

An Overview of Recent Global Financial Crises and International Liquidity Problems

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Abstract :

The global economy is currently experiencing unprecedented disruptions and instability, comparable to those of the Great Depression of 1929. Since 2007, the world has witnessed serious international financial crises, culminating in September 2008. In addition, the ongoing oil crisis, which began in mid-2014, has revealed the true state of the global economy and has had a significant impact on countries that heavily rely on this resource. These crises have worsened economic conditions and have affected international liquidity for all countries, including Algeria, which has experienced a decline in financial income from fuel exports. Moreover, the recent COVID-19 pandemic has further aggravated the situation and its repercussions on the world market and Arab countries have been significant. This study aims to explore the origins, initiation, phases, causes, and effects of these global financial crises on the global economy, in terms of international liquidity for these countries and their ability to meet their debts and settle their international transactions.

Keywords: global financial crisis; oil crisis; COVID-19 crisis; global economy; international liquidity.

Jel Classification Codes: F00; F30; G01.

Introduction:

Throughout history, the world economy has experienced several global economic and financial crises that have severely impacted the lives of millions of people. These crises have often resulted in a significant deterioration of financial markets due to the inability of local banking systems to fulfill their core functions. This has led to a sharp decline in currency values and stock prices, negatively affecting the production and employment sectors, and resulting in a redistribution of income and wealth among international financial markets.

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However, it is worth noting that the majority of economic and financial crises have affected the US economy. The most significant and well-known crisis occurred in 1929, known as the Great Depression, which followed a strong recovery in the automotive and construction sectors in the 1920s. The 2008 financial crisis also affected the US economy, which began in the fall of that year after a series of factors, including the mortgage crisis and the inability of borrowers to repay their debts, as well as the 2014 collapse in world oil prices (oil price collapse crisis 2014), which had a negative impact on the global economy due to most countries' reliance on oil revenues. The oil price war in March 2020, which was revealed by the global health crisis (Corona crisis), exacerbated the issue.

Therefore, it is essential to ask what the causes and consequences of recent global financial crises are on the world economy and how countries can cope with these crises and their effects, particularly in light of the global liquidity shortage.

The following questions arise from the above issue:

- What are the main global economic and financial crises?
- What are the causes and consequences of these crises? And what is their impact on economies?
- How does the world view its economies after the collapse of oil prices? And how did this happen?
- What solutions did the world's countries find to cope with previous and current economic crises?

Hypotheses:

In order to address the aforementioned questions, the following hypotheses are proposed:

- The current crisis is the result of a combination of several factors, including structural drivers such as the nature of the capitalist system, as well as circumstantial factors such as imprudent expansion of mortgage loans and weak oversight and transparency.
- The financial crisis has affected the entire world due to the global decrease in fuel prices resulting from the economic recession.
- The solutions and measures implemented to tackle these crises are only temporary and cannot prevent or halt these crises and their negative impacts, potentially leading to further local and global financial crises.

The objective of this study is to attempt to provide answers to these questions and others through the following steps:

I. The global financial crises: These crises have garnered significant attention in economic discourse owing to their intrinsic nature and correlation with business cycles. Consequently, this discussion shall delve into the fundamental concept of crises, its various forms, and the underlying causes that have had a profound impact on the economies of the world.

a. Definition of crises: The definition of a crisis traces its origins to ancient Greek medicine, where it signified a pivotal moment in the course of an illness upon which the patient's recovery or demise hinged. In the twentieth century, the term has evolved to denote a sudden and severe disruption in the balance of supply and demand, characterized by a rapid succession of events that further compound the

degree of uncertainty, thereby confounding decision-makers and rendering them indecisive (1).

Hence, it is possible to define financial crises as those oscillations that have a complete or partial impact on all financial variables, encompassing the volume of issuances, stock and bond prices, bank deposits, and exchange rates. Financial crises generally arise abruptly due to a loss of faith in a financial system, which is typically triggered by a substantial influx of capital accompanied by a rapid surge in lending, without ensuring the creditworthiness of borrowers. This eventually leads to a decline in the currency's worth, causing waves of capital outflows.

b.Types of financial crises: There are three distinct types of financial crises.

- Banking crises: These crises can take on two forms: The first is a liquidity crisis that arises when a bank is suddenly faced with an overwhelming number of deposit withdrawals. This can occur when a bank has lent or invested most of its deposits and only holds a small percentage in reserve to meet daily withdrawal requests. If depositors demand more than this reserve, the bank may not be able to meet the demands, resulting in a banking crisis. The second form is a credit crisis that happens when banks have ample deposits but are hesitant to lend due to the possibility of not being able to meet withdrawal demands in the event of a lending crisis.

-Financial market crises and speculative bubbles: These events can take place in financial markets. They are economically known as speculative bubbles, which occur when the primary purpose of acquiring an asset is to speculate on its price rather than investing in it to generate income. In such scenarios, the eventual collapse of asset prices is inevitable and leads to panic situations in the aftermath of the crash.

-Currency crises: happen when currency authorities opt to devalue the currency because of speculation, leading to a substantial impact on the currency's capacity to act as an intermediary in exchange or as a store of value. This crisis is commonly known as a balance of payments crisis (2). Therefore, the potential crises that may occur are confined to three significant types: the crisis resulting from the monetary system, the crisis arising from the balance of payments, and the crisis resulting from an unequal distribution of wealth among people, i.e., resulting from wealth misallocation (3).

The great depression crises (1929-1933): After the crisis that swept most of the world during World War I, there was a period of relative stability in international monetary and financial relations due to reforms and adjustments made to the prevailing monetary systems. However, this stability was short-lived as the global economic crisis of 1929 erupted. Beginning in 1924, stock market prices flourished and continued to rise for five years until they reached their peak in October 1929 (Dow Jones Industrial Average). This led to investors losing everything in the market and the bankruptcy of around 3,500 banks in a single day (4). The economic crisis was marked by the following characteristics (5):

- The disturbance of the relatively stable state of the entire capitalist system.
- It was recurring in nature due to its close association with crises.
- It persisted for a relatively long period.
- A significant drop in the levels of interest rates.
- Variances in duration and unit of time among different countries.

- The breakdown of the global monetary system in most nations.
- The suspension of the repayment of foreign debts by 25 countries.

October 1987 crises: On October 19, 1987, the global financial markets suffered a collapse, famously known as "Black Monday," that originated from the New York Stock Exchange. The sudden selling of shares by investors caused the Dow Jones index to plummet by 508 points in just one day (6). This panic rapidly spread to other stock exchanges around the world, resulting in widespread chaos and significant losses. The Black Monday crash was the most severe since the disastrous collapse on October 28, 1929, when the Dow Jones index fell so dramatically that even experts were unable to control it through brokers or large traders, a phenomenon referred to as the spot market (7). The underlying factors that contributed to the crisis include (8):

- The rapid expansion of international financial market activity, which reached its pinnacle in 1987.
- The increasing interconnectivity between these markets.
- The diversity of assets being traded.
- The magnitude of transactions in the global financial markets.
- The use of modern communication methods, which accelerated the speed at which crises spread from one market to another.
- The trading of major international currencies became the primary conduit for transmitting crises.

Southeastern Asia crises: The countries of South East Asia and South Korea, which were once considered economic success stories, experienced a major financial crisis that affected their currencies and stock markets. This crisis represented a rupture in their economic development model, as they had previously enjoyed a strong record of economic performance while ignoring emerging problems. This led to their exposure and contributed to the currency crisis of 1997, when exchange rates fell due to currency speculation and declining profits in the stock markets. As a result, monetary authorities had to raise interest rates, prompting investors to sell their stocks and deposit their value in banks to take advantage of the higher interest rates (9).

The severity of the crisis was evident from various global economic indicators, which revealed the following imbalances (10):

- The sharp decline in the value of the Thai currency, known as the "Bhatt", which led to an increase in overseas loans and exposed the financial and business sector to risks.
- The government's inability to reduce the new and exacerbated inflationary pressures associated with a large external deficit and the disruption of financial markets.
- Weak government oversight and regulation, which raised political doubts about the government's commitments and ability to carry out the necessary reforms to address the crisis.
- Excessive lending and borrowing.
- Financial liberalization in the balance of payments.

II. The 2008 global financial crisis: Causes, consequences, and mitigation policies:

a- The emergence and development of the 2008 global financial crisis: The 2008 financial crisis is one of the most severe economic crises the world economy has faced since the Great Depression, especially after the global economic system failed to contain and mitigate its effects. The US Federal Reserve (11) attempted to rescue financial institutions and markets by purchasing various high-risk assets and providing loans, resulting in a sharp decline in interest rates to less than 0.1%. This led to a rise in real estate values and shares of real estate companies, which in turn encouraged Americans to invest in long-term housing and property. The resulting expansion and leniency resulted in loans being provided to low-income individuals without proper verification of their ability to repay the loans (12). Consequently, the crisis affected a large number of banks and companies in the United States and around the world, including financial and real estate companies. Thus began the discussion of a global financial crisis, with the US serving as its starting point.

b-Causes of the 2008 global financial crisis and its consequences :

-The economic recession in the United States: The 2008 global financial crisis was caused by several factors, one of which was the economic recession in the United States. This was evidenced by a decline in various financial market indicators such as the Dow Jones Industrial Average, which fell to 679 points, the Standard & Poor's index, which fell to 75 points, and the NASDAQ, which fell to 95.2 points (13). The US economy was the primary culprit behind the crisis, and its impact was felt in other countries, leading to an economic recession that affected global exports and resulted in fluctuations in the dollar's exchange rate against other currencies.

-Mortgages: The decline of US interest rates spurred banks to offer mortgages at rates as low as 0.5%, leading to a surge in home purchases across various regions of the country. As a result, banks expanded their property loan portfolios, contributing to an unprecedented rise in real estate prices. The practice of raising property values to obtain a new loan, known as 'sub-prime' lending, has resulted in loan prioritization based on loan type (14). Consequently, many houses are subject to multiple mortgages from different parties.

-The securitization of real estate debt: this involves transforming less liquid assets into securities that are easily tradable (15). During the global financial crisis, this process involved converting debts owed to primary lenders, such as banks and other financial institutions, into securities that could be traded on financial markets (16). To create a new wave of securities, banks would accumulate a significant mortgage portfolio and borrow from other financial institutions. This process allowed for the pooling and distribution of individual loan risks to security holders and guarantors.

-Insufficient and unregulated financing can be attributed to four main factors: declining housing prices, increasing personal debt, failing financial institutions, and inadequate regulation by monetary authorities. Other contributing factors include the prevalence of speculation, the proliferation of innovative financial instruments such as derivatives, and corruption at the upper echelons of financial institutions.

Furthermore, financial liberalization policies have exacerbated the severity of the situation.

-The use of financial derivatives: Financial derivatives refer to instruments designed to hedge against or speculate on fluctuations in financial securities. They may include futures, options, forward contracts, and swaps. As of June 2009, the total value of derivative contracts reached \$25,372 billion, with outstanding derivatives estimated at \$600 trillion by the Bank for International Settlements. This figure is ten times larger than the size of the global economy.

b-The economic impacts of the global financial crisis :

-The global financial crisis had significant economic impacts, including the bankruptcy of numerous banks and companies. In response, central banks injected additional funds into financial markets to mitigate the crisis (17). The crisis led to the collapse of some of the largest banks in the United States, which were burdened by sub-prime assets, primarily related to mortgages. Additionally, the crisis contributed to the decline of the automotive industries in Europe and Japan.

-The global financial crisis has had a significant impact on economic growth rates. Since the start of 2008, the world economy has experienced a sharp decline, and most capitalist economies have suffered a considerable economic contraction. These declines have hampered growth due to the interconnectivity of financial and economic systems. According to international reports, the real growth rate of the world economy fell by approximately 3.2% in 2008 (18).

-The stock markets collapsed following significant and successive drops in stock prices caused by the unexpected collapses of major banks and other institutions. These collapses prompted investors to abandon stock ownership and instead turn to the purchase of US Treasury bonds due to their robust guarantees. The US government utilized these funds to finance banks and purchase risky assets and mortgage-backed securities. The sharp decline in the stock markets has been attributed to increased speculation in global financial markets.

-The impacts of the global financial crisis on the labor market have been reflected in rising unemployment rates across various sectors. Prior to the crisis's peak, the US unemployment rate had already reached nearly 7%. Sectors such as construction, automotive, tourism, financial services, and real estate have been particularly affected in this regard.

III. The 2014 oil crisis, consequences and impact in the current context (Covid-19):

The significant and abrupt decline in oil prices in mid-2014, which has continued until the present day, has garnered the interest and attention of oil and economic experts worldwide, particularly in countries that rely heavily on this economic resource. This reduction in capacity has limited these countries' ability to invest, generating political pressures and events that have led to this crisis. While the primary reason for the global economic crisis of 1929 was an erroneous economic law, US oil companies continued to produce oil under conditions of declining

demand. Unless a solution to the Covid-19 crisis is found, the world economy may soon enter a phase of crisis.

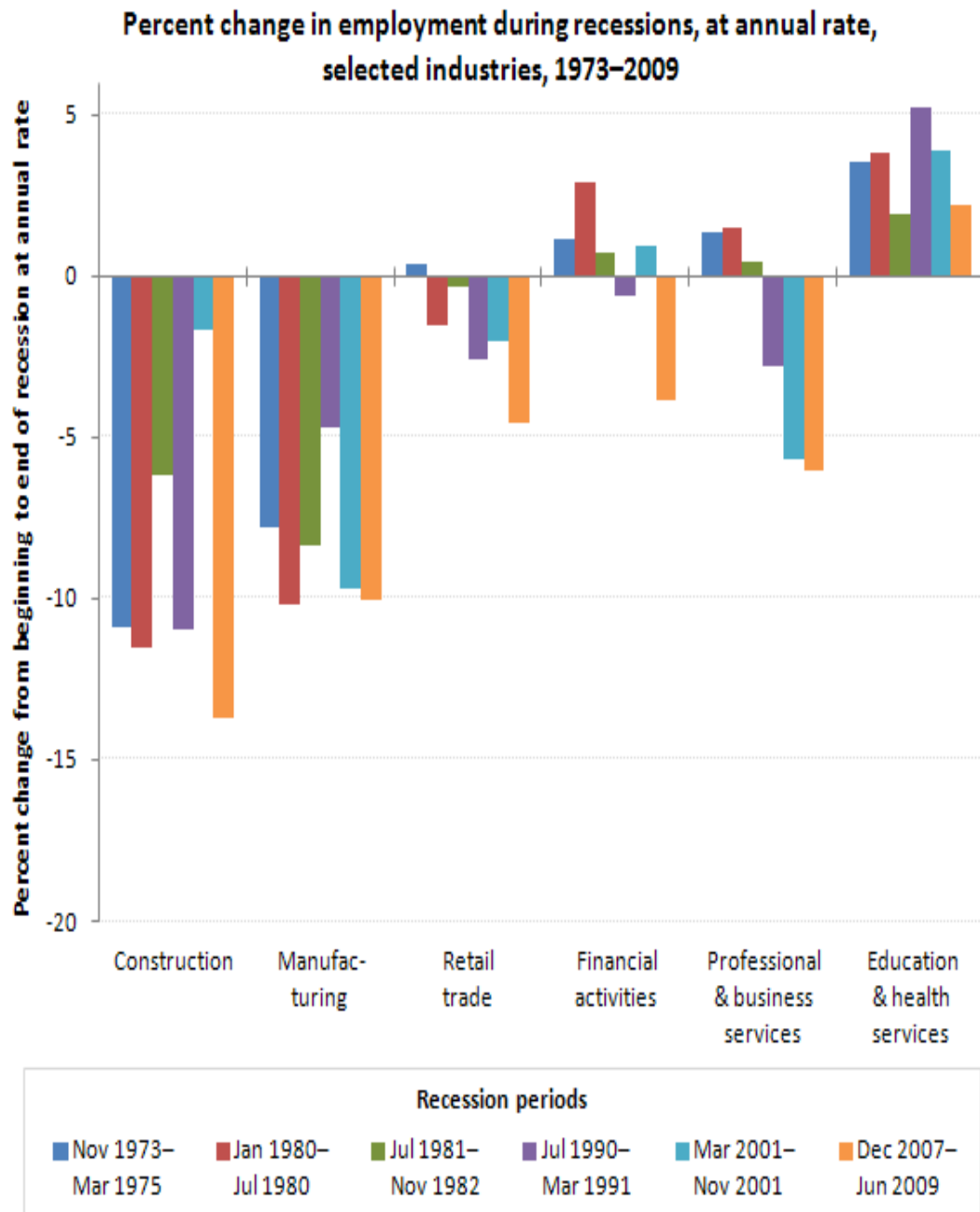
a-Consequences on the global market (20): The drop in US oil prices is anticipated to have significant consequences on the global market, including the possibility of more collapses in major financial markets. Banks that provided loans to companies operating in various oil-related fields may also suffer negative repercussions, leading to a new financial crisis spiral. There is a likelihood of large-scale bankruptcies among oil companies, which could lead to the collapse of banks and insurance companies on a larger scale than the 2008 global financial crisis. In response, central banks or governments may intervene to nationalize oil companies, similar to what happened with other institutions during the 2008 crisis. The negative economic repercussions of the Covid-19 pandemic may further exacerbate this situation.

b-Repercussions on Arab countries: The Arab nations have faced a range of challenges since the oil price crash in July 2014, followed by an oil price war in March 2020, and ultimately culminating in a negative outcome due to the COVID-19 pandemic. Countries that produce oil, including the six Gulf States, Iraq, Libya, and Algeria, are experiencing deficits and increasing debts, which has led to the imposition of new prices on goods and services that were previously supported by the government. Based on the available data and estimates, the economies of the aforementioned countries have been negatively affected by the decline in oil prices between 2015 and 2018, and further losses in their sovereign wealth funds are projected due to the COVID-19 crisis. Therefore, these countries should expedite their efforts to diversify their economies and reduce their dependence on oil as a primary source of income.

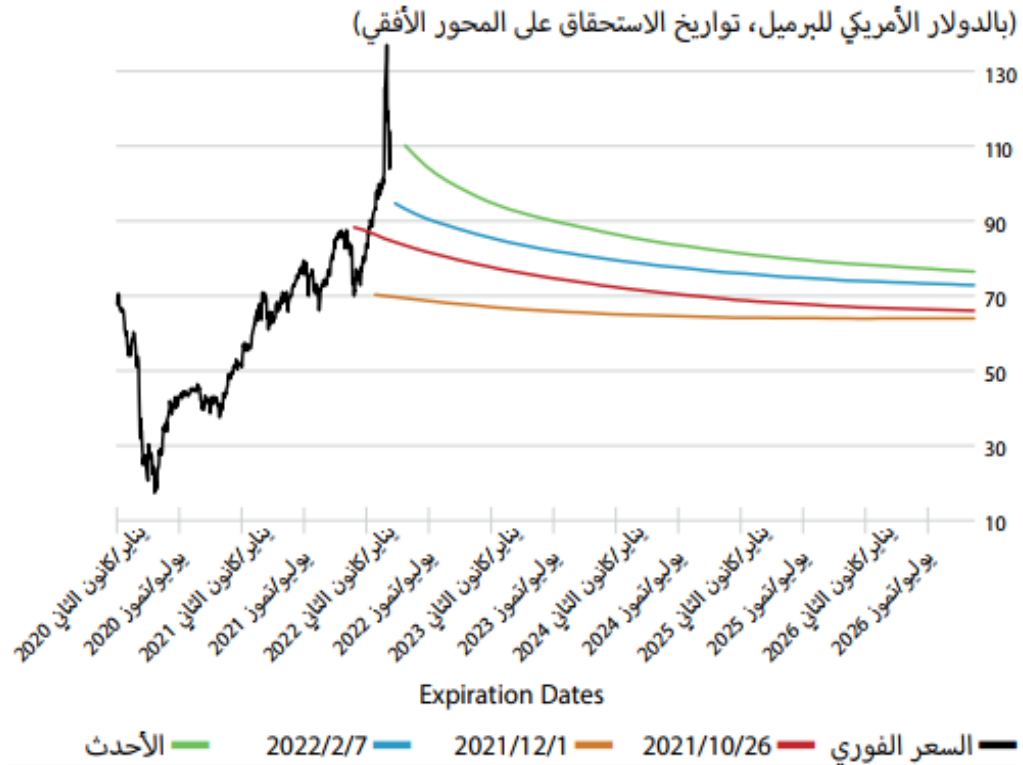
On the other hand, non-oil Arab countries have the potential to explore alternative sources of energy. However, they face financial constraints in building up strategic reserves and rely on loans or secured credit facilities to fulfill their oil requirements. Moreover, they lack the necessary infrastructure to store oil over an extended period.

In light of the preference of governments for greater economic intervention, there is a need to reassess the future of globalization and its institutions. The communication and information revolution is a product of globalization and its most significant achievement.

In terms of employment, the 2007-09 recession was notable for the significant declines observed in the construction and manufacturing sectors, with respective average annual percentage decreases of 13.7% and 10.0% measured from the first to the last month of the recession, marking the largest such declines since World War II (22).



من المتوقع لأسعار النفط المرتفعة على المدى القصير أن تتراجع على المدى الطويل



المصدر: مكتب رئيس الخبراء الاقتصاديين لمنطقة الشرق الأوسط وشمال أفريقيا بالبنك الدولي؛ وبلومبرج إل بي.

ملاحظات: يشير الخط الأسود إلى السعر الفوري لخام برنت. تشير الخطوط الملونة إلى أسعار العقود الآجلة لخام برنت في 26 أكتوبر/تشرين الأول 2021 و 1 ديسمبر/كانون الأول 2021 و 7 فبراير/شباط 2022 والأحدث (18 مارس/آذار 2022 في هذه النسخة).

The global energy market has been subjected to oil price fluctuations, particularly after the 2014 oil crisis, which witnessed a remarkable hike in oil prices, surpassing \$100 per barrel of Brent in February 2021, thereby exerting pressure on the market. There is an anticipation of a long-term decline in oil prices to restore balance to the oil conditions and markets, prompted by inflation forecasts that could have a considerable impact on the financial instability of several developing nations, notably those grappling with debt issues (23).

Conclusion:

Based on an analysis of global financial crises and their causes and consequences, economic studies suggest that adherence to investment rules and regulations and diversification into non-oil sectors is a suitable solution for overcoming the current economic crisis. Therefore, it is crucial to consider and implement proposals that aim to contain or reduce the severity of these crises. This includes:

A review of international financial and monetary relations, such as the Bretton Woods agreements, and the adoption of new reforms in the international monetary system.

Reducing the negative effects of financial and economic globalization and regulating financial markets through financial regulation processes, especially in the United States, major powers, and EU states, and taking strong measures to reduce stock market speculation.

Increasing administrative oversight and applying the principle of absolute transparency to bank directors and managers, especially those who have benefited from financial rescue plans in all areas, including compensation, bonuses, and salaries received by employees of these banks.

Giving priority to local businesses in the process of obtaining bank loans, after governments have contributed to the rescue of these businesses, especially in affected countries.

Fighting unemployment caused by the crisis by granting economic immunity to businesses and institutions in affected countries and ensuring that they are kept out of the circle of investment movements.

For Algeria, a significant challenge to promote self-sufficiency and bring the national economy to the forefront is diversification of the sources of national income, by focusing on sectors beyond oil. For instance, the agricultural sector could be given attention, as food products from agriculture represent a major share of imports. It is also important to attract foreign investment to modernize and revitalize the economy. Public spending policies can also play a vital role in enhancing economic conditions, improving the investment climate, and stimulating economic growth to achieve development and prosperity. Moreover, the fight against tax evasion is crucial, and diversification of the basket of currencies in the foreign exchange reserve can help maintain the economy's stability. Lastly, returning to the basis of Islamic financing could be considered, given its deterrence against imbalances and crises. Islamic financing is seen as the best alternative and the most appropriate direction to mitigate the effects of global financial crises. Islamic banks and their financing formulas can be used to invest money and generate profits without dealing with financial derivatives.

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