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GLOBAL FINANCIAL CRISIS 2008: A COMPARATIVE STUDY OF MONETARY POLICIES IN SELECTED COUNTRIES: A REVIEW OF LITERATURE

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ABSTRACT

The Global Financial Crisis of 2008 also known as a sub-prime mortgage crisis is regarded as the second worst crisis after the first great depression which happened in 1929-1939, almost took a decade for the recovery mode. The present paper is an attempt to explore the devastated second worst global financial crisis 2008 which occurred during the mid of September 2007 leaving a prolonged negative effect on businesses, economic growth, exchange rates, foreign capital flows, created a contagious spillover in rest of the world through an extensive literature review carried out by researchers, economists and academicians to understand the magnitude of the crisis in selected economies. The study focuses on select countries on the basis of their development. United States of America has been studied to represent the developed countries, India to represent the developing countries and Nigeria to represent the Under-developed countries. An extensive review of literature is conducted to provide an effective regulatory framework towards which the authorized (Central Banks) can work on preventing crisis in future. The dependent variables (monetary policy tools) for the study used by the researchers were interest rates, liquidity rates and bank rates to control the inflation as an independent variable. Statistical tools used by various researchers and academicians like econometric models-Vector auto regression, correlation and such were used to analyze the data on the basis of event study, period-wise study and studies involving before and after crisis. The findings from their research reveal lacunae in estimating the effectiveness of the central bank's policy framework, especially in predicting the crisis as well aftermath. The suggestions from the study form the basis to conduct a thorough and extensive research in future.

Keywords: *Global financial crisis, central bank policy response, monetary policy tool, economic growth, exchange rates, capital flows, interest rates, liquidity rates*

1. INTRODUCTION

The Global Financial Crisis of 2008 also known as a sub-prime mortgage crisis is regarded as the second worst crisis after the first great depression which happened in 1929-1939, almost took a decade for the recovery mode; business losses in trillions, decline in consumer wealth estimated in trillions of U.S. dollars; triggered a significant decline in economic activities; and prompted substantial financial commitments by the governments. The main reasons for this failure were mortgage loans extended to borrowers at highly concessional terms; weak oversight and poor supervision of banks and financial institutions; and excessive relaxation of fundamental rules and regulatory requirements for financial institutions. As a result of the above weaknesses an accumulation of bad loans and business loss amounting to US$ 2.3 trillion (or 17 percent of the USA's GDP) were realized. Economies worldwide started slowing down in the late 2008 as credit tightened and international trade declined. Governments and central banks responded with an exceptional fiscal stimulus, monetary policy expansion, and institutional bailouts. To rescue the world economies from this global down turn, the International Monetary Fund (IMF) called for arrangements to provide emergency liquidity, improve financial sector supervision and take a comprehensive approach to financial sector stability assessment that includes all types of institutions. Advanced economies were among the most hit nations with the impact of crisis. Developing nations like Europe, Latin America and India were among few which were not hit largely but evidenced a sudden fall in total output followed by the stock market crash. Sub-Saharan nations and low-income countries sustained the crisis since they were able to escape the economic storm due to the little exposure towards the international trade except for the oil exporting. Such nations were hit on a marginal scale.

1.2 ROLE OF CENTRAL BANKS IN MANAGING THE CRISIS

The Central bank is responsible for regulating the money supply in the country and channels all its implementations through the policies in consultation with the government in office. The implementation of policy is routed through the banking system prevailing in the country. The global financial crisis is a result of the lacunae in the banking system which is now clearly established. The correction to the banking system calls for central banks acting through policy responses, directives, changes in regulation and the usage of various monetary policy tools.

1.3 OBJECTIVES, METHOD, ANALYSIS OF LITERATURE REVIEW, RESEARCH GAPS, RESULTS & DISCUSSIONS AND FUTURE SCOPE OF RESEARCH

1.3.1 OBJECTIVES:

1. To understand the study methods adopted by various researchers in understanding the nature of the crisis and the role of central banks in controlling the financial crisis.
2. To determine the research methodology used to analyze the study and the study time period.
3. To present the findings based on the research methodologies and identify the gaps and thereby, provide the scope for future research which can help the researchers to suggest an effective regulatory monetary measures to avoid the future crises.

1.3.2 METHOD:

The present paper is conducted as an extensive literature review of various academicians and research scholars. From these reviews, it is observed that the data period used to study the crisis differed from methods of analysis and represented different perspectives. Event study for the period of 10 years were used, while in some studies, panel data analysis is used to predict the reasons for the crisis. Few studies compared the impact between the COVID-19 and global financial crisis on the US economy and European economy. Variables used in the study were; bank interest rates, liquidity ratios which were analysed to provide an effective framework for setting effective monetary policies by the central banks. Statistical tools like correlation and regression and advanced statistical tools like co-integration and Vector Auto Regression were also used to study the variables. Time-series along with co-integration and co-efficient analysis were also used. From the following methodology researchers could get overall insights in identifying the gaps such that it can assist the central banks to take necessary actions in times of crisis.

1.3.3 ANALYSIS OF LITERATURE REVIEW:

Marouane Daoui et al (2023) conducted a review of literature on monetary policies in developing countries mainly focusing on the effectiveness of monetary policy in promoting economic growth. It studies the relationship between monetary policy and economic growth. The findings of the study emphasized on learning the activities of central banks in developing countries which are supervised using economic models. The study determines the factors like profitability of central banks and monetary unions, the independence of central banks in their operations, and lags (delays), inflexibilities, and instability analysis which can probably affect the effectiveness of monetary policy. The results show varied findings with respect to the relationship between monetary policy and economic growth. It is complex and varies from country to country. The authors suggest to underpin the future scope in studying the relationship between monetary policy and economic growth in depth. The determination for future research will help the policymakers in understanding the relationship between monetary policy and economic growth in detail. Few studies show that the impact of monetary policy is limited or non-existent. Also, studies have shown that the monetary policy actions are crucial for economic growth.

Li, Farmanesh, Kirikkaleli, and Itani (2021) compared the effects of COVID-19 and previous global financial crises on the US economy. They employed qualitative and quantitative techniques to investigate the resemblances and variances in the economic consequences of these two crises. According to the authors' findings, while both crises had substantial economic repercussions, COVID-19 had a more substantial and longer-lasting impact on the US economy. The research underscores the significance of adopting appropriate policy measures to alleviate the detrimental consequences of economic crises.

Oravsky, Toth, and Banociova (2021) investigated how selected European countries coped with the economic fallout of COVID-19 in the context of the global economic crisis of 2008. Data from Eurostat was used to analyse the economic performance of 10 European countries from the fourth quarter of 2008 to the third quarter of 2020. According to the findings of the study, the impact of the COVID-19 crisis on the European economy was severe, but not as catastrophic as the global economic crisis of 2008. The researchers observed that countries that had implemented austerity measures in response to the 2008 crisis were better equipped to handle the economic shock caused by the pandemic.

Jimoh Olatunji and He Weihang (2017) in their study examined the trends of the global financial crisis and its impact on the Nigerian economy. The study highlighted the success of the monetary policy by the Central Bank of Nigeria which used banking sector and economy as a central point. The descriptive method of data analysis was used and the results reveal that Nigerian economy had achieved a high level of implementation of policy by Central Bank of Nigeria (CBN) to control the widespread of Global Financial Crisis (GFC) in the economy. It urges the policymakers to take adequate, stable and comprehensive measures to address the future crises. To ensure the maintenance of the banking system stability and injecting liquidity into the system, a strong prudential supervision and regulation of the financial sector were provided as the key suggestions.

Moid U. AHMAD and Shamima NASRIN (2017) discussed the study of Indian central bank's (Reserve Bank of India) various parameters in controlling inflation, interest rates, exchange rates and money supply in the economy. The significance of CRR and interest rates like Repo which are used as a means for liquidity and inflation is explained. The study tested and verified the effectiveness of the changes in monetary and policy rates on the desired critical variables in understanding the effect and the quantity of effects which could help in framing a better policy by central banks. The statistical tools such as correlation, regression and advance statistical tools such co-integration and Vector Auto Regression were used to study the variables and conclusions were drawn. The data pertains to Indian economy and the study period used in this research was 2011-2014. The study used monthly and quarterly data. The study helps in providing with right information for the decision makers to formulate sound policies keeping in consideration with future crises.

Malaolu, Ogbuabor, and Orji (2014) conducted a study on the impact of the global financial crisis on Nigeria's financial sector and its implications for monetary policy responses. The research aimed to assess the extent to which the global financial crisis affected Nigeria's financial sector and the country's response to the crisis. The study utilized secondary data obtained from the Central Bank of Nigeria and the International Monetary Fund (IMF). The data were analyzed using descriptive statistics and regression analysis to examine the impact of the crisis on the Nigerian financial sector. The findings revealed that the global financial crisis had a significant adverse effect on the Nigerian financial sector, especially on the stock market and the banking sector. The crisis also led to a decrease in foreign capital inflows and a decline in the country's Gross Domestic Product (GDP). Furthermore, the study found that the Nigerian government implemented monetary policy responses, such as reducing interest rates and injecting liquidity into the financial system, to mitigate the effects of the crisis.

Sebastian et al (2010) examined in detail about the global financial crisis 2008 and its impacts. Analyses of the financial and subsequent economic crisis by the leading international institutions like the International Monetary Fund have focused on OECD countries. The study discusses the effects of the crisis on the OECD countries. The author's observations show least effect on developing economies like sub-Saharan Africa. Although, they were affected to a little amount they coped up with that relatively quickly. The developed countries governments were preoccupied with their domestic problems. It examines how the countries of the South (less economically developed countries) were affected by the global economic and financial crisis and how they responded, what lessons the South could learn and what policy agenda needs to be pushed forward to better support the interests of developing countries, least developed countries as well as emerging-market economies. It also covers the effects through the GDP from the loss caused due to global recession which impacted largely through trade channels. The conclusions drawn from the study reveal that strengthening national regulation and supervision of financial markets is suggested to be an essential minimum condition for greater stability, but only this would not be sufficient to prevent the build-up of new imbalances in a system. The national regulation and supervision of financial markets should have an effective mechanism of policy coordination.

Syed Tehseen Jawaid et al (2010) using a comparative study investigated the effect of fiscal and monetary policies on economic growth of Pakistan. The study data was for the period 1980 to 2009. They used statistical tools such as time-series along with co-integration method. The results reveal that both the fiscal and monetary policy have significant and positive effect on economic growth. Findings from data analysis performed in coefficient of monetary policy, show that it is much greater than fiscal policy. This result indicate that the monetary policy is more concerned with economic growth than fiscal policy. The suggestions from the study are that the policy makers should focus more on monetary policy actions than on fiscal policies in order to enhance economic growth.

Zenon Quispe and Renzo Rossini (2010) discussed in their report about the global financial crisis in two stages. The first stage of the study was undertaken between the last quarter of 2007 and the collapse of Lehman Brothers which was featured by capital inflows and the second stage of the , study was undertaken post-Lehman stage which was associated with a rapid and severe weakening of external conditions. The authors identified that in emerging markets the central banks required, at both of the above stages, the combination of both conventional and non-conventional monetary policies as there is a need for preserving the monetary transmission mechanism. In countries like Peru, the sequence of monetary policy adoption began with the unconventional policy measures due to the weakening of interest rates. The role of central banks in maintaining a high level of international reserves in order to intervene in the foreign exchange market was highlighted.

Filardo et al. (2010) explores the timeline, impact, and policy responses to the global financial crisis in the Asia-Pacific region. The authors provide an overview of the events leading up to the crisis, including the housing bubble in the United States and the collapse of Lehman Brothers. They also examine the impact of the crisis on various countries in the region, such as Japan, Korea, and China. It provides a comprehensive analysis of the international financial crisis and its impact on Asia and the Pacific, as well as the policy responses adopted by countries in the region. The authors conclude by emphasizing the importance of continued policy coordination and collaboration to prevent future financial crises.

Nassif (2010) conducted a research study on the immediate impacts and economic policy responses of Brazil and India during the global economic crisis of 2008. The study analysed the effect of the crisis on both countries' economies and how they responded to the crisis with their economic policies. According to the study, both Brazil and India were hit hard by the global economic crisis of 2008, and the impact was felt across all sectors of their economies. However, Brazil's economy was affected more severely due to its dependence on international trade, while India's economy was relatively less affected due to its more diversified economy. The study concluded that both Brazil and India were able to weather the global economic crisis due to their prompt policy responses. Additionally, the study suggested that the two countries' policies could serve as a model for other developing countries facing similar economic crises.

Ari Aisen and Michael Franken (2010) conducted the research and reported the same in the IMF Working Paper. The paper empirically estimates the main determinants of bank credit growth during the 2008 global financial crisis. Using a sample, covering over 80 countries, the findings reveal that larger bank credit boomed prior to the crisis and lower GDP growth of trading partners are among the most important determinants of the post-crisis bank credit slowdown. Structural variables such as financial depth and integration were also relevant. Conclusions show that counter-cyclical monetary policy and liquidity played a critical role in alleviating bank credit contraction after the 2008 financial crisis, suggesting that countries should pursue appropriate institutional and macroeconomic frameworks conducive to countercyclical monetary policies.

Viswanathan (2010) conducted research on the impact of the global financial crisis on India. The author explored how the crisis affected the Indian economy, trade, foreign investment, and employment. The study found that India's economy was affected by the crisis, but it was less severe than other countries. However, the crisis had a significant impact on the Indian stock market, which experienced a significant decline. The author also examined the steps taken by the Indian government to mitigate the impact of the crisis, including the introduction of fiscal stimulus packages and monetary policy measures. The study emphasizes the importance of implementing effective policies to strengthen the financial system and address the challenges posed by global economic crises.

Dick K. Nanto (2009) discussed the process for coping with the crisis by countries across the globe into four basic phases. The first phase has been the intervention to contain the contagion and restore confidence in the system. There is a need for extraordinary measures both in scope, cost, and extent of governmental reach. The second phase was coping with the secondary effects of the crisis, particularly the global recession and flow of capital from countries in emerging markets and elsewhere that have been affected by the crisis. The third phase is to make changes in the financial system to reduce risk and prevent future crises. The fourth phase of the process is dealing with political, social, and security effects of the financial turmoil.

J B Taylor (2009) analysed the causes of the financial crisis and evaluates the effectiveness of the policy responses. The study draws on data from the United States and other countries to provide a comprehensive analysis of the crisis and its aftermath. The research identifies several factors that contributed to the financial crisis, including the housing boom and subsequent bust, lax lending standards, and the proliferation of complex financial instruments. The study also evaluates the policy responses, including monetary policy, fiscal stimulus, and regulatory reforms.

Mohanty, D. (2009) delivered a speech at the 3rd Indian Council for Research on International Economic Relations-International Weiterbildung und Entwicklung (ICRIER-InWEnt) Annual Conference in New Delhi on November 12, 2009. The speech was titled "Global financial crisis and monetary policy response in India." In his speech, Mohanty discussed the impact of the global financial crisis on the Indian economy and the measures taken by the Reserve Bank of India to address the crisis. He emphasized the importance of maintaining financial stability and the need for a coordinated global response to the crisis. The author explained that the Indian banking sector was relatively insulated from the crisis due to its limited exposure to toxic assets and the conservative approach adopted by Indian banks. However, the crisis did have an impact on the Indian economy through its impact on exports, foreign investment, and global liquidity.

Rajiv Kumar and Pankaj Vashisht (2009) in the ADBI Working Paper Series explain the effects of the global financial crisis in Indian financial sector through three distinct channels that are financial markets, trade flows and exchange rates leaving a lesser impact in the first round since Indian financial system was not deeply integrated with the global financial system. However, in the second round, the Indian financial sector could not escape. Efforts were made by the governments and central banks all over the world. Government and the Reserve Bank of India also took aggressive countercyclical measures, sharply relaxing monetary policy and introducing a fiscal stimulus to boost the domestic demand. The paper argues that with very limited fiscal manoeuvrability and the limited traction, of monetary policy, policy measures to restore the Indian GDP growth back to its potential rate of 8–9% was suggested to be, focusing on addressing the structural constraints that are holding down private investment demand. The RBI implemented cuts in policy rates as unconventional measures to prevent the economic growth and stabilize the inflation via effective interest rate management.

Research Unit LARRDIS, (2009) conducted by the Research Unit of the Rajya Sabha Secretariat in June 2009, the global economic crisis had a significant impact on India's economy. The report highlights the various channels through which the crisis affected the Indian economy, including declining exports, reduced foreign investment, and a slowdown in domestic growth.The report suggests that India's high dependence on exports made it vulnerable to the global economic downturn. With the collapse of demand in key markets such as the United States and Europe, Indian exporters faced a sharp decline in orders, leading to a decrease in production and employment. Furthermore, the report notes that the crisis resulted in reduced foreign investment in India, with investors shifting their focus to safer assets such as gold and government bonds. This had a negative impact on India's long-term growth prospects, as foreign investment has been a key driver of the country's economic growth.

Claudio Borio and Philip Lowe (2002) BIS Quarterly Review report discusses about the proposals made to set up forward-looking indicators of banking distress wherein considerable efforts were made to develop ***"early warning indicators"*** of crises which appeared to be more like banking crisis. These indicators could help policymakers take remedial actions in a more appropriate time. The three core variables were selected in the study- the ratio of (private sector) credit to GDP; equity prices (deflated by the price level); and the real effective exchange rates. The sample size includes 34 countries (21 industrial and 13 emerging market economies), selected on the basis of homogeneity in terms of economic development. The data period undertaken for the study covered the period from 1960–99. The results from the study reveal that among the two-variable composite indicators, the credit/asset price combination is superior to the credit/exchange rate alternative, especially as the horizon is lengthened. The credit/asset price combination being superior to the credit/exchange rate alternative, among the two variables predicts a higher percentage of crises and exhibits a lower noise-to-signal ratio.

1.4 RESEARCH GAPS

1.4.1 DEVELOPED COUNTRIES

Most of the existing literature has focused on the impact of policy responses on the U.S. economy, neglecting the global impact of these policies. A comprehensive study that examines the global impact of policy responses by the Federal Reserve System would fill this research gap and provide valuable insights into the effectiveness of these policies in addressing global financial Additionally, this study seeks to evaluate the global impact of these policies and provide insights into their effectiveness in addressing financial crises beyond the U.S. economy.

1.4.2 DEVELOPING COUNTRIES

While there are many studies on the policy responses of central banks to global financial crises, there is a lack of analysis on the effectiveness of RBI's policies in mitigating the impacts of these crises. Additionally, there is limited empirical evidence on the factors that influence the policy responses of RBI to global financial crises, such as the role of political, institutional, and economic factors.

1.4.3 UNDER-DEVELOPED COUNTRIES

Here, the reviews conducted belong to the selected country like Nigeria. The Central Bank of Nigeria (CBN) has been instrumental in formulating and implementing policy responses to such crises in Nigeria. While there have been studies on the effectiveness of these policy responses, there remains a research gap in understanding the factors that determine the success or failure of such responses. One potential area of research could be to examine the impact of external factors, such as global economic conditions and international policy decisions, on the effectiveness of the CBN's policy responses. Another possible avenue of research could be to investigate the impact of domestic factors, such as political instability and corruption, on the CBN's ability to respond effectively to global financial crises.

1.5 RESULTS & DISCUSSIONS, AND SCOPE FOR FUTURE RESEARCH

1.5.1 RESULTS AND DISCUSSIONS

Although the researchers have largely conducted a theoretical literature review, but lack in effectively measuring the magnitude of crisis and the adoption of monetary policy measures taken by Central banks in selected economies using exhaustive data. The use of statistical tools such as time-series along with co-integration method can be used in comparative country wise study. The lacunae in few studies do not compare the coordination of both fiscal and monetary policy in ensuring the economic growth which can impact significantly.

1.5.2 SCOPE FOR FUTURE RESEARCH

From the review analysis conducted in the developed countries, the assessment of the potential implications of the policy responses by the Federal Reserve System is identified to direct the financial well-being of the future of the global financial system. This could involve identifying the challenges and opportunities that the FRS may face in responding to future financial crises and the potential changes in their policy frameworks.

A comprehensive study in developing countries can be conducted to analyse the policy responses, in particular India, the Reserve Bank of India can make a comparison of policy actions taken in series of global financial crises. This study can explore the factors that had influenced the policy responses of RBI.

In under-developed countries, country-wise comparative analysis of the policy responses by the Central Bank of Nigeria during different global financial crises can be undertaken to understand the effectiveness, efficiency, and sustainability of monetary policies in these nations during crises.

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