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Financial Crisis

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General Introduction

The financial crisis have a great impact on the economies of many countries. The world has been mop by a series of the harsh financial crisis, beginning with the Great Depression in 1929, then Black Monday in 1987, followed by the October 1989 crisis, all the way to the market crisis in the nineties and the Southeast Asian crisis, in addition to the global financial crisis of 2008, which had severe impacts on the economies of countries of the world.

The First Chapter

The Concept of Financial crisis

First: the definition of the financial crisis

- **The financial crisis compound of two terms:**

1-Crisis: It is a sudden disruption of the balance in one of the economic activities in a country or several countries, it is generally called the imbalance between supply and demand (production and consumption).

2-Financial: It includes accounts that record financial operations and transactions related to liquidity with the institution or bills of exchange bonds and shares .

- **A financial crisis is defined** : as a sharp decline in the financial markets of a country or a group of countries, and one of its most important features is the failure of the local banking system to do its main tasks, which is negatively reflected in a significant decline in the value of the currency and stock prices, which results in negative effects in the financial sector. Production and employment, which results in a redistribution of income and wealth among the international financial markets.

- **The financial crisis is defined :**as the breakdown of the full financial system, go with by the failure of a large number of financial and non-financial institutions, with a sharp contraction in overall economic activity.
- **A financial crisis is defined** : It is a situation in which the demand for money increases compared to its supply, and this means that physical liquidity decreases significant due to the withdrawal of money in banks.

- ## Second: the Characteristics of the Financial Crisis

represented by:

1- Its occurrence in a and sudden way: that is, it cannot be predicted, because the crisis at its inception reason shock and a high degree of tension and attracts everyone’s attention, which weakens the capabilities of effective and quick action to challenge it.

2-Lack of enough information about it: leads to a lack of visibility for the decision-maker and the difficulty of unknown risks of the crisis, whether in size or degree.

3-Time limitation: The surprising occurrence of the crisis does not allow enough time to answer to it because it needs a quick solution because of the threat it attract to the interests of organizations.

4 -Complex and intertwining: the interfere of its factors and reason that lead to a loss of control over it.

5- Its continuous escalation: the speed of the escalation of events leads to high degrees of doubt in the alternatives given to face front the quickened events, that is, the absence of a quick and serious solution.

6 - The base of fear: it results in a state of fear and panic that may reach the point of creep and limit thinking.

So, in general, the financial crisis is look at through its future impact as a real line that is not related to the past and the present, but rather its impact will increase in the future.

Third: The Dimensions of the Financial Crisis

What are the dimensions of the financial crisis?

A- The dimension of the sudden : as the crisis arises and explodes at a sudden time and place.

B- The dimension of the panic: is the resulting from the serious threat to the interests and the core objectives of the current and future

C- The dimension of time: is the resulting from the limited time available to decision-makers to take a quick and correct.

- **Fourth: Factors that Impede the Discovery of the Financial Crisis**

represented by:

1- The inability of the economic unit to reply in a timely method to the surrounding and potential dangers crises.

2- The existence of a wrong image and an unsound conviction of the economic unit as this reality leads to scanty attention to the risks and crises that surround the economic institution It is called early warnings.

- **Fifth: The Reason of the Financial Crisis**

represented by:

1- Macroeconomic instability. One of the most important sources of financial crisis is fluctuations in the terms of trade, meaning:

- A/ When the volume of trade exchange decreases, it is difficult for bank clients working in the field of export and import to perfect their obligations, especially debt service.
- B/ The large changes in interest rates globally do not only affect the cost of borrowing but also affect foreign direct investment flows to countries and the degree of their attraction.

- 2- Weak government oversight and control: This leads to go up political doubts about the government's obligations and its ability to carry out timely reforms to face the crisis.

- 3- An imbalance in the application of timely macro-financial and monetary policies: especially if this agree with a lack of transparency and the expansion of deception in of financial statements in institutions that are the first cause of trouble.

- 4- Financial sector trouble: Financial crises happen suddenly, as a result of:
- A/ The expansion of granting loans leads to the emergence of the problem of discord between the assets and liabilities of banks, especially in terms of not keep up enough amount of liquidity to meet their present and pressing obligations during times when global interest rates are high and more attractive than domestic interest rates, or when local interest rates are high.
- B/ The expansion of credit granting, large inflows of capital from abroad, and the breakdown of stock markets, meaning that non-preventive financial liberalization helps increase the entry of foreign banks into the financial market, which increases Competition pressures on local banks, especially in credit activities that are not prepared for them, and accepting new types. Risks may not be borne by the bank, and without the necessary preparation and control before financial liberalization, banks may not have the necessary resource and skill to deal with these new activities and risks.

- 5- Information asymmetry: It is one of the most important reasons that lead to the occurrence of a banking financial crisis, as one of the parties dealing in financial and banking event has more information than the others, while the second party will not be able to assess the risks exactly, which results in making a wrong decision.

- 6- The spread of economic moral corruption: such as lies, rumors, monopoly and fictitious information, and this corruption leads to the inability of the debtor (borrower) to pay their loans.

- 7- The weakness of the accounting, control and regulatory system, represented by:
- A/ Weakness in the accounting system and accounting procedures followed and the degree of detection of information, especially with look on to bad debts and their percentage in the cash liquidity held by the bank.
- B/ Weakness of the legal system supporting banking operations and non-compliance with the law about the maximum limit for loans extended to one borrower and their percentage of the bank's capital.
- C/ The lack of effective banking supervision is a direct reason of the crisis.
- D/ The incorrect and lean evaluation of credit risks and the focus of risks in one area, such as the expansion of real estate and consumer loans, for example.

8- Distortion of the incentive system, represented by:

- A/ That the owners of banks and their major management are not financially affected by the financial crises that they contributed to in their occurrence. For example, their services are not finished or they are charged with the losses that occurred as a result of the crisis, especially when the bank keep up risks that exceed its ability.

- B/ that the major management in banks and their lack of experience were among the most important basic reasons of banking crises.

- C/ That the process of change the bank’s structure and rotating administrative positions did not succeed in stopping the occurrence of crises or limiting their effects because the same administrative team last in the decision-making positions so that no real change occurred in management and the way it evaluates and manages credit risks.

- 9- Exchange rate policies and government intervention in credit allocation, represented by:
- A/ exchange rate policies, based on the monetary currency:
- -In the event that the state takes on a fixed exchange rate policy, the occurrence of a currency crisis reasons a deficit in the balance of payments, and then a shortage in the money supply and an increase in local interest rates, which increases the severity of the financial crisis on the banking sector.
- -In the event that the state takes on a flexible exchange rate policy, the occurrence of a currency crisis will right away lead to a devaluation of the currency and an increase in local price levels, which will cause a decrease in the value of the assets and liabilities of banks.

B/ government intervention in the distribution of credit:

Where the distortions resulting from the government’s policy on public sector banks are among the most important reasons of financial crises. It should be noted that there are basic schools in interpreting financial crises:

-The school of rational expectations: assign the reasons of the crisis to the asymmetry of information among actors at the level of the financial market, which leads to differing so their behaviors and expectations of prices.

- The school of financial instability: which focuses on the irrationality of dealers and their herd behavior.

- The Marxist school: which attributes the crisis to the natural contradictions within the capitalist system and the shocking growth of financial capitalism.

The Second Chapter

Theories and Stages of Development of the Financial Crisis,

Channels of their Expansion and Models

- **First: The Theories that Explain Financial Crisis can be Summarized as follows:-**

- **1- The Bubble Burst Theory**

It is known as a price bubble, a financial bubble, or a speculative bubble, and this bubble is formed when the price of an asset rises behind its fair value in an unjustified way, and then panic begins to show and prices fall out. This effect extends toward the prices of other stocks, whether in the same sector or in other sectors, and the surprising fall out in the prices of financial and physical assets occurs as a result of the blow up of the bubble, resulting from the sale and purchase of huge quantities of one or more types of assets, stocks and real estate at prices that top their normal prices, as happened in The USA real estate bubble of 2007.

- **2-Minsky's Theory**

This theory round around explaining the financial crises in the capitalist system that the economy goes through economic cycles from recession to growth, and after going through the recession stage, companies prefer to finance their activities with care and not take great risks, and it is called hedge financing. As for the growth stage, hopeful expectations begin to achieve profits, companies begin to obtain financing and expand borrowing, assuming the future ability to repay, and hopeful spreads to the financial market and lenders begin to expand lending to companies without enough hedging or verifying the recoverability of loans and with the occurrence of a financial crisis For a particular country, the financial sector begins to feel danger, and this affects the ability of companies to pay, and the financial crisis begins, which turns into an economic crisis that leads to recession again.

- **3- Match Theory**

This theory suppose the existence of positive relationships between the decisions taken by the players in the economic arena (speculators and investors), so the investor's decision may often be affected by the expectation of other investors, meaning that the decision to buy the asset is based on the expectation that the value of the asset will increase, while at other times the investor makes the decision Because he expects other investors to take the same decision.

- **4-The Big Fool Theory**

It occurs as a result of speculators’ actions by buying assets at prices higher than their real value because they believe that they will sell those assets at high prices to other speculators (fools), and the bubble continues as long as fools remain willing to buy assets at high prices, and the bubble stops at the last fool the (biggest fool) who will not find anyone to buy From the original at a high price.

- **5-Theory of Greed**

According to this theory, investors will tend to extrapolate the special returns of a certain range of assets, which makes them continue to bid on the purchase of risky assets to obtain the maximum return.

- **6-The herd theory**

This theory is based on the slope of investors to buy and sell in the direction of the market, and the local and foreign investor plays an important role in the happened of financial crisis, and studies indicate that the local investor is the first to flee when the crisis occurs because he has more information than the foreign investor, and in most reason, the foreign investor follows The local investor, that is, the foreign investors are more apt to herd behavior than the local investors.

- **7- The Theory of Excess Liquidity**

Excess liquidity resulting from increased income or ease of credit from financial devices supports the purchase of high-priced assets, which means that a large amount of money chases a limited number of financial assets.

- **8- The Theory of Infection Effect**

That is the transfer of financial and currency crises or the fall of stock markets and their expansion to other countries.

- ## Second: The Stages of Development of Financial Crises

The stages of the development of financial crises can be gathered into three basic stages:-

- **1- Pre-crisis stage: This stage is depicted by the presence of economic index and events that indicate the emergence of the crisis by:**

A/ economic index: This stage may be priced by many omens and indicators that predict almost the crisis, and among these indexes are those related to the high rates of financial deficit, government consumption, the increase in the volume of bank credit and short-term foreign debt due to the banking sectors, ups and downs in stock prices, the increase in the rate of bad debts and the major shifts in Financial markets, weak control and supervision systems, lack of transparency and detection, and other things that are an introduction to the beginning of a financial crisis.

B/ events: stage emergence of the crisis, where events and situations are not know in terms of direction or size.

- **2- The stage of the crisis: This stage is described by:**
- A/ The difficulty of controlling the speed variables of the crisis to reach the point of explosion predicts the real danger to the economy, and this is from that shock and the state of imbalance that it reasons.
- B/ The existence of an index that shows sharp ups and downs in the prices of financial assets, stock prices, and real estate.
- C/ The increase in bankruptcies, the dash to withdraw deposits, and the closing of many projects.
- D/ insurance some institutions and providing help to financial institutions by governments.

- **3- The stage of crisis receding and ending : This stage is described by:**
- A/ The financial and monetary system face the crisis after its explosion, by changing the financial and monetary policies.
- B/ Carrying out the necessary reforms in management, regulatory controls, and work systems to get out of this financial crisis.
- C/ The action and explosion of the crisis, its peak, the beginning of a break through, and the turning point towards another stage of the economic cycle lead to the end of the crisis and a break through.

- **Third: Channels of the Expansion of Financial Crisis**

There are a number of channels that contribute to the expansion of the financial crisis, namely:

A / the transmission of the financial crisis across the sections of the single financial system, and is represented by:

1- The first channel: It represents the transfer of the obligation crisis from the loan and bond market towards the banking system. The stopping of paying private debt services on the part of some countries may negatively affect the possibility of their bankruptcy.

- 2- The second channel: It shows the opposite reason of the first channel, as the emergence of bankruptcy in banks will lead to a decrease in the provision of loans to debtors, and so the possibility of their bankruptcy.

- 3- The third channel: A crisis in the exchange rate that would lead to problems in bond prices as a result of investors giving up them and switching to bonds in another currency.

- 4- Channel four: Bankruptcy of debtors would reason panic among investors (foreign in special), so they would quit those bonds, and there would be a trouble in the exchange rate of its currency as a result of the large quantities of sale presented.

- 5- Channel five: The devaluation of the currency, or mere expectations of that, may lead to the emergence of a wave of withdrawal of deposits from banks in order to convert them into foreign currencies in order to avoid exchange losses, which reason a banking crisis in banks.

6- The sixth channel: If many banks with liabilities abroad go bust, this will lead to the recording of exchange losses on the part of customers who carries out operations abroad.

7- Channels seven and eight: They represent the transition from a crisis in the stock markets to a crisis in the bond markets, which often occurs given that investing in bonds is an alternative to investing in stocks.

- 8- The ninth and tenth channels: They express the transfer of the crisis from the deposit markets to the money markets and opposite, as a large number of banks are considered as dealers in the financial market, whether as financial intermediaries or securities dealers, and banks, especially in developed countries, own a large share of market capitalization. Finance.

- 9- Channels Eleven and Twelve: It describes how a crisis in the exchange markets can turn into a crisis in the money markets, and vice versa. For example, when the currency is devalued, foreign investors panic and they accept to give up their financial assets residing in that currency.

- **B/ Transmission of the financial crisis from one country to another**
- The financial crisis expands to expansion to financial systems in countries other than the country exposed to the crisis, through the following methods and channels:
- 1- Trade agreements and the pressures that may result from them on the exchange rate.
- 2 - The rapid and important decline in the exchange rate of the local currency of a country, prompts investors to return their assessment of the risks linked with investing in other countries, which negatively affects the confidence that these investors place in these countries.
- 3 - The existence of financial relations and links between different countries that lead to the spread of negative reflexes and the transfer of financial difficulties apparent in one country to other countries.

- **Fourth: Models of Financial Crisis**

The empirical analysis of financial crises allows us to different between three types of models:-

- **1-Models of the First Generation**: it explains the reasons of the financial crisis through two factors:
- - The monetary expansion under the fixed exchange rate system reasons a decrease in the stock of monetary exchange reserves for hard currencies, and this reflects negatively on the macroeconomic policies in the country.
- -The persistent deficit in the balance of payments.

- **2- Models of the Second Generation:** The reason for the occurrence of the financial crisis in these models is due to self-expectations.
- **3- Models of the Third Generation:** These add models of the first generation and models of the second generation. Generally, it explains the reason of the financial crisis:
- -Lack of information in the financial markets.
- - The weakness of the banking system.

Chapter Three

Types of Financial Crises

Types of Financial Crises

We set apart between four types of financial crises, which are:-

- **First: Banking crisis:** The bank is look one of the most important financiers of the economy, as it plays a major role in economic development by financing different development projects, but banking activity is full of with risks of all kinds that bank managers seek to avoid, but they may stand helpless in some reason to avoid them, which show them to the banking crisis.

- **The banking crisis is defined** as the inability of the bank to meet the demands of individuals as a result of the large or surprising increase in the demand for withdrawing deposits, which shows the bank to bankruptcy.

- **1- Characteristics of the Bank Crisis**
- **It is represented by:-**
- - The bank or several banks were subjected to a strong stampede on the part of deposit to withdraw their deposits.
- -Banks' inability to handle withdrawal requests.
- - The liquidity of the available banks and the size of their reserves (the legal reserve) do not cover the size of the required withdrawals.
- -The emergence of the so-called liquidity crisis in banks.

- - The ability of the central bank to intervene as a last resort for liquidity in the event that one bank is exposed to this crisis.
- - But if the infection expansions to the rest of the banks, then that case it is called a banking crisis, and then the central bank may be unable to intervene to save the banks.
- - There is another form of the banking crisis that occurs when banks refuse to grant loans for fear of their inability to meet the expected withdrawal requests, and this fear reasons a crisis in lending, which is called the credit crisis.

2-Types of Banking Risks that Reasons a Financial Crisis

The most important types of crises that the bank may be exposed to:

- Credit risk: It means the final or partial inability of the borrower to pay the loan amount and its interest, and in this case, the bank bears a real loss that could lead to serious results, as it affects the financial balance of the bank unusually.

- Liquidity risk : which usually results from deposit withdrawing their deposits in large amounts and collective at a time when banks do not have enough liquidity to cover these withdrawals.

-Funds freezing risk : This crisis is represented by the bank's inability to pay its debts from demand deposits in a certain time or fixed deposits at the time of their maturity.

-Interest rate risk : It is a risk that the bank bears as a result of granting loans at fixed interest rates.

- A risk related to the bank's reputation: It results from the expansion of negative news or publicity related to the bank among the masses, such as tumors.

-Inflation risk : The continuous rise in the general level of prices leads to a rise in interest rates as a result of the application of a deflation monetary policy and thus the lack of expansion in credit, i.e. in granting loans.

- Exchange rate risk : This risk show as a result of fluctuations in exchange rates, and therefore it represents the loss resulting from the change in debt prices denominated in hard currency. In the event of a decrease in the exchange rates of the country's currency, this means a definite loss for the lending bank, as the purchasing value of the funds that the bank will obtain will be less than the value of the loan.

-Operational risk : This is a risk that is not included in the market risk and the credit risk, and therefore has a special classification. Others consider the operating risk as a result of human, administrative, legal, technological, or practical errors. Some banks also classify technological risks in the same group private. not included in the employment risks.

- Strategy risk : related to making strategic decisions (such as those related to the environment in which the bank is located) in managing the business or incorrect application of these decisions.

3- The Reasons of the Banking Crisis

There are two main reasons for the events of the banking crisis, and they are:

A / reasons related to microeconomics, represented by:

- An imbalance between assets and liabilities in banks.

-Excessive state interference in directing loans.

-Many governments guarantees for banks.

-Early financial liberalization.

B/ the reasons related to the macroeconomy, and they are represented by:

-Increasing the volume of lending.

-High global interest rates.

-Low export prices.

- **Second: The Exchange Rate crisis:**before talking about the exchange rate crisis, we must different between two types of the exchange rate, namely:

- A-The nominal exchange rate: is the number of units of the local currency with one unit of the foreign currency, or the number of units of the foreign currency against one unit of the local currency.

- B-The real exchange rate: it expresses the competitive of domestic goods against foreign goods, meaning that it shows the number of units of foreign goods needed to purchase one unit of domestic goods. The closer the real exchange rate is to the nominal exchange rate, the lower the inflation rate.

- An exchange rate crisis occurs as a result of a surprising change in exchange rates in a way that affects the ability of the currency to perform its functions as a medium of exchange or a store of value. Therefore, this crisis is also called the balance of payments crisis. Decisions lead to a breakdown in the price of that currency, and this type of crisis can also occur as a result of the inflow in granting credit, so the volume of unbelieving loans increases with local banks, and then a nominal decline occurs in the value of the national currency against foreign currencies until the real exchange rate becomes closer to The low currency rate, leading to a wave of capital outflows.

- **The definition of the exchange rate crisis** is the severe spoiling of the country's local currency, which forces the local central bank to take several measures, including raising interest rates and tricking a percentage of the exchange reserve.

- **1- Characteristics of the Exchange Rate Crisis**

It is represented by:

- It arises as a result of the rapid and large changes in exchange rates.

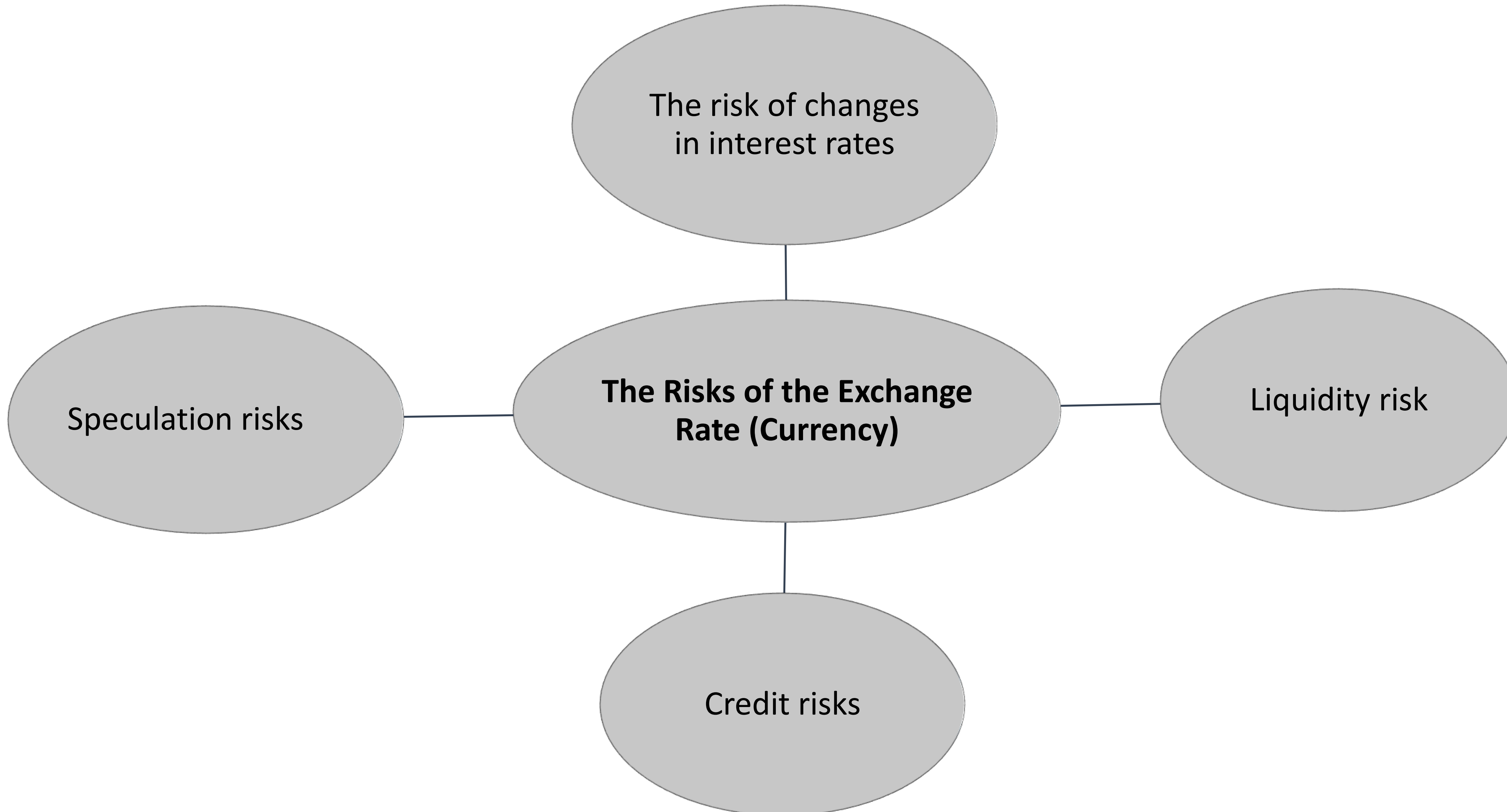
-It affects the ability of the currency to perform its role as a store of value or as a medium of exchange.

- The monetary authorities take decisions to reduce the currency price as a result of speculative operations, and this may lead to a basic breakdown of the currency price, It is also called the balance of payments crisis

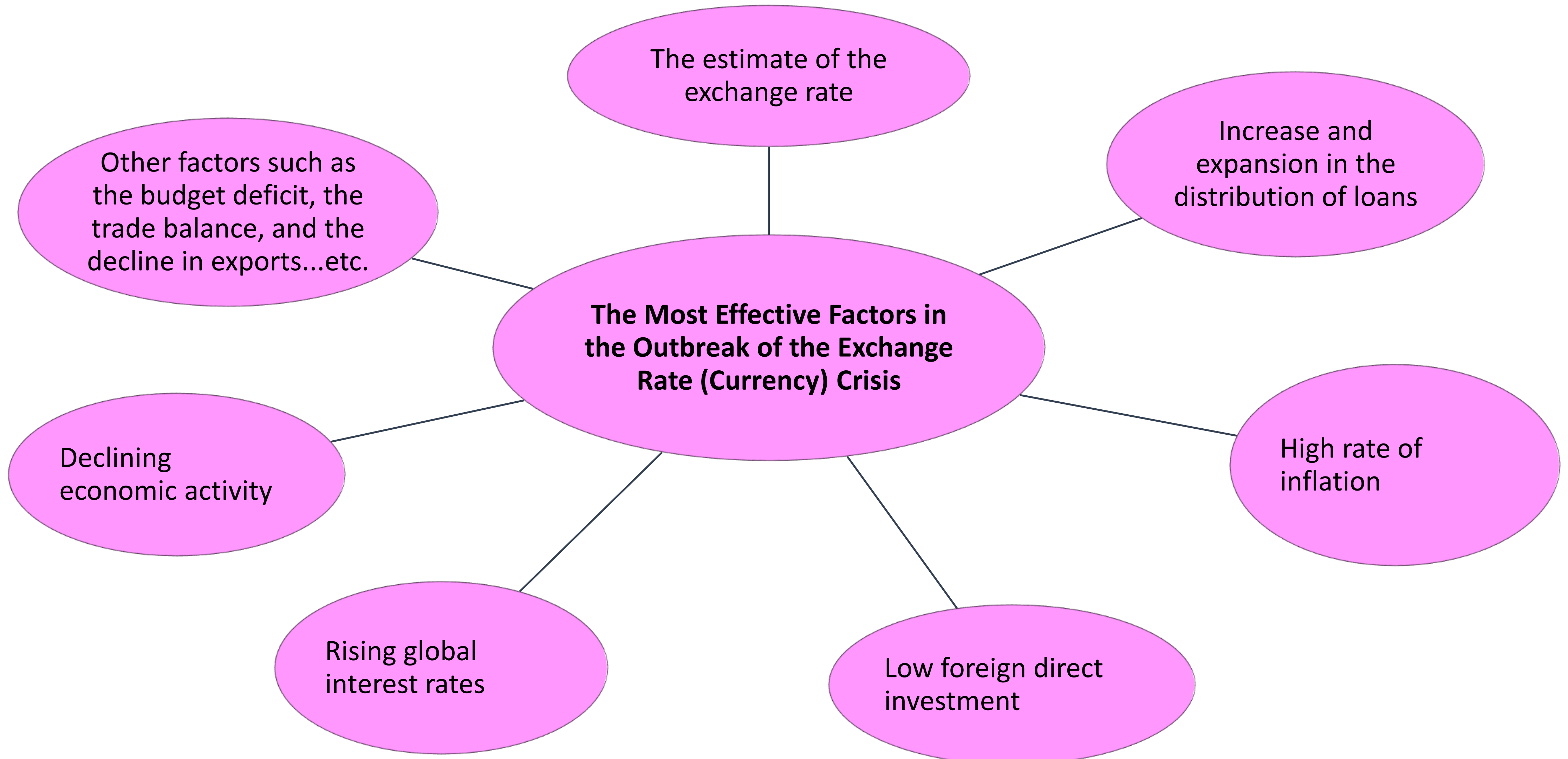
-Also, this type of crisis can occur as a result of the large inflow of capital into the internal, accompanied by an excessive and quick expansion in granting credit, and the volume of doubtful loans increases with local banks.

- The occurrence of a nominal decline in the value of the national currency compared to foreign currencies, until the real exchange rate becomes closer to the low currency rate, leading to a wave of capital outflows.

2-Types of Exchange Rate Risks that Reasons a Financial Crisis



3- The Reasons of the exchange rate crisis:

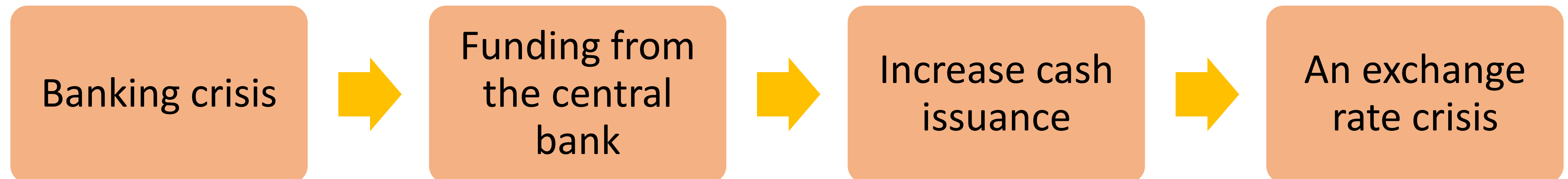


4- The Interaction Between the Exchange rate Crisis and the Banking Crisis

A / From the banking crisis to the exchange rate crisis:

according to the Velasco model, the central bank tries to destroy the relapsing banks by pumping the monetary mass that leads to the exchange rate crisis,the relapsing of the value of the local currency as a result of its high volume compared to the volume of goods and services.

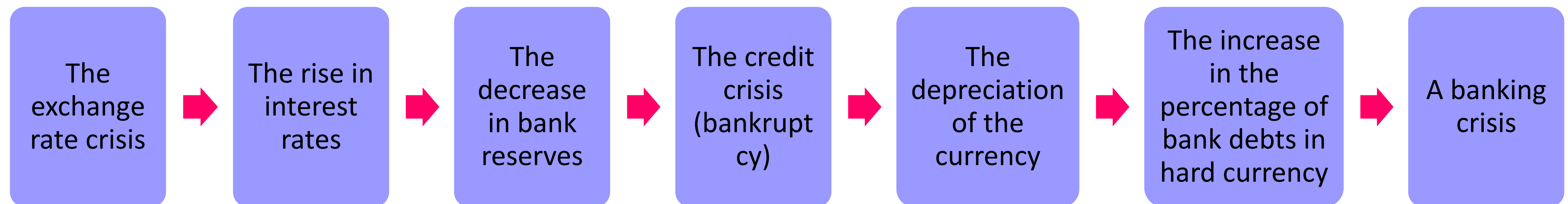
The lower figure shows the transition from the banking crisis to the exchange rate crisis:



B/ From the exchange rate crisis to the banking crisis:

according to the Stocker model, it results from an external shock such as a rise in external interest rates compared to the internal one, a decrease in bank reserves.

The figure below shows the transition from the exchange rate crisis to the banking crisis:



- **Third: Financial Market Crisis:** This type of crisis occurs as a result of what is economically known as the event of bubbles, where the bubble is created when the price of assets rises behind their fair value in an unjustified way, which is what happens when the goal of buying the asset is the profit resulting from its high price. And not because of the ability of this asset to generate income. In this case, the breakdown of the asset's prices becomes a matter of time when there is a strong tendency to sell it, so its price begins to decline, and then panic situations begin to appear, and prices breakdown, and this effect extends to the prices of other assets, whether in the same sector or in other sectors.
- **Definition of financial market crisis** This means the interference of many heaped-up factors, perhaps one of the most important of which is the race of investors towards liquidity, who resorted to loans to finance their purchases of assets that must be repaid.

- **Characteristics of the Financial Market Crisis**

It is represented by:

-It arises as a result of what is economically known as the “bubble” event, which occurs when the price of an asset rises beyond its fair value as a result of intense valuation.

-The objective of buying the asset is the profit resulting from its high price and not because of the ability of this asset to generate income.

-During the return of asset prices to their true value, a breakdown occurs and they reach their lowest levels.

-The breakdown in the value of assets is accompanied by states of panic and fear, and its impact extends to the prices of other assets, whether in the same sector or other sectors.

- **Fourth: Debt crisis:** These are crises that mean that a country or a group of countries has become unable to pay off its external debts. It occurs when the borrower stops paying its dues or when the lenders believe that the lag is possible, and therefore the lending countries stop making new loans and try to liquidate the existing ones; Thus, the debt crisis reflects the inability of the borrowing country to fulfill its repayment obligations, whether this inability is frank or in the form of debt rescheduling.

- **Defining the debt crisis** as the value of existing and distributed obligations, at any time, for residents of a special country towards non-residents to pay the basis, with or without interest.

- **1- Debt Classification Criteria**

The Global Development Finance Report issued by the World Bank classifies the weight of the debts of the countries of the world according to two main indexes:

- A/ The ratio of the present value of the total debt service the principal and interest, to exports that include goods, services, and immigrants' remittances. The bank relies on the value of exports because it reflects the country's ability to provide foreign currencies to service its debts.

- B/ The ratio of the present value of the total debt service to the total government income: the national income is adopted as the optimal criterion for measuring the ability of the national economy to generate income and bear the burdens of indebt.

• 2- Characteristics of the Debt Crisis

It is represented by:

-It arises when the state is unable to pay its loans and the interest accrued on them.

- This crisis is look one of the most dangerous financial crises because it makes countries more dependent and weaker financially in front of the outside world.

- The public sector stopped paying its obligations, which leads to a sharp decline in capital inflows, and there may be a lag in payment for a number of reasons, the most important of which is the questionable financial solvency of the borrower and the toleration of the bank's management in granting credit without enough guarantees from the borrower.

Chapter Four

Index Indicating the Occurrence of the Financial Crisis and Infection and its Containment Mechanisms

- **First: Index Indicating the Occurrence of the Financial Crisis**

There are many economic Index that is used to predict financial crises before they :

- **1- Index related to macroeconomic policies: Among these Index's , we mention:**
- A- An increase in the unemployment rate.
- B- High-interest rates on local deposits and loans.
- C- High - inflation rates and the general level of prices.

- D- An increase in the percentage of consumer loans to the total value of local loans.
- E- The decline in the value of cash reserves in hard currencies.
- F- The decline in the rate of economic growth due to the decline in the gross domestic product.

- **2- Index related to the structure of the financial and monetary markets: they be as follows:**
- A- The high risk of financial assets, such as real property assets.
- B- The weakness of the administrative device in supervising the financial markets and banking sectors.

- C- The absence of transparency and detection related to the presentation of the financial statements of economic institutions, reason the lack of knowledge of the true value of financial assets in banks and financial markets.
- D- An increase in the volume of short-term external debt.

- E- The monopoly of some institutions over the financial markets and the resulting ease of their control over these markets, entering and exiting them.
- F- Decrease in partnership in stock markets.
- **And that these two indexes, which were above-mentioned, warn of the existence of a defect in the economic system of the state, and in the event that it is not faced early, it will be a major cause of the occurrence of the financial crisis.**

- **Second: The Infection of the Financial Crisis**
- **1- Defining the infection of the financial crisis**
- In defining the infection of the financial crisis, the World Bank depend on two criteria:
- **A/ The broad concept:** infection is defined as the transmission of shock between countries, which can occur in a period of crisis or a time of stability. infection can also be related to a negative shock or a positive shock.
- **B/ The narrow concept:** This means that the change in the mechanism of expansion during the crisis time, as the rise in ties between countries during the crisis time reflects the transmission of infection.

- **2- Theories of infection of the financial crisis**
- There are two theories that explain the infection of the financial crisis, namely:
- **A/ Situational financial crisis theory:**
- This theory is based on three pillars:
- **-infection of multiple balances**: The outbreak of a crisis in a country results in a change in the expectations of investors in other countries, resulting in an economic imbalance and then the emergence of a crisis.
- **- Liquidity infection:** It is represented by the occurrence of a liquidity shock, which requires investors to reconfigure their financial portfolio, such as selling their assets in other countries.

-Political infection: the development of European currencies at the beginning of the nineties, through which he noticed the presence of political pressures, led by central banks, to take part in the exchange rate.

- **It can be noted from the previous theories that the expansion of the crisis takes a very short of time, and it can also be complete that the transmission of the shock differs in the time of stability from the time of crisis.**

- **B/ The theory of the financial crisis is non-situational:**
- This theory is based on trade, and common shocks such as changing interest rates, high-risk evasion, random liquidity shock, and a change in global demand. Through this theory, we break up:
- -Financial markets tend to be interdependent.
- -The shock spread mechanism is like in the time of crisis and the time of stability.

Third: Mechanisms to Contain the Financial Crisis

There are many mechanisms aimed at containing the occurrence of the financial crisis, they can be summarized as follows:

1- International Monetary Fund programs to contain the financial crisis, which are:

A/ The Economic Installation Program: It includes:

-**Contractionary monetary policy:** The International Monetary Fund recommends the need to follow a deflation monetary policy aimed at controlling the money supply in order to reduce inflation and correct the balance of payments situation by following monetary policy tools, setting ceilings on domestic credit, raising interest rates, ...etc.

-**Contractionary fiscal policy**: It gol to control the state budget deficit by increasing revenues or reducing expenditures, or both. The percentage of deficit in the state's general budget compared to the gross domestic product.

B/ Structural Adjustment Program: It is represented by a set of institutional or regulatory measures that guarantee the correct practice of the market mechanism and aim to eliminate obstacles to growth.

C/ Early Warning Programs: They are econometric models used by the Fund in its try to predict currency crises before they occur. These models are based on external fluctuations and exploit the regular relationship that emerges from historical data between the variables that would reason crises. There are two Possibilities for the institutional officials of the early warning program, which are:

-The first possibility: is success in predicting the crisis: it is represented in the ability of officials in the institutions to identify the warning signs that predict the imminent of a crisis.

-The second possibility: Failure to predict the crisis: It is represented in the inability of officials in the institutions to recognize the early warning signs that predict the imminent of a crisis.

- 2- Work to reduce the trouble and risks to which the banking system is exposed, especially those that are under the internal control of the state, by using the method of change in financial assets and insurance, keeping a larger part of the financial reserves to face such fluctuations, and using solid financial and monetary policies that are more obligations to its objectives.

- 3- Giving greater independence to central banks for carrying out their primary function of implementing monetary policy.

- 4- Reducing the role of the state in the banking sector and reducing the loans directed by the government with the restructuring of the banking sector. The way to do this may be to support and pay to reduce the role of the state through a program to privatize the banking sector.

5- Strengthening and merging the accounting and legal system, increasing transparency, and disclosing the percentage of bad debts out of the total assets of the banking sector.

6- Raising the maximum limit of paid-up and licensed capital so that banks can meet their present and future obligations in a world where capital transfers are very fast.

- 7- Increasing banking supervision and following international standards, such as the Basel Committee's standard for capital fill, in addition to developing and amending the legal, institutional, and regulator frameworks for the banking sector.

- 8- To demand more transparency in debt products, especially financial derivatives, which the top banking regulators in the world admitted that they do not understand, just as their central banks do not understand them.

Chapter Five

The Most Important Global Financial Crises and Their Impact on Capital Markets

- **First: The Most Important Financial Crises**

There is a group of financial crises that the global economy has faced over the past decades, and they are:

- **1- The crisis of the Great Depression "Black Thursday" (1929-1933)**

- It is one of the most famous financial crises in the global economy and its most severe impact, as it was the reason for changing the structure of the global financial system.

- **A/ The genesis of the 1929 crisis**
- - This crisis began in 1929 in the wake of a train in which the United States of America attend unmatched growth, as money flooded all American banks and companies, and a large part of it was employed in the stock market.
-
- - Although the twenties period was an of economic recovery and expansion when industrial production doubled, and the unemployment rate was less than 1% in the United States of America, the main shock that Wall Street was exposed to was a result of increased speculation, which caused a rise in stock prices with a decrease in their returns Capital leaked from New York to London by raising the Bank of England interest rates, and the stock market on 10/24/1929, and the crisis forced industrialists to increase their production in order to pay off their debts.

- - The increase in production and supply in the market also led to a decline in prices, and the crisis continued towards its minimum level in 1932, when industrial production unmatched a decline of 28%, unemployment rose to 16% in 1931, and workers’ wages fell by 39%, and the number of unemployed people in America alone reached 14 million. Per capita income decreased, which wanted a 50% devaluation of the dollar and an expansionary spending policy to help the unemployed, find employment, and employ young people in refor-estation and building roads in order to increase demand and launch industrial production again, as Germany, France and England were all affected by this. crisis to varying degrees.

B/ The Reasons of the Great Depression

The most important reasons that led to the explosion of the crisis can be summarized as follows:

- -Because of the instability of the monetary institutional system in the United States of America.
- - bad practices, exploitation of customer confidence, and manipulation of securities prices.
- - to the breakdown of the stock market, and the decline of the Dow Jones index in the three years following 1929 by 89%.
- -decrease the volume of loans due to the bankruptcy of commercial banks, months after the collapse of the stock markets.

- -Bankruptcy of no less than 608 banks, including (America the bank).
- -Increasing the volume of investment, especially in the industrial and construction sectors.
- - The Federal Reserve reduces interest rates periodically and pumps large amounts of money into the market.
- - Short selling by speculators of shares that are not in their ownership at high prices in the hope of buying them at low prices for a profit margin.
- - The spread of rumors about the intention of President Franklin Roosevelt's administration to lower the price of the dollar, led to people heading towards selling the dollar and buying gold.

- **C / Characteristics of the Great Depression crisis, represented by:**
- - The crisis caused relative instability in the entire capitalist system.
- - It had a cyclic character based on its close to the cyclic economic crises in the capitalist system.
- -The permanence of this crisis for a relatively long period, as it took about (4) years.
- - The deepness and severity of this crisis are exceptional. In the United States, for example, deposits with banks decreased by 33%, and discount and lending operations decreased by twice. It led to the loss of many savings of depositors, especially the young ones.
- - This crisis caused a drop in the values of the major international currencies by about (50%) to (84%) compared to the pre-crisis level.

- - The significant decrease in the levels of interest rates, as interest rates fell from 55% in 1929 to reach 31% in 1933. This decrease was a first due to the increased demand for money to pay off previous loans, but with the permanence of the crisis, the demand for loans decreased sharply due to Decreased industrial production and exchanges and increased capital supply.
- - The crisis coincided with the sharp fluctuations in currency exchange rates, and this led to the breakdown of the golden system in most countries, and this coincided with the drop in the purchasing power of most currencies due to the increase in the deficit in the general budget and the balance of payments and the decrease in the volume of official gold reserves.
- -As a result of the long-term international credit crisis, 25 countries stopped paying their foreign loans, including Germany and Austria.

D/ The Results of the Great Depression

The effects of this crisis spread outside the United States of America to hit the countries of Western Europe in a way that threatened the pillars of the capitalist system, and its results led to the following:

- - Loss of legality of the basic assumptions of the free classical economic system known as "let it work, let it pass".
- -The Keynesian theory emerged to assert the necessity of state intervention in economic life.
- -Low profits, capital accumulation, high unemployment rates and low wages.
- - The contraction of foreign trade by 40% compared to 1929.

- -prevalent unemployment is estimated at about 100 million unemployed in various countries of the world.
- - The breakdown of the currency values of 56 capitalist countries and the occurrence of a severe drop in world trade.
- -The breakdown of the international monetary system.
- -The breakdown of the stock market prices continued until June 1932, when the shares of the famous investment company (Gold Sachs-Man) fell from $104 per share to $75.1 in 1932, i.e. a loss of 98%, and the value of the shares of (American Groupe Founders) company decreased from $75. $ to $ 0.75 between 1929 and 1925.
- - Trade stock exchanges (goods stock exchanges) followed the breakdown and affected the producing countries.

- **H/ Mechanisms for Treating the Great Depression**

The crisis was addressed through a set of plans adopted by these countries, namely: –

- **1- The plan for the new movement in the United States**, represented by:
- -The first primacy is to combat unemployment: through the establishment of a group of federal agencies to employ the unemployed in launching many large public projects and stren-gthening the subsidies provided to the unemployed for public benefit activities, and by calculating the number of their families.
- - The second primacy is to fight over-production and low prices: The government has a rapid rise in prices as a condition for determining the ability of enterprises to achieve profits.

- **2- Britain's plan**

In September 1931, the British floated the pound sterling, and its decline did not stabilize until the end of the year after it had declined by 31%. % and the unemployment rate decreased by 7%.

- **3- The German economy plan:** A willing recovery policy based on domestic demand instead of imports was adopted. A primary plan and a four-year plan were adopted during the period 1933-1939, aiming to:
- -shoot money into the economy in the form of financial aid for the construction of housing and major public works, especially roads.
- - It will aim to form a stock of strategic raw materials, raise the production of heavy industry and war industries, and increase the replacement policy, and this program has led to significant results.
- -Subsidies provided by the government increased from 5.2 billion marks in 1933 to 3.10 billion marks in 1938.
- -Demand production and with it the national GDP increased by 44% annually.
- -These two plans helped eliminate unemployment completely in Germany in 1939.

- **4- France's plan: It relied on:**
- -activating production by raising revenues and carrying out huge projects.
- -Reducing working hours (without reducing wages).
- -Refuse to decrease the currency.
- -The results of the French plan were acceptable, as industrial production increased by 16% in one year, and unemployment decreased by 18% between the years (1935-1938).

It is worth noting that the plans adopted by the United States of America were the reason for reducing the severity of this crisis.

2- The Stock Market Crisis 1987-1989

- The stock market and goods exchanges are the mirrors that reflect the economic aspects of any country. Here we will address the crises of 1987 and 1989, which affected the stock market in the first place:
- **First: the Black Monday Crisis of 1987**
- This crisis is one of the violent financial crises that shook the global economy in the twentieth century, and this crisis resulted in billions of dollars in losses.
- **A/ The genesis of the Black Monday crisis in 1987**
- -Financial and economic reports confirmed that this crisis began in the US capital markets, and then moved and spread to the rest of the world.
- - This crisis began with the start of work on Monday, October 19, 1987, and that day witnessed a clear and large imbalance between supply and demand in both the present and futures markets. The main source of this imbalance was due to the presence of very large numbers of selling orders in an unprecedented manner.

- **B/ The Reasons of the 1987 Crisis**
- -The large development in the international financial market activity reached its peak in 1987.
- -The power of the financial markets' correlation with each other.
- -The drop of the US dollar against other major currencies.
- -The magnitude of the deals and transactions discussed in the global financial markets.

- -Diversity of financial assets.
- -The US budget deficit continued, as it exceeded $17 billion within a month.
- -The use of the latest methods of communication, and the most advanced techniques in managing financial operations helped to speed up the transmission of crises from one market to another.
- -The drop of the US dollar against other major currencies.
- -The power of the relationship between the monetary and financial systems.

C / The Results of the 1987 Crisis

- - The Australian Stock Exchange index fell completely, real estate prices fell, and the Nikkei index of the Japanese stock market breakdown.
- - The decline in stock prices and the breakdown of the Dow Jones and Financial Times indices.
- - And a clear contraction in corporate investments and production.

- Banks are exposed to bankruptcy due to the inability of borrowers to pay their loans to those banks.

- - An increase in the number of unemployed, especially those working in banks and financial institutions.

- -Countries and central banks were affected by the decline in the value of the dollar, especially oil countries.

- **D/ Mechanisms for dealing with the 1987 crisis**

- To get out of this crisis, the following measures were taken:

- - Trading was hanging on (Tuesday, October 20, 1987) in many stocks traded on the New York Stock Exchange and in the options and futures markets.

- -Big companies stepped in to buy back their shares.

- The Central Bank intervened, in search of granting more credit for the trading of securities, and near the closing on Tuesday, stock prices began to rise.

- -Banks operating in Hong Kong with the government and the Bank of China provided $4 billion to the Hong Kong Stock Exchange in order to get rid of its crisis.
- -In Japan investors were invited by the government to support stock prices on the Tokyo Stock Exchange.
- - The central banks of the United States of America, Japan, France, Germany and Britain cut interest rates and worked to provide the necessary liquidity in order to support the stock exchanges.

- **Second: The Orphan Friday Crisis 1989**
- This crisis appeared less than two years after the 1987 crisis, but each of them differs from the other in terms of the conditions of origin and its effects.
- **A/ The genesis of the 1989 crisis**
- - Since the breakdown of the stock markets in October 1987, investors have retreated from dealing with the American stock exchange during the year 1988.
- - The US stock market fluctuated within narrow limits without having a specific direction.
- - The companies also carried out, in an unprecedented way, mergers or separations, selling, reducing operations, and structural reorganization.

- ## B/ The Reasons of the 1989 crisis

- It can be said that the crisis of October 1, 1989, differs from the crisis of 1987 for many reasons, the most important of which are:
- - The improvement of economic conditions and the lack of index of an imminent economic crisis.
- -Due to the high stock returns, the owners of the shares were not strongly moved to abandon them by offering them for sale, so the increase in the offer of shares for sale was relatively weak and far from causing a drop in prices.
- - The lack of expectations about the possibility of a significant increase in interest rates.

- The dash of investors (in 1987) to sell their shares actually caused a rev of the price decline and inflicted huge losses on the sellers, while in 1989 investors preferred not to dash to sell, which helped calm the markets and limit the decline in prices.

- - Limiting the sales tocks of securities to small investors, without the intervention of large companies, means that the size and scope of operations are weak and thus do not cause a significant impact on prices.

- - In the October 1987 crisis, the government's position was depicted by indifference, which affected negatively and move the crisis, but in October 1989, governments rushed to intervene to stop the crisis, by facing the increasing sales of a very large amount of liquidity, and this helped to contain the crisis.
- - In federal Germany, the financial society did not consider what was happening in the stock exchanges a real crisis, but rather a slight disturbance in prices that did not possess the elements of a crisis, and indeed the situation gradually stabilized.

• C/ The results of the 1989 crisis

- \- The size of US corporate debt has reached $2,000 billion.
- -On October 13, 1989, unrest began after the US government stated statistics indicating an escalation in inflation.
- -Total and retail prices increased during the month of September by 9% and 5%, respectively.
- \- The Dow Jones index, the Tokyo Yaniq index, the Financial Times index, and the CAC index lost points ranging from 142 points to 647 points.

- **D/ Mechanisms for dealing with the 1989 crisis**
- - However, after the breakdown in stock prices, US Treasury Secretary Nikos Brady speed to rest investors not to sell.
- -Governments also speed to intervene to stop the crisis.
- - The effects of the 1989 crisis were not as great as the 1987 crisis, because the situation was heading quickly toward stability, to return to what it was.

- **3- The 1994 Mexico crisis**

- According to Michel Camdessus, former administrative director of the International Monetary Fund: The Mexican crisis was the first big crisis in our new world, the world of globalized markets.

- **A/ The genesis of the Mexico crisis**
- -The crisis occurred as a result of the large inflow of capital out of the country.
- -The occurrence of a balance of payments deficit (current operations balance deficit).
- -Mexico's inability to pay its foreign debts, resulted in a drop in the exchange rates of the national currency, the peso.
- - The government was forced to increasingly raise interest rates in order to support the currency, but as soon as the currency floated, the value of the peso fell, and credit expansion slowed down as a result of high-interest rates.

- ## B / the Reasons of the crisis in Mexico

- - Evaluating the national currency at a higher value than its real value, to hide the drop in private savings and to hide the deficit in the account of current operations.
- - The huge rise in consumption and in the import of goods whose prices are believed to rise later, and this rise is a result of the increase in the evaluation of the peso.

- - After the rise in the interest rate and managing the short-term government debt and the expansion of credit granted to the banking system are among the most prod reasons leading to the occurrence of the Mexico crisis, which prompted the government to follow a strict monetary policy and expand the scope of intervention in the exchange rate to maintain the stability of the currency.

- - The fluctuations in the exchange rate and the successive financial turmoil resulted in tragic negative effects on the Mexican economy, as the value of the Mexican currency (the peso) fell by 40% of its value in mid-December 1994, due to the successive declines in indirect investments, as well as the government's decision to float " The peso "and its zeal of the management of the exchange rate system.

- **C/ The results of the Mexico crisis:**

- - It appeared at the beginning to the countries of the world that the depreciation of the peso is normal and has no effect on the rest of the economies, except that from the beginning of January 1995 the impact began to spread to a group of currencies from the financial markets in Singapore, London and New York, and the most important currencies that were exposed to the decline were the Polish zloty, the baht Thai, Argentine Peas.

- - This situation prompted investors in developing countries to get rid of the securities they owned from emerging markets in order to obtain hard currencies (marks, dollars, Swiss francs, and Japanese yen).

- Such behavior led to a decline in the currencies of emerging market countries in a manner that seems consistent, as it touched the currencies of countries that do not have any economic symmetry between them, as is the case with Hungary and Indonesia so that the central bank governors of Southeast Asian countries find themselves together to decide to raise interest rates for their countries in the hope of luring investors. to keep what they have of the currencies of these countries.

- - Argentina also took the same measures as Bologna and Brazil, and the matter did not stop but moved after January 20 to the dollar, so the fear of the outbreak of crises similar to the Mexican crisis in the rest of the developing countries may lead to reactions that end with the breakdown of global financial markets.

- ## D/ Mechanisms for dealing with the Mexico crisis

- On this basis, the International Monetary Fund, along with other countries, provided financial support to Mexico, so that the contributions were distributed as follows:

- -The International Monetary Fund warrant to provide a loan of $8.17 billion to Mexico in the form of a By-Stand facility.

- -The US treasury provided a loan of 20 billion dollars settle from the exchange rate stabilization fund, so this loan was in the form of a swap agreement, in addition to this, in exchange for guarantees about oil revenues. The Treasury asked the Federal Reserve for a short-term loan of $6 billion.

- -As for the Bank for International Settlements, it pledged to provide a loan of $10 billion.

- -Some commercial banks also pledged to provide a loan of $3 billion.

- **In light of the assistance provided by the International Monetary Fund and other countries, the Mexican government has worked to follow a program of reforms, which is known as the Zedillo Plan, which in fact aims to achieve several goals, especially:**

- - Fighting inflation, especially by fixing the prices of basic materials. The emergence of inflation may be attributed, in particular, to the deterioration of the peso exchange rate.
- -Bringing in long-term foreign savings by following the privatization program, especially in sectors that were formerly a state monopoly, and allowing foreigners to win the entire capital of Mexican banks.
- - Work to reduce the budget deficit of the Mexican state and the current balance

- **4- The 1997 South East Asian Crisis**

The countries most affected by the Asian financial crisis were Indonesia, South Korea, and Thailand, followed to a lesser extent by Malaysia, the Philippines, Laos, and Hong Kong, as well as China, Taiwan, Singapore, Brunei, and Vietnam, all of which suffered from lower demand and market confidence across the region.

- **A / The Emergence of the Southeast Asian Crisis in 1997**
- -The crisis has hit the fastest-growing economies in the whole world, as growth rates ranged between 6% to 10% annually during the period preceding the 1997 financial crisis.
- -The International Monetary Fund has confirmed that the cause of the crisis is the existence of defects in the application of the capitalist system by these countries.
- - The decline in growth rates in the countries of Southeast Asia in 1998, as they ranged between -5% and -7%.

- - The countries of South East Asia have pegged their currency to the US dollar, which helped them stabilize their exchange rates.

- -Statistics indicate that the countries of South East Asia have attracted 61% of direct foreign capital and 29% of indirect foreign capital to the total capital destined for the so-called countries on the path of growth during the period from 1991 to 1994.

- **B/ The Reasons of the Southeast Asian Crisis**
- The factors that caused this financial crisis are:
- - Not calculating risks sufficiently: investors and bankers did not calculate the risks sufficiently, and the focus was on searching for high rates of returns outside the markets of the United States of America, Europe and Japan, which in those years were suffering from a clear degree of slowdown in economic growth rates with a decrease their interest rates.
- - That a large part of the loans and flows had been directed toward construction projects and non-productive institutional expansions, and this led to the presence of companies and buildings at extreme prices.

- -The nature of the capitalist structure: it was different from what existed in the developed capitalist countries.
- - The existence of structural imbalances in the investment decisions and spending of the private sector, and there is a defect in the methodology of managing banking institutions in the Asian tiger countries.
- - Absence or lack of transparency in the government institutions sector in Southeast Asian countries, especially in the financial aspects.
- - The existence of hidden government interventions in the private sectors in the countries of Southeast Asia.
- - Speculations on currency prices and the clear rise in the exchange rate, which exceeded the real value of the local currency.

- - Existence of large basic deficits in the current account.
- - The significant rise in short-term foreign debt.
- - The very large flow of capital into countries, most of which was in the form of short-term borrowing.
- - The concerned authorities in the countries raised the interest rate with the aim of not converting from the national currency to foreign currencies, especially the US dollar, to encourage investors to convert their dollars into local currencies.

- ## C / The Results of the Southeast Asian Crisis

There are several results of this crisis, namely: -

- -The financial markets in Southeast Asian countries incurred losses of about 600 billion dollars. The stock markets lost about 60% of their value on average during the period 01/07/1997 to 02/07/1998.
- - Many investors feared the drop in the economies of Southeast Asian countries, which made them hasten to sell a large number of shares to reduce their losses, which increased the drop in the value of shares and panic the confidence of investors.
- - The sudden withdrawal of foreign capital at a time when these funds contributed to raising the growth rates of these countries during the last years before the crisis.

- The bankruptcy of many banks and companies, led to a rise in unemployment and inflation.

- - The failure of the banking system to perform its main tasks and the drop in the conditions of other financial and economic institutions.
- - Decline in the gross domestic product, the decline in economic growth, capital flight, and reduction in public and private spending.
- - Increasing current account deficits and balance of payments and increasing indebtedness abroad in crisis countries.

D/ Mechanisms to Treat the Southeast Asian Crisis

It consists of responding to two aspects:-

- 1- Domestic side answer:
- - Both Thailand and Malaysia imposed restrictions on capital movements.

-Malaysia announced that it would establish a fund to support stock prices, but later abandoned it.

- - Korea, which faced some of its companies and institutions subject to bankruptcy, but then acted in a different and fuzzy way, as it spent its foreign exchange reserves in a desperate try to defend its local currency in October and November 1997.
- - As for Indonesia, it expanded the scope of exchanging its local currency, the rupee, and then floated it after 1997, eased the laws and rules governing foreign ownership of shares, and stated that it would implement more than 100 investment projects by withdrawing its huge deposits from the banking system. Interest rates rose sharply, which led to the withdrawal of foreign capital.

- <u>2- The Response of the International Monetary Fund</u>

- The International Monetary Fund worked to calm the situation or restore confidence to the countries of Southeast Asia within the framework of its management of the crisis in two stages:-

- **First: The first stage:** This stage was marked by the Fund signing three emergency loan agreements with Thailand, Indonesia and Korea in 1997. These three agreements included the provision of huge and new international financial support estimated at $17 billion for Thailand, $35 billion for Indonesia and $57 billion. One billion dollars to Korea, and the three loan agreements were similar in their basic content, as each of them included the following elements:

- - A large part of the loans is allocated to governments and central banks to enable them to enhance their ability to service foreign debts, and to stabilize exchange rates.

-Ensuring the provision of a macroeconomic framework depicted by a balanced budget, high nominal interest rates, and restriction of domestic credit in accordance with the requirements of exchange rate stability.

- - Adopting other structural and directive measures in order to increase transparency and competition, including fast reform of the commercial system, privatization, and breaking monopoly.

The speed objective of the International Monetary Fund was to restore confidence in financial markets, in particular by working to stabilize exchange rates by raising interest rates, restricting credit, achieving financial balance and increasing foreign exchange reserves.

- **Second: The second stage**: The management of the International Monetary Fund to contain the crisis entered its second stage on December 24, 1997, and it included new principles for the fund, including:
- -respite or partial stay of foreign debt payments according to collective agreements between creditors and debtors, as in the case of Korea, or according to individual agreements negotiated between creditors and debtors, as in the case of Indonesia.
- -Government guarantee for commercial bank liabilities.
- - Focusing on restructuring banks instead of closing them.
- -Abandoning the goal of achieving an excess in the budget and focusing only on trying to reduce the budget deficit.

And some principles remained unchanged in the second phase, such as the fund's insistence on fixing exchange rates through high-interest rates and restricting domestic credit, adopting large-scale structural measures in the areas of financing, trade, and monitoring the business sector.

- **5- The financial crisis of 2008**

The mortgage crisis in the United States of America is considered one of the most severe financial crises that shook the largest economies in the world and destabilized the largest international financial markets, and its reflection looms up to the global economy as a whole.

- **A/ the emergence of the 2008 financial crisis**
- It is represented by:-
- -The origin of this crisis is the granting of high-risk real estate loans.
- -The inability of borrowers to pay their debts.
- - A liquidity crisis occurred in banks, resulting in financial collapse and halting investment projects in many countries of the world.

- **B/ The Reasons of the 2008 financial crisis**
- It is represented by:-
- - The sudden rise in interest rates for mortgage loans in America from 2% to 5.7%, caused the inability of poor American families to pay their debts to banks.
- - Banks rescheduling their debts at a higher interest rate, i.e. raising their interest rates by a greater percentage compared to the previous one.

- \- The global financial system and the system of financial markets are based on the system of financial derivatives, which depend mainly on formal paper transactions based on probabilities, and do not entail any actual exchanges for goods and services.
- \- Bank securitization is an innovative financial tool, as the bank converts bank loans into at-hand securities, that is, converting them from illiquid assets to liquid assets.
- The weakness of the supervisory system, information asymmetry and lack of transparency in banks and other financial institutions, move the mortgage crisis.

- **C/ The results of the 2008 financial crisis**
- It is represented by:-
- - Expedite withdrawal of deposits from banks.
- -Many financial institutions have frozen granting loans to companies and individuals for fear of the difficulty of recovering them.
- - The lack of liquidity in circulation among individuals, companies, and financial institutions, and led to a sharp contraction in economic activity and in all other sectors, which led to borrowers stopping paying their debts.
- -Collapses occurred in many Gulf stock exchanges.

- - The low level of trading in the money and money markets, and caused confusion and imbalance in the index of decline and rise.
- - Low level of energy used in companies due to lack of liquidity and freezing of obtaining loans from financial institutions at very high-interest rates and incorrect guarantees.
- - Decrease in sales, especially in the real estate sector, cars and others, due to weak liquidity.
- -An increase in the unemployment rate due to comment, bankruptcy and liquidation, and every employee and worker is threatened.
- - An increase in the rate of demand for social benefits from governments.

- - Low rates of consumption, spending, savings and investment, and this led to more recession, unemployment, defaulting, stopping, liquidation and bankruptcy.
- - The decline in the exchange rate of the dollar against other currencies, especially the euro and yen.
- - The borrowers lost their assets and their mortgaged homes because of the loans, and they became among the homeless, immigrants, the poor and the needy.
- - The decline in oil prices continued, which had a negative impact on economic growth rates in the Arab Gulf countries.

- **D/ Mechanisms to treat the 2008 financial crisis**

The nature of the global financial crisis of 2008 requires the taking on and implementation of a set of strategies, policies, procedures and programs at the local and global levels, the most important of which are:-

- **1- The American financial rescue plan**

It is represented by:

- - The US administration put forward a treatment plan, the essence of which is for the US treasury to pump huge amounts of cash into the credit and financial markets.
- -Allowing the US government to buy 700 billion dollars of losing assets linked to the mortgage.

-The state contributes to the capital and profits of companies benefiting from this plan, which allows profits to be made if market conditions improve.

- -The Minister of Treasury is assigned to coordinate with the authorities and central banks of other countries, to draw up similar plans.
- -Raising the ceiling of guarantees for depositors from one hundred thousand dollars to 250 thousand dollars for a period of one year.
- -Granting tax exemptions worth $100 billion to the middle class and companies.
- - Determining the compensation for the heads of companies when they are dismissed.
- - Preventing the payment of compensation that encourages useless risks, and financial rewards for company officials who benefit from tax cuts have been set at five hundred thousand dollars.

-Recovering bonuses that were offered on expected profits that have not yet been realized.

- -A supervisory board supervises the implementation of the plan, and this council includes the head of the Federal Reserve, the Minister of the Treasury, and the head of the Stock Exchange Regulatory Authority.
- -The Congressional General Accounting Office maintains a presence in the Treasury to monitor asset purchases and audit accounts.
- -Appointing an independent observer general to monitor the decisions of the Minister of Treasury.
- - The judiciary studies the decisions taken by the Minister of Treasury.
- - Take action against seizures of property.

- **2- British financial recovery plan**

  represented by:

- -specify 64 billion dollars to purchase the shares of a number of British banks, i.e. contributing to the bank’s capital, and providing financial aid to a number of small institutions.
- -Banks' obligation to lend to hom-owners and small establishments at the levels of lending that prevailed during the 2007 year.
- -Reducing the salaries of bank managers, encouraged the concept of risk.
- -The government appoints members to represent it on the boards of directors of banks.

- Purchasing a large number of new issues of shares, which were intended to increase its capital in order to face the crisis.

- - Guaranteeing British deposits in Iceland after the break of the Icelandic banking system.
- **3- The plan for the financial ruin of France**
- It is represented by:
- -The first plan is to provide guarantees for joint loans between the banks themselves at a value of 300 billion euros.
- -The second plan is to obtain stakes in troubled companies and financial institutions at a value of 40 billion euros.
- - At the end of November 2008, T announced a new plan to help the housing and automobile sectors, with a value of 26 billion euros, about 33 billion dollars.

- **4- The plan for the financial ruin of Germany**
- It is represented by:
- - The German government approved a plan to rescue banks, including the establishment of a fund to restore stability to the markets, and allocated 400 billion euros for it.
- -He called on the German government to restrict the salaries of bank officials that are targeted by the government rescue package and to determine bonuses and termination dues.

5- Russia's financial collapse plan: The Russian Parliament approved a plan to save the country's banking sector at a value of $84 billion.

- **6- The financial collapse plan for Japan**: The Japanese Central Bank pumped 13 billion US dollars into the markets to prevent a disturbance in the liquidity rates in the markets.

- **7- China's financial collapse plan**: The government abolished taxes on stock purchases, and also bought shares from the markets of state-affiliated financial institutions. The Chinese Central Bank announced a $586 billion plan to stimulate the Chinese economy

• Second: the impact of global financial crises on financial markets

The impact of the financial crises on the financial markets differed according to the severity of the crisis and the emergency changes in it, which is reflected in trading and investment. The following is a presentation of these effects:

- **1- The impact of the Great Depression of 1929 on the financial markets**

It is represented by:

- - 76 million shares were sold and prices collapsed as a result.
- -Investors' losses amounted to $74 billion.
- -Unemployment rates rose, which led to a decrease in the volume of global investment.
- - The bankruptcy of many banks, which amounted to 5,000 banks in the United States of America, and the losses of depositors amounted to about 3 billion dollars.

- **2- The impact of the 1987 crisis on the financial markets**
- It is represented by:
- -The crisis led to a decrease in the real value of assets in dollars.
- -Investors rush to get rid of their financial assets denominated in dollars.
- - An increase in the supply of financial assets (especially stocks), which leads to a collapse in their prices.
- -Many investors switched from holding stocks to bonds.
- - Many investors resort to replacing their long-term financial assets with short-term ones, which provides them with more guarantees to face other expected crises.

- **3- The impact of the 1994 Mexico crisis on the financial markets**

  It is represented by:

- - The high Mexican trade deficit, is estimated at 29 billion dollars.
- Investors withdrew their money from the local financial markets, which was the beginning of the crisis in Mexico.
- Increasing capital flows out of Mexico.
- Low foreign exchange reserves.

- **4- The impact of the 1997 Southeast Asian crisis on the financial markets**

It is represented by:

- - A significant decline in investments, whether domestic or foreign.
- Foreign investors withdrew their money from Southeast Asian countries.
- -The rates of financial flows to Southeast Asian countries decreased.
- -Increasing pressure on currency prices and stock exchanges by investors.
- - The reactions of turmoil that spread in the financial markets in Southeast Asian countries took many global investment institutions according to them.
- - The high degree of investment risks in emerging markets, which was accompanied by a decrease in capital flows to Southeast Asian countries.

- **5- The impact of the 2008 mortgage crisis on the financial markets**

  It is represented by:

- - The decrease in the volume of investments in developing countries from 13% in 2007 to 5.3% in 2008.
- - There is a state of intense fear among investors regarding the future of the economy and investment, which has led many of them to not want to take risks and to search for safe investments in other sectors.
- -Many investors withdraw their money from the US economy.
- -The occurrence of instability and volatility in the financial markets.

- -Institutions faced a shortage of their ability to borrow and had to sell securities.
- - The lack of transparency in the OTC market led investors to flee from risk.
- -Investors from international banks, institutions and companies who invested in bonds covered by real estate assets have been directly affected by the current financial crisis and have suffered losses that are difficult to estimate.