Volume-4, Issue-4, April-2015 • ISSN No 2277 - 8160

Research Paper | Management

# Global Financial Crisis – Impact and Performance of Global Market Indices Pre and Post Crisis

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**ABSTRACT**

*The global financial crisis surfaced around 2007 and started showing its adverse effects by mid of 2008. A combination of low interest rates and large inflow of foreign funds during the boom years helped the banks to create easy credit condition for many years. Banks and Financial Institutions repacked these debts with other high risk debts and sold them to worldwide investors creating financial instruments called Collateral Debt Obligations. In this way risk was passed on multifold through derivatives trade. Since the collateral debt instruments had been globally distributed, many banks and other financial institutions around the world have started reporting losses. This with the failure of a few lending institutions in the U.S. the entire financial system in the world has been affected. With this backdrop, the current study describing the global financial crisis focuses on performance of global financial market indices during pre and post crisis era.*

**KEYWORDS :**

## Introduction

The global financial crisis initiated to show its effects in the middle of 2007 and into 2008. During the boom years mortgage brokers attracted by the big commissions encouraged with poor credit to accept housing mortgages with little or no down payment and without credit checks. A combination of low interest rates and large inflow of foreign funds during the boom years helped the banks to create easy credit condition for many years. The real estate bubble encouraged the demand for houses as financial assets. Banks and Financial Institutions repacked these debts with other high risk debts and sold them to worldwide investors creating financial instruments called Collateral Debt Obligations (CDOs). In this way risk was passed on multifold through derivatives trade. Surplus inventory of houses and increase in interest rates led to a decline in housing pricing in 2006-2007 resulting in an increased defaults and foreclosure activity that collapsed the housing market. Consequently, a large number of properties were up for sale affecting mortgage companies, investment firms and government sponsored enterprises which had invested heavily in subprime mortgages. Since the collateral debt instruments had been globally distributed, many banks and other financial institutions around the world have reported losses of approximately U.S. 435 billion dollars as on 17th July 2008. This with the failure of a few lending institutions in the U.S. the entire financial system in the world has been affected.

## Methodology

The present study focuses on the origin and causes of global financial crisis and the impact of the crisis on the Indian economy. The data for the study has been collected purely from secondary sources.

## Objectives

1. The causes of Global Financial Crisis
2. Impact on Indian Economy and Indian Stock Market (BSE Sensex)
3. Studying the global financial crisis and its impact on global stock market performance during 2005-2014

## Causes for Global Financial Crisis

A number of Banks and Financial Institutions bearing huge losses lead to bankruptcy. Lehman brothers a big investment bank reported bankruptcy in 2008. The major reasons were

- Surplus inventory in housing market
- Speculation in real estate
- High risk mortgage loans
- Lending credit practices
- Securitization practices
- Un reliable credit ratings
- Poor regulation practices
- Fair value accounting rules
- Failure of global corporate governance

## Impact on the Indian Economy

Indian economy cannot be separated from the financial crisis resulted in the developed economies due to the globalisation. Because of the crisis, Indian economy experienced

- Decreasing GDP growth rate
- Increasing inflation rate
- Volatility in exchange rates
- Decline in Forex flows from Foreign Institutional Institutions (FIIs)
- Affected the Information Technology
- Doubtful about creation of new investments
- Slow down of real estate market
- Bear position of stock market
- Slow down of exports
- Increased unemployment

## Impact on Indian Stock Market

In India the stock market has undergone significant transformation with the liberalised measures. The BSE has emerged as one of the largest exchanges in the world in terms of turnover and listed companies. The inflow of foreign capital has made a crucial contribution to the growth of stock market. This transformation geared up more integrating the local economies with the international economy. With this reform process, the globe has inturn become a local market by integrating the world stock markets which by working round the clock continuously influence each other. Basically this led to increase the demand for information regarding the global markets vis a vis knowing their impact on other markets.

The stock market activity was one of the principal activities in the corporate world among the chain of activities, which got affected due to the financial crisis. The stock market indices were one of the principal indicators of the economic activities. The movements of stock market indices present the future economic outlook. A falling stock index reflects the dampening of the investment climate while a rising stock index indicates more confidence and soundness of the economy.

During the year 2008-09 when the global recession started, all the markets started showing negative returns indicating the integration of markets and their connectivity. The global financial meltdown and subprime lending crisis that took place in the U.S. has not only affected the U.S. market but also other global and Asian markets equally. In the year 2008 all selected markets reacted to the global economic meltdown equally and by reporting negative returns during that year.

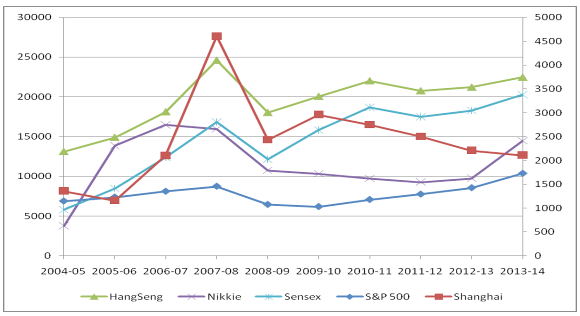
**Table 1: Movements of Select Major Indices during 2005-14**

| Date | S&P 500 | % | Shanghai | % | Hang Seng | % | Nikkie | % | Sensex | % |
|---|---|---|---|---|---|---|---|---|---|---|
| 2004-05 | 1,148 | | 1,357 | | 13,118 | | 3,750 | | 5,786 | |
| 2005-06 | 1,232 | 7 | 1,159 | (15) | 14,906 | 14 | 13,855 | 269 | 8,482 | 47 |
| 2006-07 | 1,353 | 10 | 2,104 | 81 | 18,125 | 22 | 16,481 | 19 | 12,375 | 46 |
| 2007-08 | 1,459 | 8 | 4,609 | 119 | 24,624 | 36 | 15,955 | (3) | 16,799 | 36 |
| 2008-09 | 1,076 | (26) | 2,433 | (47) | 18,026 | (27) | 10,750 | (33) | 12,125 | (28) |
| 2009-10 | 1,031 | (4) | 2,962 | 22 | 20,062 | 11 | 10,319 | (4) | 15,799 | 30 |
| 2010-11 | 1,180 | 14 | 2,752 | (7) | 22,036 | 10 | 9,726 | (6) | 18,648 | 18 |
| 2011-12 | 1,293 | 10 | 2,503 | (9) | 20,774 | (6) | 9,276 | (5) | 17,454 | (6) |
| 2012-13 | 1,428 | 10 | 2,211 | (12) | 21,222 | 2 | 9,756 | 5 | 18,268 | 5 |
| 2013-14 | 1,730 | 21 | 2,111 | (5) | 22,485 | 6 | 14,474 | 48 | 20,262 | 11 |

Source: NASDAQ; % Refers to % change over the period

From the above table it is clearly evident that Shanghai and Nikkie indices are showing high variations with decreasing trend whereas the Hang Seng and Sensex are showing moderate variations. Out of all indices, S&P 500 is showing stable performance with fewer variations and on an average the mean return is moving around 10% giving an indication that the market is yielding a stable return. A clear downward trend can be observed for Shanghai and Nikkie indices from the year 2007 and 2006 respectively. Both of them varied from 119% and 269% to as low as (47%) and (33%) during 2007-08 respectively.

**Figure 1: Movements of Select Major Indices during 2005-14**




In the years 2006-2008 almost all the selected markets are showing highest point of peak which indicates the investors' attitude towards market which was putting him under an impression that the markets will continue the same boom. In 2007-08 developed countries have experienced more volatility, and all countries experienced largest negative returns mainly due to the turmoil in the financial sectors of the U.S. and other European markets. From 2010 onwards all the markets started posting positive average returns.

## Conclusion

While the developed world, including the U.S., U.K., E.U. and Japan has plunged into recession, the Indian Economy was affected by the spill-over effects of the Global Financial crisis for some time. But the Indian Economy has remained largely orderly in the crisis time. Great savings habit of Indian public, Companies with strong fundamentals and strong conservative policies, and regulatory regime have saved Indian economy from going out of gear. Further, Indian market provided an alternative engine of growth to the world economy as it remained considerably insulated from the crisis.

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