Global Recession-The Sub-Prime Crisis

Leena Kaushal

Abstract

The present paper is an attempt to examine the impact of Global recession on the Indian Economy as a whole. The subsequent subprime mortgage crisis in the United States has besieged complete world economy with the varying degree of recessional impact. The central element in the current financial turbulence that led to the recession is the housing bubble. International financial institutions of advanced economies suffered a major setback in terms of heavy losses and it was certain that the impact will be passed on to the various countries of the world. India, like most other emerging market economies is certainly impacted by the recent financial crisis but the impact is not as serious as borne by US or Europe. Thanks to Indian banks that are more or less secured from the ill effects of subprime mess because their exposure to complex instruments like CDO's is almost nil.

Keywords: Global Recession, Housing Bubble, Lehman Brothers

Introduction

The recession in the US market and the global meltdown termed as Global recession has besieged complete world economy with a varying degree of recessional impact. The world's financial system has gone through its greatest crisis and certainly the greatest crisis in the history of finance capitalism. It was triggered by the bursting of the housing bubble and the subsequent subprime mortgage crisis in the United States. The global financial crisis was intensified with the bankruptcy of Lehman Brothers in September 2008. And as the cliché goes, whenever the US sneezes, the world catches a cold, and seems it has come true.

Recession-What is it!

There is no official definition of recession, but it is generally recognized as the period of decline in economic activity. The very short periods of decline are not considered as recessions. The practical definition of recession defines it as, two consecutive quarters of decline in a country's real (inflation adjusted) gross domestic product (GDP) - the value of all goods and services a country produces. (Back to Basics, F&D, December 2008). This definition is a useful rule of thumb, but has its own drawbacks as it is constricted in the sense that it only considers GDP whereas a wider set of measures of economic activity can provide a timelier gauge of the state of the economy to determine whether a country is indeed in a recessionary phase.

The National Bureau of Economic Research (NBER), a private research organization defines a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators. A recession begins when the economy reaches a peak of activity and ends when the economy reaches its trough." (Back to Basics, F&D, December 2008). Consistent with this definition, the committee focuses on a comprehensive set of measures—including not only GDP, but also employment, income, sales, and industrial.

Genesis of Recession

Recessions may have many potential causes and it is a challenge to predict them. It is a global phenomenon that is unavoidable. Similar to a products life cycle which is characterized by the growth, maturity and the decline phase, the economy of the country also undergoes the growth, slow growth and no growth phase. An economic recession is primarily linked to the various actions that are taken to control the money supply in the economy. The monetary authority of the country is responsible for striking the balance between money supply, interest rate and inflation. Whenever there is imbalance between these three, the economy is forced to correct itself. It is the natural balance of these variables.

Recession could be linked with sharp changes in the prices of the inputs that are used in producing goods and services. A sharp increase in oil prices can be a harbinger of a coming recession. As energy becomes expensive, it pushes up the overall price level, leading to a decline in aggregate demand. A recession can also be triggered by a country's decision to reduce inflation by employing contractionary monetary or fiscal policies. When used excessively, such policies can lead to a decline in demand for goods and services, eventually resulting in a recession. (Stijn Claessens and M. Ayhan Kose, 2009)

Some recessions, including the current one, are ingrained in financial market problems. The bust of the housing bubble in 2007 was the genesis of the current US crisis. Since 1995, the home sale prices have outpaced the overall rate of inflation. This run up in the housing prices had translated millions in the housing wealth. The increase in housing price had an important short term economic consequence. It has helped to sustain the housing sales and construction of new houses. It was the belief of most of the home owners that the prices of their houses will at least outpace the inflation. Rising housing prices encouraged consumer spending and at the same time demand for more houses in the housing sector. It is quite obvious for a home owner to feel relaxed looking at the rising valuation of one’s property. Which in-turn gives him leverage to increase his consumption by borrowing against their increased equity. The short term effects of a housing bubble seem to be favorable but the long term effect, recession and eventually deflation which the world witnessed this time is extremely harmful for the home owners and economy as a whole.

The subprime lending crisis has everyone in mayhem. It is being blamed for the entire down turn of the US economy. The ever growing housing prices attracted many buyers. The owners who brought the property for less but could manage to sell it off at a huge profit, sometimes even before the first mortgage payment was due attracted many borrowers with money and those who wanted to make a quick buck into real estate.

Borrowers are designated as sub-prime borrower when their credit to income ratio is less than desirable. With the sky rocketing housing prices everyone wanted to own a home. Even a marginal borrower could get money for a home, thanks to sub- prime lending. Banks, lenders and mortgage brokers became greedy and as the subprime market grew the marketing to bring in more borrowers also gained grounds.

Sub-prime borrowers are the one who want to avail loan but the banks are not ready to lend them at the nominal rates because they do not qualify their basic requirement. They do not have desirable credit to income ratio. The demand for such loans is so high that lenders are often ready to take on risks associated with lending to the people with poor credit ratings or limited credit histories at high rates. The FICO score indicates the rate of default to the lender. Borrowers with the credit scores below 620 are considered to be the one with high default rate .On the contrary the borrowers with credit scores above 720 qualifies easily for the loan. Subprime loans are therefore characterized as the one with greater risk for the lender and this very risk is offset with the higher interest rate being charged by the sub-prime borrower. Looking at the profit potential of making sub-prime loans, the subprime borrower became the ideal borrower for many institutions and this is how problem instigated.

The excessive mortgage exposure took the sub-prime loans to unheard of levels and eventual collapse of the financial system in 2008. Sharp increase in the asset prices were well facilitated by the easy credit made available which eventually led to the rise in

the debt accumulation. Corporations and households were forced to reduce Investment and consumption because of their failure to meet increasing debt obligations which in-turn reduces their economic activity. It was a massive credit boom which resulted in recession and turned out to be a costly affair. (Stijn Claessens and M. Ayhan Kose, 2009). It has been observed that recession is prolonged, painful and causes far reaching economic consequences, if accompanied by housing price burst or credit crunch or both.
Recessions can be the result of a decline in external demand. Adverse effects of recessions in large countries with strong export sector—such as Germany, Japan, and the United States can rapidly be felt by their regional trading partners, especially during globally synchronized recessions. Recession could be predicted by the behavioral patterns of numerous economic variables—including credit volume, asset prices, and the unemployment rate—though they could be both the cause and the result of recession. Even though economists use a large set of variables to forecast the future behavior of economic activity, none has proven a reliable predictor of whether a recession is going to take place. Changes in some variables—such as asset prices, the unemployment rate, certain interest rates, and consumer confidence—appear to be useful in predicting recessions, but economists still find it difficult to accurately forecast a significant fraction of recession.(Stijn Claessens and M. Ayhan Kose, 2009)

Recession Dated Back

Recessions does not occur that often, some 122 completed recessions could be documented in 21 advanced economies over the 1960–2007 periods. The proportion of time spent in recession is measured by the percentage of quarters a country was in recession over the full sample period. Recessions accompanied by 28 credit crunches, 28 house price busts and 58 equity price burst has been identified in the past. (Stijn Claessens and M. Ayhan Kose, 2009).

Recession on an average with substantial variations have lasted for about four quarters with the shortest being two and largest being thirteen quarters. The recession's amplitude which is basically the decline in the output from its peak to its trough tends to be 2%.Cumulative loss from the recession gives the combined information about both duration and the amplitude of recession to measure its overall cost was typically calculated to be around 3%.When recessions last for more than three months they happen to be more costly affair.

Credit crunches and housing busts are often extensive and deep. In the past a credit crunch episode typically lasted for some two and a half years and was associated to nearly 20% decline in the credit which was measured by the volume of claims on the private sector .A housing sector on the other hand lasted even longer for four and a half year with 30% decline in the real house prices. An equity price burst lasted more than 10 quarters and towards the end the equity prices had plunged by fifty percent. The international evidence proves that the current recession that is associated with credit crunches and burst are often more worse than other recessions as they are not only longer but are also associated with much larger output loss typically two or three times greater compared to than other recessions with less financial stress. (Stijn Claessens and M. Ayhan Kose, 2009)

Characteristics of Recession

Even though each recession has some unique features, but frequently they exhibit a number of common characteristics:

Recessions characteristically last about a year and often result in a significant output cost. By and large it is associated with a decline of 2 percent in GDP but could be as high as 5 percent.

The decline in consumption is often petite, but both industrial production and investment register much larger declines than that in GDP and they typically overlap with drops in international trade as there is sharp slowdown in both export and import. There is rise in unemployment rate and fall in inflation as a result of curtailed overall demand for goods and services.

The Housing Bubble and Financial Turbulence

While there is no dispute that housing prices have vastly outpaced the inflation rate over the last seven years, it is possible that higher housing prices reflect shifts in underlying fundamentals, which have led people to place increased value on home ownership. This is precisely what Federal Reserve Board Chairman Alan Greenspan argued in recent testimony before the Congress (Fed Chief Blames Corporate Greed; House Revises Bill, New York Times, July 17, 2002, Page A1).

The central element in the current financial turbulence that led to the recession is the housing bubble. The housing bubble in US became a full-blown crisis by 2008 and finally busted under the weight of rising interest rates and ever deepening mortgage market crisis for those borrowers with weak credit history. The housing bubble in the US grew along with the stock bubble in mid-90’s.The bubble grew because the people who have increased their wealth substantially with the extraordinary performance of the stock market were spending based on their increased wealth which resulted in the consumption boom of late 90’s, with the saving rate out of disposable income falling from close to 5% in the middle of the decade to just over 2% by 2000. (Dean Baker, 2008)

The stock wealth induced consumption boom led people to buy bigger and better homes and thus spent some of their new stock wealth in housing. In the short run this increase in demand had a effect of triggering a housing bubble as the supply was relatively fixed.

Therefore the increased demand led to increase in the housing prices and ultimately increase in price further increased the expectations that the prices would further continue to rise, the home buyer were ready to pay far more for homes than would have otherwise making their expectations self fulfilling.

The considerable supply side effect began to be felt from mid 90's through late 90's because the prices in both ownership and rental market had started soaring high. Another evidence to support that the country was experiencing a housing bubble was that the rentals had risen by less than 10 percent in real terms by 2002 which was very modest compared to the run up in the house sale prices. By 2002, housing prices were almost 25 percent above the average rate over the three years immediately preceding the start of the bubble (1993-95). In 2002, for the first time ever, the oversupply of rental housing due to increase in building was witnessed with the vacancy rate rising to a record level of over 9% compared to 7.5% in mid 90's. (Dean Baker, 2008)

Unlike Japan, in 2000-2002, where the housing bubble collapsed along with the collapse of stock bubble, in US the collapse of stock bubble helped to feed the housing bubble. Housing bubble looked upon as the safe investment alternative compared to the stock market. The recovery from 2001 recession was going on a slow pace, with job cuts still being the regular feature throughout 2002 and 2003 summers. Recovery was administered by the Federal Board by continuously cutting interest rates as low as1% which was historically 50 years low and average interest rate on 30 years fixed rate mortgage touched 5.25% in the summers of 2003.These extraordinary low interest rates accelerated the run up in house prices, which touched the peak of 31.6% compared to the annual rate of 7.1% from fourth quarter of 2002 to fourth quarter of 2006.This triggered the construction and the housing starts eventually peaking at 2,070,000 in 2005, more than 50% above the rate of pre-bubble year and resulted in the fall of savings rate to less than 1% in year 2005-2007. (Dean Baker, 2008)

In 2007, the bubble did began to burst as the building boom led to so much over supply that it became difficult to support the prices. By the fourth quarter of 2006 vacancy rate on ownership units was almost 50% above the prior peak. This process accelerated through the fall of 2007 and into 2008.With the decline in the housing prices, more house owners faced foreclosures. The foreclosure was partly voluntary and in parts involuntary.

The foreclosure was voluntary when the homeowners realized that they owe more than the value of their home. Their house were valued far lower than the amount of the outstanding mortgage and it was better option indeed to walk away from the mortgage. The foreclosure can be involuntary if the house owners who intended to borrow against equity to meet their monthly mortgage payments now feel distressed because the falling house prices had destroyed their equity so they are now forced to eliminate the option.

Foreclosures whether voluntary or involuntary, led to the effective increase in the housing supply in the market. In the first quarter of 2008 foreclosures were running at an annual rate of 2.8 million per year which was nearly 60% of the rate of sale of existing home in the quarter. In the hardest hit area the foreclosures actually exceeded the existing home sales.

A similar dynamics worked on the demand side where during the run up phase of the bubble, lending standards were quit liberal but with the onset of default that began to soar up in 2006-2007 bank tightened their lending standards by demanding large down payments from the borrowers which in turn reduced the numbers of successive homebuyers by 20-25%.Towards the end of 2007, the real house prices crashed by more than 15% from the peak which touched 30% by the beginning of 2008.(Dean Baker, 2008).

There is nothing in this world that lasts forever, so how could the real estate boom outshine it. The housing market is very sensitive to the changes in the interest rates. It was not the tough task to bid up high housing prices with the loans affordable at low interest rates leading to a constant low monthly payment burden. The low interest rates also encouraged the builder to build more and more comfortable and luxurious houses. The Federal Reserve's accommodative monetary policies over the decade thus resulted in the massive reallocation of resources from rest of the economy into the housing sector and once it was evident that the production was driven by speculation rather than fundamentals, the bubble busted. It is perceptible from the past researches that at the center of almost every housing bubble one can find a central bank.

Components of the Crisis

In the past it has been witnessed that the roots of the crises are embedded in the developing and emerging countries and are attributed to the loose domestic monetary and fiscal policies. But marking a distinction, the current global financial crisis has had its roots in the US.

The tremendous rise in the mortgage credit to the low credit quality households were the result of persistent rise in the housing prices coupled with the accommodating monetary policy and the negligent lending standards during 2002-2006. The "originate and distribute" model has securitized most of the mortgages which were on rise because of the low margin and low initial payments offered to the homebuyers, essentially termed as subprime. These mortgages were bundled into a variety of tranches, assigned credit ratings and sold to a range of financial investors.

In the beginning of the 2004, the rising inflation numbers were startling and enforced US Federal Reserve to withdraw monetary accommodation. Because of this withdrawal there was hike in the interest rates which ultimately increased the mortgage payments. Increased payments consecutively increased the defaulters which majorly comprised of sub-prime borrowers. Defaulters were responsible for the losses borne by the financial institutions and investors alike. Though the loans were apparently securitized and were sold to the off balance sheet special institutional vehicles (SIVs), but the losses were eventually borne by the banks and the financial institutions eroding a significant fraction of their capital.

The subterranean crisis in global financial markets, the intense level of risk aversion, the growing losses of banks and financial institutions, the high level of commodity prices (until the third quarter of 2008) and their subsequent collapse, and the sharp correction in a range of asset prices, all are held collectively responsible for the sudden slowdown in growth momentum in the major advanced economies. Global growth for 2009, which was seen at a healthy 3.8 per cent in April 2008, is now projected to contract by 1.3 per cent (IMF, 2009). Major advanced economies are in recession and the EMEs (Emerging market Economies) – which in the earlier part of 2008 were widely viewed as being decoupled from the major advanced economies – have also been engulfed by the financial crisis-led slowdown.(Rakesh Mohan,2009)

Global Impact

Global imbalances and housing bubbles

The global economy undergone a severe recession imposed by a massive financial crisis and a heightened loss of confidence. Various efforts are taken to stabilize financial markets and to restore confidence. The global activity was projected to decline by 1.3 percent in 2009 as a whole before rising modestly during the course of 2010 .This spin is basically dependent on how well the financial authorities act to reinstate financial stability majorly through and fiscal and monetary policies leading to sustained strong support for aggregate demand. The global economy is undergone its most severe recession of the postwar period. World real GDP has significantly declined in 2009, with advanced economies experiencing deep contractions and emerging and developing economies slowing abruptly. Trade volumes have witnessed a sharp fall along with the inflation numbers.

The failure on the part of central bank and other associated regulatory authorities to deal with the systematic risk attached to the fast credit growth and asset price bubbles resulted in the persistent large current account surpluses and generated a huge demand for financial assets issued in deficit countries—notably for U.S. assets. Apart from this, the accommodative U.S. monetary policy also contributed to low real interest rates worldwide, which in turn induced considerable risk-taking and fed fast credit growth.

The US witnessed tremendous rise in the credit market debt of households and non-financial businesses from 118 to 173 percent of GDP between 1994 and 2007 .Along with the US , an unparalleled increase in the home price was accompanied by similar boom in many developed economies. (Noel Sacasa, 2008)

Impact on India

In the age of globalization, it is impossible for any country to isolate oneself from the fluctuations in the world economy. International financial institutions of advanced economies suffered a major setback in terms of heavy losses and it was certain that the impact will be passed on to the various countries of the world. India, like most other emerging market economies is certainly impacted by the recent financial crisis but the impact is not as serious as borne by US or Europe. Thanks to Indian banks that are more or less secured from the ill effects of subprime mess because their exposure to complex instruments like CDO’s is almost nil.

The impact in India was well witnessed by the plummeting share prices, rupee depreciating against dollar and a severe cash crunch faced by our banks as a result of shortage of liquidity in the market. The secondary market enjoyed the uptrend in 2006-07 with the BSE Sensex closing close to 21K.The year also witnessed large inflow of FII’s and large participation of domestic investor. Scaling new heights could be attributed to the impressive growth in the profitability of Indian corporate, overall higher growth in the economy and other global factors such as

continuation of relatively soft interest rates and fall in the international crude prices.
Lately in 2007 when the FII's found themselves in severe credit crunch resultant of subprime crisis, started withdrawing their money from the Indian stock market to meet their liabilities back home. They were the prime accuse of the wreck havoc in the stock market. The selling pressures from the FII showed stock market the downward path. FII's after selling stocks got their money converted into dollars which lead to the increase in the demand for dollars and rupee started losing strength against dollar.

In contrast to the extreme volatility leading to freezing of money markets in major advanced economies, money markets in India have been, by and large, functioning in an orderly fashion, albeit with some pressures. Large swings in capital flows – as has been experienced between 2007-08 and 2008-09 so far – in response to the global financial market turmoil have made the conduct of monetary policy and liquidity management more complicated in the recent months. However, the Reserve Bank has been effectively able to manage domestic liquidity and monetary conditions consistent with its monetary policy stance.
Monetary policy continued with pre-emptive tightening measures up to August 2008 through the series of increase in the cash reserve ratio and issuance of market stabilization scheme (MSS) In April 2004, RBI was empowered with MSS to manage the large capital inflow appropriately by issuing government treasury bills and medium duration dated securities.RBI also raised its policy rates addressing the constant inflationary pressures both from domestic demand and increased global commodity prices. The banking sector witnessed the negligible effect of sub-prime crises firstly because of the RBI's policy of limited exposure to complex derivates and other prudential policies. Accredited to the relatively lower presence of foreign banks in the Indian Banking Sector, the failure of Lehman Brothers did not have

direct impact on India. However, during September –October 2008 concomitant pressures were viewed in the foreign exchange market due to the outflow of large capital by portfolio investors. The net capital inflow during 2008-09 was substantially lower than in 2007-08 with depleting reserves. The large part of the reserve loss (US$33 billion out of US $ 54 billion) during April-Dec 2008 was reflected as valuation loss. (Rakesh Mohan, 2009).

Catastrophe of Lehman Brothers

15th Sept 2008 became the black day in the history of financial market with US fourth-largest investment banker and a 158 years old global financial giant Lehman Brothers, filing for bankruptcy. The firm was engaged in investment banking, equity and fixed-income sales, research and trading, investment management, private equity, and private banking. It was a primary dealer in the U.S. Treasury securities market. The firm was headquartered in New York City with its offices spread throughout the world, marking a global presence.

The seeds of financial crises were sewn during the real estate boom. During the real estate boom period the delinquency rates dropped as an upshot of the good economic conditions and the sustained real estate prices hike. A prolonged period of low interest rates lead to rise in housing prices that was completely abnormal by historical standards. From March 1997 to June 2006 the Case and Shiller national index of real estate prices increased every month, except for two. During the same period the average increase in real estate prices was 12.4% per year. (Zingales, 2008)

As a result of these favorable conditions, lending standards deteriorated and this relaxation was intensified by securitization, i.e. the practice of pooling mortgages together to resell them in packages. For the first time, the standard mortgages were replaced with the lower quality mortgages. The growing demand for subprime loan securities created an environment where subprime loans were originated without regard for borrowers' ability to pay. Augmented targeting of likely subprime borrowers, many of whom were minority borrowers, created a perfect storm for the crisis. It was triggered by dramatic rise in mortgage delinquencies and foreclosures in the United States and adversely impacted banks and financial markets around the globe.

Majority of the U.S. mortgages issued in recent years to subprime borrowers were adjustable-rate mortgages. After U.S. house prices peaked in mid-2006 and began their steep decline thereafter, refinancing became more difficult. As adjustable-rate mortgages began to reset at higher rates, mortgage delinquencies soared. Securities backed with subprime mortgages, widely held by financial firms, lost most of their value. The result has been a large decline in the capital of many banks and U.S. government sponsored enterprises, tightening credit around the world and this led to huge losses for Lehman.

Trends in Capital Flow

The narrowing down of capital flow and the sell–off in the domestic market adversely affected both the external and domestic financing for the corporate sector. The export sector faced a setback due to the slowdown in the demand in the major advanced economies. But a significant correction in the international oil prices eased out the inflationary measures as measured by wholesale price index.

The government finances borne the brunt on account of higher expenditure due to higher international crude oil prices, increased fertilizer prices, sixth pay commission award and the debt waiver scheme. On the other hand fiscal stimulus packages leading to additional expenditure and tax cuts had add on pressure. The fiscal deficit was more than doubled from 2.7% of GDP in 2007-08 to 6% in 2008-09 and revenue deficit peaked as high as 4.4% of GDP. Primary balance also turned into deficit in 2008-2009 due to the recorded surplus during the preceding two years. Primary balance describes the condition where expenditures (excluding interest payment and debt redemption) are covered by revenues excluding bond revenues (deficits). In this condition, general expenditures for the year and the tax burden for the same year are balanced.(Rakesh Mohan,2009)

According to the IMF, it was evident that the prevalent global circumstances will lead to the increase in the government debt ratios and fiscal deficits in the advanced economies. The overall, real GDP growth has slowed down to 6.9% in the first three quarters of 2008-2009 from 9% in the corresponding period of 2007.008 and the government final consumption expenditure has gone up from 2.7% to 13.3%.The Indian financial system successfully weathered the crisis. The credit growth was significantly high at around 30% during 2007-2008 without any significant relaxation in lending standards. However, the RBI pre-emptively tightened prudential norms in view of rapid credit growth in certain sectors. As a result of these efforts our domestic banks have not recorded as losses and their balance sheets are adequately capitalized and healthy. The CRAR of all the scheduled banks collectively was 13% at the end of March 2008 which was well above the regulatory requirement of 9 %.(Rakesh Mohan, 2009)

The abridged foreign funding and the jaded domestic capital market exerted pressure on some segment of the financial system including NBFC’s and mutual funds. A large proportion of resources in the mutual fund come from the corporate. Now due to the substantial correction in the stock market and alternative sources of funding being dried up the mutual funds faced the pressures of large redemptions and the maturity mismatches between assets and liabilities further aggravated the problems and the pressure for fund availability finally rested on the banks.

The reduced capital inflow also created some pressures in the foreign exchange market. Per the policy objective RBI sold foreign exchange in the market, but this emphasized the mismatch by exerting pressures on the rupee liquidity. This situation was well tackled by the RBI through pro-actively managing liquidity since September 2008 by reducing CRR from 9% to 5% by January 2009 thus injecting nearly 1,60,000 crore of primary liquidity in the system. RBI also slashed the SLR by 1% and opened new refinancing windows and provided refinancing facilities to SIDBI and EXIM banks. RBI also cut down the reverse repo rate from 9% to 4.75% and similarly reverse repo from 6.25% to 3.25%.and started purchasing the government securities under its Open Market Operations .(Rakesh Mohan,2009)

Conclusion

The financial crises in advanced economies eroded the trust amongst the major financial market and sector players on account of huge losses and uncertainty about future losses and capital erosion. On the other hand, the Indian money market have been relatively functioning well , though under pressure, and the credit goes to the Reserve bank who has effectively managed the situation but effectively managing domestic liquidity and monetary conditions consistent with its monetary policy. Reserve bank had promptly initiated series of measures to facilitate orderly operation of financial market and ensured that the financial stability was withheld by extending additional liquidity support to banks.

India is not largely impacted by the US recession , simply because India has come a far way from what it was in 1980’s and 1990’s.Indian banking system has not experienced any set back compared to its peers in the Asian region. The exposure of Indian banks and financial sector to complex derivates was limited and also the RBI has prudentially executed all its policies to handle the crisis meticulously. The relatively low presence of foreign banks in the Indian banking system also minimized the direct impact on the domestic economy.

Thus, the number of prudential measures that were augmented over the past five years to stabilize the Indian Financial system in conjunction with overall cautious approach towards financial and external sector liberalization has contributed to domestic and financial stability.

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