The Global Financial Crisis During the Years 2008 and 2009

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Abstract

During a global financial crisis, the exchange rate reacts to economic conditions in a volatile manner. During the financial crisis between 2008 and 2009, the exchange rate incurred losses of individual countries' overall currency value. The losses occurred because of the lack of confidence in investors. The losses affected the banking and financial institutions, collapsing the housing market. The purpose was to explore existing research on the great financial crisis that affected the world and compare countries with the largest economic influences in the world. The study is grounded in the fact that this crisis disrupted the banking system worldwide, causing several major financial institutions, such as commercial banks, mortgage firms, insurance agencies, and credit unions, to fail. In addition to the financial industry, many large and small businesses failed to survive during the Great Financial Crises. The data came from sources such as scholarly literature from sources related to the causes and effects of the financial crises. The literature reflected behavior patterns and purposes that disrupted the global economy used by various countries. This research reflected that government leaders respond proactively and collaborate and share ideas, information, and resources to prevent a financial crisis of this magnitude from happening again. Bank managers must provide records publicly and promptly. As the United States, China, and Japan represent the largest economies, the U.S. governmental leaders must align with Japan to encourage China to support a global collaboration between the other global leaders to ensure sterner banking regulations. Consequently, this study could lead to a more stable global economy to prevent a future disaster of this magnitude.

Keywords: Foreign Exchange, Global Crisis, Subprime Mortgages

1. Introduction

1.1 The problem

During a global financial crisis, the exchange rate can react to economic conditions in a volatile manner. According to Dalio (2022), during the financial crisis between 2008 and 2009, the exchange rate incurred losses that went to 40% of the overall value of individual countries in currency value. The losses occurred because of the lack of confidence in investors. Many global factors can influence the price of the exchange rate of a particular currency, such as natural disasters, political disputes, conflicts between nations, and financial crises felt by many worldwide (McLaughlin, 2019). The pivotal dangers relate to political risk and the foreign exchange market. In addition, governments worldwide significantly influence how technology can solve problems with proper use and implementation that could lead to economic growth or devastation.

1.2 Importance of the Problem

The Foreign Exchange

The system, referred to as the Foreign Exchange (FX), is the over-the-counter market used by bank managers that determines the current value between international markets (Johnstone et al., 2019). Foreign exchange also refers to the (forex market) which gives bank managers the latitude to provide money to people to buy and sell commodities and exchange currencies from all over the world. The market operates for approximately 5 ½ days non-stop and distributes trillions of dollars with thousands of trading. The goal of the traders is that a currency will appreciate and

give more significant value in the long or short time, or it may depreciate compared to another currency.

Business owners and managers can use this system to purchase imported goods and commodities from other businesses worldwide (Rella, 2019). The importing business can buy the goods at the local exchange rate despite the differences in the income currency rate between the two countries. From the sources of information related to the Global Financial Crisis of 2008-2009, the derailing of the free market may appear as the primary cause of the financial crisis (Dewilde, 2021). A few economic theories exist, but most economists agree that the United States government's lack of regulations and interference enormously affected the crisis. According to Dewilde (2021), financial institutional decision-makers used the lack of government regulations to make bad decisions, therefore making money faster than usual. The scary notion is that such a financial crisis could happen again. The recent bank failures and the Federal Reserve Board members raising interest rates regularly remind people of how financial challenges remain.

2. Method

This study is a systematic literature review. A systematic literature review summarizes, analyzes, and corroborates a group of studies and the results of studies (Xiao, & Watson, 2019). The main objective of this study is to summarize, analyze, and classify existing research on the great financial crisis that affected the world and compare countries with the largest economic influences in the world.

3. Literature Review

3.1 The Cause and Effect of The Global Financial Crisis of 2008-2009

The Global Financial Crisis of 2008-2009 occurred from many factors, but the housing market was strongly impacted. The financial impact occurred worldwide (Cipriani et al., 2023). The fall of the housing market led to low-interest rates and consumers immediately obtaining credit with unsuitable government regulations. For mortgage approval, people needed more tax documentation to use personal income. Consequently, homeowners needed help to afford to make mortgage payments. The ripple effect of the financial crisis caused many homeowners to lose their homes, and property values failed across the United States, which led to other economic declines worldwide (Dewilde, 2021).

3.1.1 The Global Impact

The global financial crisis, the Great Financial Crisis (GFC), began in 2008. Many economists call this crisis the worst the world's people have seen since the Great Depression in the 1930s (Johnstone et al., 2019). This crisis disrupted the banking system worldwide, causing several major financial institutions, such as commercial banks, mortgage firms, insurance agencies, and credit unions, to fail. In addition to the financial industry, many large and small businesses failed to survive during the GFC, along with a substantial loss in the wealth of consumers. The losses ranged in the trillions. The governments, including the United States (U.S.), began to provide economic relief. In the US, the relief emerged as the stimulus package.

As the financial crisis continued, a global shockwave occurred. The crisis led to financial failures worldwide as credit intensified for most consumers (W. Chen et al., 2018). Therefore, many economies worldwide declined during this crisis as credit was hard to obtain and international trade weakened. Specifically, half the countries in the world suffered economically. Some countries are still recovering from the financial crisis. However, other parts of the world suffered minor impacts from the Global Financial Crisis of 2008-2009 because they had better regulations (Felipe & Estrada, 2020).

3.2 Subprime Mortgage Rates

The type of mortgages sold to home buyers was subprime. Subprime mortgages were sold to consumers with poor credit scores (Cipriani et al., 2023). This crisis hurt the global economy, causing an estimated 7.4 trillion in financial losses in the stock market. The losses mounted around 3.4 billion in the United States regarding the real estate market. The institution's loan officers approved mortgages at a higher-than-normal interest rate than prime lending rates. Unfortunately, many of the subprime mortgage rates were adjustable and started at a lower interest rate but increased drastically to much higher interest rates. Lower interest rates with people purchasing homes based on income stated without sufficient proof of actual income led to a downward spiral. As more consumers purchased low-priced credit, more people brought homes they could not afford. With greater demand, the value of homes rose and then dropped drastically as more homeowners went into foreclosure. More people found themselves in a position where they could not refinance because the value of their homes declined.

Unfortunately, home buyers could not refinance their mortgages because the value of the homes declined, leaving many homeowners with no equity, leading to a downward financial spiral across the globe (Yunus, 2018). Unemployment escalated while many homeowners lost their homes because of foreclosures. The unemployment rate

rose to 10% because several company leaders filed for bankruptcy, and 7.5 million people in the United States lost jobs (Bennani, 2023). After the GFC, many Americans could secure employment, but the jobs did not meet their economic needs as their previous jobs. From the economic estimates, the net worth of the average household in America dropped to approximately 17 trillion dollars, resulting in a net loss of twenty-six percent.

3.3 The Decline in the Fertility Rate from the Financial Crisis

As financial uncertainty existed in many countries during the Global Financial Crisis of 2008 -2009, families delayed having children (W. Chen et al., 2018). Consequently, the future productivity of the labor force could fall from the global financial crisis. Another less documented effect of the financial crisis is the impact of net migration in advanced nations. From a global perspective, nations may not recover from the financial crisis for years beyond the perspective of many economic predictions.

3.4 The Spiral Effects of the Great Financial Crisis

The financial crisis that led to a recession from 2007-2008 grew gradually for many years (Joo et al., 2020). During the summer of 2007, the reality began to show how the subprime leading for homes began to take a toll on the economy. Many lenders defaulted on loans, and many investors needed help withdrawing their money. For example, the British Bank of Northern Rock needed emergency money from other British banks. However, although these warning signals existed, many investors should have paid more attention and continued to conduct business as usual until the huge investors on Wall Street began to incur sufficient losses (Sharma et al., 2020). Then came the collapse of Lehman Brothers Bank and then other banks across the United States, Europe, and the UK. This financial crisis caused the foreign exchange market, global debt, and the devaluation of many assets worldwide (Johnstone et al., 2019).

The most significant impact of the GFC was the collapse of the housing market, but the crisis affected the price, cost, and distribution of crude oil. Considering that crude oil represented approximately half of the commodities market during the beginning of the millennial and then dropped drastically in the heights of the GFC. For example, when the GFC emerged, the price of crude oil increased by twenty-eight percent (Joo et al., 2020).

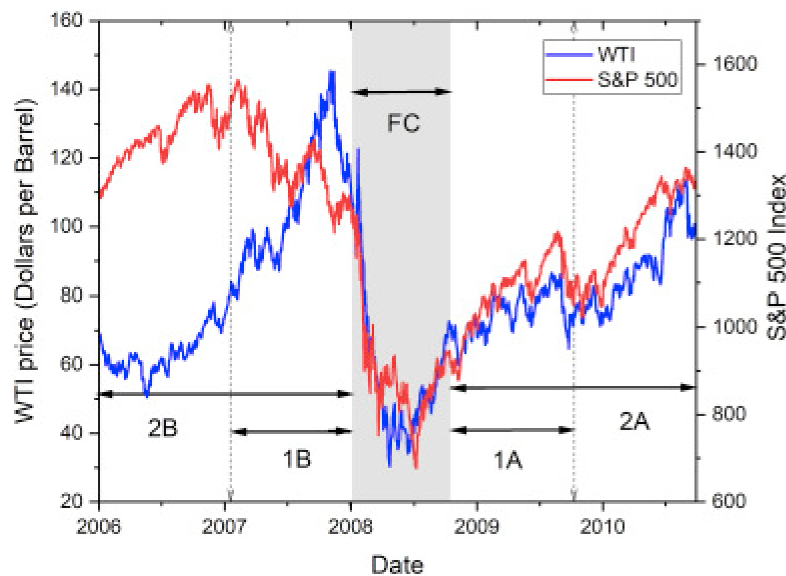

Figure 1.

Note. This graph signifies the darkened stretch, which specifies the financial crisis from September 2008 to May 2009. The overall impact emerges as an index of the stock market, the S&P 500. Joo, K., Suh, J. H., Lee, D., and Ahn, K. (2020). Impact of the global financial crisis on the crude oil market. Energy Strategy Reviews, 30, 100516. https://doi.org/10.1016/j.esr.2020.100516

3.5 Foreign Exchange Rate

The foreign exchange rate is the process of exchanging the value of a particular currency in comparison to another country's currency (Salomao & Varela, 2022). This process significantly impacts the direction of money between two nations. For example, during a specific time, the exchange rate between the United States (U.S.) and Canada was 1.31,

which means that 1.31 of money emerges for exchanging $1.00 of US currency. Consequently, the U.S. dollar is worth 31 cents more than the Canadian dollar ((Eichler & Littke, 2018). The exchange rates align with the supply and demand of the currency's market. This process is what makes the exchange rate a floating rate. Consequently, the value of a specific country's currency is the starting point to determine the actual exchange rate.

3.6 The Exchange Rate and Business Operations

Global business leaders and managers make operational decisions based on the exchange rate (Eichler & Littke, 2018). The decisions reflect the cost of supply and demand of products on the global market and customers from abroad. Specifically, the rate between the two nations emerges from the market value between both nations. For example, the state of economic activity, the interest rates, the gross domestic product, the cost of production, inflation, and the unemployment rate will significantly impact the exchange rate. When changes occur in the exchange rate, business leaders will see the effect on operations with the change in the cost of materials and supplies brought from another nation and the change in demand and supply of products from abroad. The leaders and managers of financial institutions, such as banks within each country, regularly determine the currency's value for trading.

3.7 Types of Exchange Rates

The exchange rate can occur in two forms: the market value at present and the spot rate (cash value) (Lustig et al., 2019). The current market value is the present value of a resale product or asset. The rates are by estimating the rising or falling prices, which is the forward value of the assets or security. Although the exchange rate occurs between two countries, some countries have different rates with their borders. In addition, a few countries have set limitations on their currencies. In this case, the country could have an onshore and offshore rate. However, a better rate is likely within the country's boundaries as opposed to outside its boundaries, which falls under the control of the government (Akram et al., 2020). An excellent example of a government-controlled currency is China. The Government in China determines the currency's value. This manipulation strategy gives the yuan an artificial trading point above the median point from the beginning of the trading process without allowing the free market to dictate.

3.7.1 The Current Value

The current value reflects the liquidity of an asset in terms of how quickly the assets can convert to cash (W. Chen et al., 2018). Security and brokerage firm agents that represent investors rely on the current market value of an investment instrument to learn if the account holders' account or portfolio drops below the margin totals. When the value of the account or portfolio falls below the margin set by the broker, this forces the agent to make a margin call.

The Margin Call. The margin call is the alert sign to obtain the appropriate financial resources to get the account or portfolio in good shape in the required standing previously set (Khan et al., 2022). This process would require additional funding by a cash deposit or more shares in the form of securities to raise the ratio of assets above the level of debt. However, for assets in the form of non-liquid, the current value can depart from the actual value of the asset. Non-liquid assets refer to real estate, land, equipment, vehicles, and other non-tangle assets. The investor mainly accepts the current market value at the end of the day, the closing price, or the bid price, the final price a potential buyer is ready and willing to pay for an asset or some security transaction.

3.7.2 The Forward Rate

As the spot rate is the current exchange value between the currency of two countries, the forward rate is when the investor or buyer between two countries reflects on the expectations of the interest rate or the yield at a future time (Khan et al., 2022). The yield is the future value the investor expects of a time based on the previous history of the stock or bond. This process is done by using a calculation that divides the interest or dividends of the invested amount. The forward rate can change based on the investors' expectations and feelings for potential interest rates later from one country to another.

As an example, when traders hypothesize (speculate) that a nation will reduce its monetary policy compared to another nation, such as the U.S., the investor would likely purchase the U.S. dollar as opposed to the other nation which will contribute to the devaluation of the other nation's dollar value (Khan et al., 2022). Consequently, the buyer or the seller uses the forward rate to balance the risk based on historical data concerning the fluctuations and volitive of the market. This process occurs daily worldwide, leading to winners and losers in the global market.

3.8 The Impact on China, Russia, and Japan

Consequently, the great financial crisis (GFC) reached globally (L. Chen et al., 2020). The GFC was not like any financial crisis in recent years, such as the Asian crisis between 1997 and 1998 and the Russian debt crisis that took place in 1998. The crisis in Russia and China had minimal effect on the entire world. During the crisis in Russia, China,

and Japan, a harbor moment aligned with the characteristics of crisis-related movements. In addition, interest rate differences expound more on the crisis-related exchange rate actions in 2008–09 than previously. The financial crisis that afflicted Russia, China, and Japan was when most nations used floating interest rates. However, many nations were able to fix their exchange rate to prevent their financial crisis from spreading globally. However, during the GFC, several nations that were not in the middle of the monetary and fiscal policies that led to this great recession were impacted. Leaders of nations saw the value of their currency denigrate drastically. The interest rate differences escalated between nations at an abnormal level, causing more significant uncertainty in the exchange rate and the stock markets worldwide. As the financial crisis continued, many nations were already using floating and managed rates, which left them desperate to find the right strategy to adjust to a global financial crisis, which people had not seen since the Great Recession.

3.8.1 Russian in the GFC

Russia, known by many, is the world's energy superpower because it has the largest natural gas reserves (L. Chen et al., 2020). In addition, Russia has the world's second-largest reserves in coal and is in the top ten of the largest oil reserves. Russia's government was affected by the GFC in two areas. First, the price of oil dropped drastically, causing an economic panic. Second, the panic led to a term called capital flight. The capital flight was the process of a large sum of money flowing out of Russia. This economic panic emerged from the GFC that was taking place worldwide. In other words, investors withdrew money from Russian banks and businesses into what they felt were safer investments. Consequently, the GFC reduced the Russian tax base and the overall economic productivity. Despite the many economic problems for Russia during the GFC, money laundering, tax evasion, and terrorism persisted, which reflected the limited resources available.

3.8.2 Japan in the GFC

Japan is the world's third-largest economy, and the impact of the GFC hurt its economy in many directions (L. Chen et al., 2020). The Japanese economy sustained itself during the GFC until the peak period of 2008 because many business owners were forced to lay off workers. The owners laid off workers or closed because exports to other countries began to slow drastically. This economic crisis reduced the demand for many Japanese products. As expected, this problem not only occurred for Japan but also for many developing nations in Asia and across the globe**.** These nations experience a drop in their currency, the devaluation of their stock, and many other types of assets in dollar value.

3.8.3 China in the GFC

China is the world's third-largest economy, and its effects from the GFC extended to many parts of the world (L. Chen et al., 2020). The business leaders in China, as in many other developing nations, experienced a significant decline in their export operations. Like the U.S. government, the leaders of the Chinese government implemented a large-scale stimulus compendium. In addition, the governmental leaders integrated an ample supply of money into the economy to move it into the recovery stages. On the upside, this strategy led to more substantial credit expansion, but in many cases, it caused weakness in the financial market and the exchange rate value.

3.9 Macroeconomic Factors of the Exchange Rate

From a macroeconomic perspective, during a global recession, economic policy uncertainty (EPU) looms more significant than usual on the exchange rate, which causes greater volatility (Eichler & Littke, 2018). When the global market receives influences from a volatile exchange rate, a weaker global economy emerges for many reasons that stem from an unpredictable exchange rate. For example, when an increase in terms of trade occurs because of the recession, a ratio comes within the increase in price or cost of the export items, which reflects the price of the imports. Consequently, this change drops the price because of the decline in the demand for foreign products demand. In other words, when nations experience uncertainty regarding future growth, a volatile exchange rate is more likely to reduce economic growth in the domestic and foreign markets. The effect on the exchange rate caused by the global financial crisis brings risks to domestic speculations.

3.10 Tactical Consequences

Since the GFC of 2008, several governmental leaders from developing nations implemented policies to monitor the financial system with new monetary and fiscal strategies. Furthermore, after the GFC of 2008, Central Bank managers worldwide brought the interest rate to zero or close to that rate. Unfortunately, several policymakers saw their budget deficit grow. Considering that China's economy is the fastest growing in the world, many economists indicated that for world financial equilibrium, Japan and the U.S. should work closer with China to bring a stabilized world economy, which would positively add stabilization and less volitivity in the foreign exchange rate (Makin, 2019). Another recommendation is that the U.S. governmental leaders must align with Japan to encourage China to support a global collaboration between the other global leaders to ensure stricter banking regulations.

4. Findings

4.1 Potential Solutions to Prevent Another Global Financial Crisis

4.1.1 A Safer Banking System

Many banks across advanced nations have put in place safeguard measures for monitoring financial statements to ensure more robust management of assets (Johnstone et al., 2019). Consequently, larger banks are better prepared to restrict loans to high-risk borrowers. Unfortunately, these measures may not apply to smaller banks and every nation. After the GFC, central bank leaders across the globe created a zero-interest rate policy (ZIRP) for its best customer accounts. More than 10.5 trillion dollars was created from this strategy, but it is artificial credit1, which leaves the question of whether it will help sustain economic prosperity.

4.1.2 A Complete Payment and Settlement System

Many banks across nations are working collaboratively to maximize profits by establishing international agreements to reduce the potential for the loss of monetary currency. Global bank managers are working together in partnerships (Makin, 2019). The value of partnerships with bank managers and civic stakeholders can work together to bring resources together at a faster pace with many forms of electronic payments through loans.

4.1.3 Intelligent Global Teamwork

The public-private partnership (GFC) emerged in the 1980s, but the role increased during and after the GFC (Castelblanco et al., 2023). The countries leading this partnership were the US, the United Kingdom (UK), the Netherlands, Italy, and France. After the GFC, many world economists stated that this partnership must work to reduce insufficient infrastructure in many developing countries. Idealistically, the PPP is a global agreement and a tool to allow government leaders the leverage to respond to global market failure. Through this world group by way of the World Bank, this instrument created a large variety of devices for detecting economic warning signs. Government leaders must remain conscious that more global crises can emerge for reasons unknown. The leaders of the PPP must have the appropriate monetary resources available to minimize the impact of the global financial crisis and provide relief to guarantee global satisfaction (Salomao & Varela, 2022).

4.2 Lessons Learned

The GFC was a macroeconomic crisis, and many nations are still recovering from the devastation (Makin, 2019). From my perspective, a problem exists between the monetary and fiscal policies worldwide. Some experts believe too much government intervention exacerbated the problem, while others stated that insufficient intervention occurred. The lesson learned is not to react but to act proactively and collaborate and share ideas, information, and resources to prevent a financial crisis of this magnitude from happening again. Bank managers must provide records publicly and promptly (Mazouni, 2018). This situation can occur with more forceful and transparent regulations. Reflecting on the Keynesian model, the policy during the GFC was to create more government spending. Unfortunately, more government spending leads to more government debt for the politicians to debate on what is best for the recovery.

Many factors existed that led to the GFC, but the housing market had the most significant impact. Sadly, many banks failed because of the enormous amount of home foreclosures (Johnstone et al., 2019). The foreclosures led to bank failures because many homeowners defaulted on their loans, and the property value dropped across the United States and abroad. Unfortunately, this problem may occur again because of the potential greed of some bank managers and investors.

5. Discussion

5.1 The Great Financial Crisis and the Foreign Exchange Rate

Radical activities usually occur during financial crises (Khan et al., 2022). Consequently, investors in the global financial markets saw many substantial risks because of the exchange rate volatility that affected several countries' currency values. This problem of extreme volatility peaked in 2009 during the global financial crisis in 2007.

5.2 Exchange Rate Volatility

As the GFC emerged, many governmental leaders faced the decision to manage their currency or allow it to float (Eichler & Littke, 2018). Governmental leaders relying on managed exchange rates felt the pressure with the price and the long-term effect of managing the value of their dollar compared to other nations. When government monetary or fiscal leaders manipulate their currency, it affects the value of their money supply and interferes with the bargaining power of currency on the global market. Under the influence of the nation's government leaders, the central bank managed its currency by pumping new money into circulation, artificially setting interest rates, and controlling its currency value on the exchange market. However, in many cases, government leaders felt the pressure to manage the exchange rates. However, these countries ran the risk of higher costs to their currency value, which created broader limits in appreciation of their exchange rate value. The results led many nations to weaken their long-term sustainability, dropping below equilibrium levels and reducing their competitive advantage in the global market.

For a floating exchange rate to operate, the government stays neutral, and the currency's price is calculated by the foreign exchange rate based on the supply and demand of the market. This process occurs compared to other currencies (Eichler & Littke, 2018). In essence, the government will not interfere with the market. Government leaders did not necessarily see an advantage in using floating currencies during the GFC because of the potential for price uncertainty, which limited potential investments in long-term plans. Consequently, the uncertainty caused many investors to stop investing in the international markets for fear of losing money. A vital investment strategy during the financial crisis is to expand domestic capital in the foreign exchange market to strengthen an individual or government's position. Investing in a foreign nation's capital offsets the exterior volatility with the expectation of making a profit in the long term.

5.3 Exchange Rate Fluctuations

The exchange rate fluctuations caused many physical changes that increased the strategy of carrying out trade activities (W. Chen et al., 2018). This strategy is how a country or investor makes full use of different interest rates for its currency, not based on the market but manipulated with various interest rates, leading to inflation of many products and services. In a carry trade situation, the investor will borrow the money at a low yield to purchase a higher currency with a greater yield later. Using this trading strategy during the GFC, the money could rise in value sooner than a lower-yield currency. This type of manipulation strategy intends that the investor trades at a lower interest rate with borrowed money and sells the currency with the plan to collect on the investments with a higher interest rate on the initial trading from the currency purchased initially. Government and investors examined the possibility of mitigating the impact on the exchange, which included partial intervention financed considering the cumulative demand in the market and increased regional trade to stimulate profits. Some thought the government control could encourage more interest in investing, but too many fears existed in investors' minds.

6. Conclusion

This analysis reflected on the global financial crisis (GFC), its effect on the foreign exchange market, and how it emerged, leading to the most significant global economic crisis since the Great Depression from 1929 until 1945 (Johnstone et al., 2019). Many global factors influence the price of the exchange rate of a particular currency, such as natural disasters, political disputes, conflicts between nations, and financial crises felt by many around the world. However, many economic experts related the tremendous financial crisis 2008 to the mortgage crisis in the U.S., which led to the volatility in the global exchange rate. The type of mortgages sold to home buyers were subprime mortgages. Subprime mortgages were sold to consumers with poor credit scores (Cipriani et al., 2023). The lesson learned is that government leaders should not react without sound reason but act proactively and collaborate and share ideas, information, and resources to prevent a financial crisis of this magnitude from happening again. Bank managers must provide records publicly and promptly (Makin, 2019). This strategy can occur with more forceful and transparent regulations. Another recommendation is that the U.S. governmental leaders must align with Japan to encourage China to support a global collaboration between the other global leaders to ensure stricter banking regulations. Despite the significant impact of the financial crisis in the United States, many other developing nations failed deep into the recession (Johnstone et al., 2019).

Acknowledgments

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