nations, rising from 5.6% in 2007 to 6.6% in 2009. Concurrently, and to varying degrees in different parts of the country, the crisis put significant pressure on inflation.

Figure 6 Global Impact of Recession on Unemployment



(World bank, 2023)

Following sectors are severely affected by Global Financial Crisis

- Housing and Real estate
- Financial institutions
- Construction and home Building
- Automotive Industry
- Consumer Goods and retail
- Financial markets and Investments
- Employment and Labour Market

5.CONCLUSION

To sum up, the global financial crisis that erupted between 2007 and 2009, mostly due to the collapse of the US subprime mortgage market, is remembered as a turning point in economic history that permanently altered financial markets, institutions, and economies around the globe.

The study conducted has examined the various facets of this crisis, including its origins, the changes in macroeconomic conditions, and its widespread effects on the world economy. Millions of people lost their jobs due to the crisis, which also created inflationary pressures that required extensive and unexpected policy measures.

Monetary and regulatory measures have become essential instruments for averting systemic hazards and stabilizing economies. Lessons were learnt and reforms were implemented to strengthen financial institutions against shocks in the future as the globe struggled with the fallout.

6.OPINION

Global financial crisis of 2007–2009 was a significant and complicated event. One key question is whether it was a "one-off" or if it may happen again. Even though it is difficult to foresee crises in the future with absolute certainty, tremendous efforts have been made worldwide to lessen the possibility and effect of such disasters.

A major response was regulatory change, with laws like the US's Dodd-Frank Wall Street change and Consumer Protection Act designed to improve financial monitoring, boost transparency, and reduce dangerous financial practises. To mitigate cross-border risks, there have been talks of enhancing international cooperation in financial regulation on a global scale.

It is crucial to recognise from an ethical standpoint that making money during a market event as bad as the global financial crisis of 2007–2009, which resulted in extreme economic suffering and profound effects on society, presents ethical questions. Many people and families lost their homes, jobs, and financial security because of the crisis.

In a financial context, several investors or corporations did look for ways to benefit from market fluctuations during the crisis, for short selling particular stocks or placing bets against the housing market.

A long-term outlook is crucial when dealing with the financial markets, considering the wider societal implications of investment choices.

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