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Note on Global Financial Crisis

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Description

In a financial crisis, quality prices seen a sharp decline in value, businesses and customers are unable to pay their debts, and financial institutions experience liquidity shortages. A financial crisis is often associated with a panic or a bank run during which investors sell off assets or withdraw money from savings accounts because they panic that the value of those assets will drop if they remain in a financial organization. Other situations that may be labeled a financial crisis include the overflowing of a speculative financial bubble, a stock market crash, a sovereign default, or a currency crisis. A financial crisis can damage an entire economy, a region's economy, or the entire world's economy. A lot of causes can contribute to a financial crisis. In general, a crisis can emerge when businesses or assets are overvalued, and irrational or herd-like investment behaviour can compound the problem. When a bank failure is rumoured, for example, a rapid run of selloffs might result in reduced asset prices, leading consumers to dump assets or make large savings withdrawals. Contributing factors to a financial crisis include complete failures, unexpected or uncontrollable human behavior, reasons to take too much risk, regulatory absence or failures, or contamination the Problems spread like a virus from one organisation or country to another. A crisis, if allowed unrestrained, can lead to a recession or depression in the economy. Even if steps are taken to prevent a financial crisis from occurring, it might however occur, accelerate, or deepen. Financial crisis are considered by the severe contraction of the bank lending.

During the times of financial crisis, the banks become more disinclined to lend, impairing the financing constraints. As a result, businesses slash capital R and D department spending more likely to pass up lucrative investment opportunities. A priori, it is not clear whether trade finance can serve as a substitute for bank finance during the crisis, because of the complementarity, the collapse in one may exacerbate the collapse in the other. Liquidity shocks experienced by certain firms in a systemic financial crisis may be communicated to other enterprises *via* supply credit linkages. The existing theoretical models only deal with a single customer's distress event, rather than a systemic shock that might affect all suppliers and customers alike.

During times of crisis, supply chains may instead spread and amplify liquidity shocks. The idea behind the propagation mechanism is simple: if a company's customers default, it may run into liquidity problems, forcing it to default on its own suppliers. As a result, in a network of enterprises that borrow from one another, a temporary shock to one firm's liquidity may trigger a chain reaction in which other firms experience financial difficulties as well, resulting in a huge and lasting drop in aggregate activity. 'Liquidity shock chains' can work in reverse during a financial crisis. As a result of bank credit shrinkage, businesses may be forced to withdraw credit from their customers. As a result, they pass the liquidity shock up the supply chain, causing their customers to cut the 'deep pockets,' or companies with access to external capital.

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