

Impact of the Global Financial Crisis on Emerging Markets

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Abstract: This paper explores the impact of the 2007-2008 Global Financial Crisis on Brazil and India and analyzes their policy responses. Both countries used monetary policies and fiscal stimulus to mitigate the crisis, with Brazil focusing on interest rate cuts and infrastructure investment, while India emphasized social welfare and rural development. Structural reforms in both countries improved financial stability and economic diversification, contributing to their post-crisis recovery and demonstrating resilience. The paper underscores the importance of timely and targeted policy interventions for long-term stability in emerging markets.

Keywords: Global Financial Crisis, Emerging Markets, Monetary Policy, Fiscal Stimulus.

1. Introduction

The particular financial disaster that happened in 2007-2008, otherwise known as the Global Financial Crisis (GFC) that emanated from the tumbling of the U.S. housing bubble and the aftermath of the subprime mortgage crisis is still an issue to be resolved. It has a huge impact on the world stage. It was the developing economies that were severely affected because of their foreign capital dependence, underdeveloped financial systems, and export-based economic dynamics. These weaknesses are the main source of such disasters as, among others, a great recession, capital flow reversals, and trade disruption, whether looking at understanding how markets are interconnected globally or the laity of arising risks emerging markets (Claessens et al., 2010; Stiglitz, 2010).

This piece is written to outline the effects of the GFC on the two largest developing economies of Brazil and India and the ways in which their governments managed the situation. The case studies are reviewed in this essay with a general objective of looking into the various mechanisms at the disposal of emerging economies for resilience building as they face the shocks from the global financial crisis and also the different post-recovery strategies. Analysing reactions helps us discover the points where attention must be directed when we are articulating the policies that will be focused on growing the economy.

The essay is structured as follows: The empirical analysis discusses the effect of the GFC on the economies of the two countries (Brazil and India) as both monetary and fiscal policy and structural reforms. On top of that, the final section provides a combination of outcomes and their relevant policy implications; the lessons learned and those yet to be understood are clearly emphasised.

2. Literature Review

2.1. Theoretical Framework on Financial Crises in Emerging Markets

The section headings are in boldface capital and lowercase letters. Second level headings are typed as part of the succeeding paragraph (like the subsection heading of this paragraph). All manuscripts must be in English, also the table

and figure texts, otherwise we cannot publish your paper. Please keep a second copy of your manuscript in your office. When receiving the paper, we assume that the corresponding authors grant us the copyright to use the paper for the book or journal in question. When receiving the paper, we assume that the corresponding authors grant us the copyright to use the paper for the book or journal in question. When receiving the paper, we assume that the corresponding authors grant us the copyright to use. The sudden stop theory argues that the sudden break in the capital inflows can easily hurt the new markets, which eventually causes severe economic disorders. This theory was developed by Calvo (1998), and it asserts that when international investors suddenly withdraw their money, the emerging markets are in a liquidity crisis, their currency is depreciating, and they are in the middle of an economic contraction. On the contrary, the theory of financial contagion talks about how financial crises can spread from one country to another through trade, financial markets, and investors' behaviour. Forbes and Rigobon (2002) state that contagion can occur because of the herd behaviour of the investors when the problems in one market cause panic and withdrawal from the other markets, no matter what their fundamentals are. Both theories stress that financial crises are systemic in nature and that emerging markets are very vulnerable to external shocks (Kaminsky, Reinhart, & Vegh, 2002; Dornbusch, Park, & Claessens, 2000).

The developing countries are the territories that have similar weak points, and the possibility of a financial crisis is higher. The high external debt is a severe weakness since most emerging markets depend on foreign borrowing for their growth and development. This linkage makes them depend on the changes in the global interest rates and investor sentiment (Reinhart & Rogoff, 2009). In addition, dependence on commodity exports influences these economies by the volatility of global commodity prices, leading to significant economic instability when prices change suddenly (Frankel, 2010). The other factor that makes the countries vulnerable is the underdeveloped financial markets because the weak legislation and the inadequate financial infrastructure can worsen the effects of financial shocks. The main reason domestic savings are so scarce and advanced financial instruments are not available is that these markets cannot

handle economic turbulence (Aghion, Bacchetta, & Banerjee, 2004; Mishkin, 2001). These weaknesses prove the importance of strong economic policies and regulatory measures in emerging markets to boost resilience during global financial crises.

2.2. Pre-GFC Economic Conditions in Brazil and India

In the years leading up to the GFC, Brazil experienced a significant economic boom largely driven by high commodity prices. Resource-rich by nature, agriculture and mining strengthen its global competitiveness. The parade of commodity supercycle, which sparked the price of oil, soybean, iron ore, etc, plus the de facto expansion of the international trade surplus of Brazil, played a fundamental role in affecting the country's fiscal affairs (Jenkins, 2010). Years of GDP growth at 4% to 5% were triggered by foreign direct investment inflow. As macroeconomic policies were introduced, they promoted fiscal stability by keeping the economy intact and sustaining growth. This happened simultaneously with the rising inequality, housing shortage and inadequate city infrastructure that will manifest after the realised crash falls.

On the other hand, India's services sector and ICT had a more significant influence on the country's economy than the other sectors before the global financial crisis. The economic changes took a sharp turn after the beginning of the '90s when the loosening of economic restrictions began the period of intense growth. From 2003 to 2007, the value of GDP had been increasing by more than 8% (Acharya, 2009). The IT and ICT service sector achieved excellent results, and as a consequence of foreign investment, practically one million were newly created jobs. The tech sector became one of the critical sectors of the industry through the rise of different telecoms firms and other tech companies. An increase in the number of educated young people eager to better their life conditions lead to higher consumption and a resultant boom in economic output. Further, in addition to these facts, the Indian economy still has structural issues, including a huge trading balance, insufficient infrastructure projects, and a system of inadequate regulations, which can easily be influenced by foreign shocks (Joshi, 2017). Despite the rigorous requirements to be quick-witted and prepared to respond to the crisis, the current issues would affect the capacity of a country to act quickly and accordingly.

2.3. Previous Research on Policy Responses to Financial Crises

Academic works on New Monetary Policy in currency crises emphasise interest rate changes and liquidity programs. In order to increase investment and borrowing, leading nations reduce the prices of loans (Aizenman & Hutchison, 2012). Central banks are here to pump cash into the companies, too, either to garner credit flow or avoid a likely bank collapse. These measures aim to stabilise banking and, some others, boost growth. Currency exchange rate fluctuations and capital flight might be why such programs are not as effective as they deserve (Mishkin, 2001).

Fiscal policy, another piece of the puzzle, also plays a role among the tools to deal with emerging market financial crises. The national budget and tax policies are the mechanism that acts on consumption, thus stimulating the sluggish economy during the recession. Fiscal stimulus packages, including infrastructure and social programmes expenditure, may

effectively counter the consequences of the private sector slowdown, which is perceived as one of the critical causes of recession (Blanchard, Dell'Ariccia, & Mauro, 2010). However, tax cuts and rebates stimulate consumer spending and corporate investments. Such policies guarantee the government's economic readiness and secure the timely and targeted actions implemented (Frankel & Schreger, 2013).

Building structural stability and becoming resilient to emerging market economic problems is the core of economic development. The literature celebrates an increase in finance, regulations, and economic diversification reforms. Financial regulation can be seen as a measure to control the appetite for risk and help stabilise the banks (Rajan & Zingales, 2004). A multi-crop economy protects the countries against external threats. Therefore, they become less sensitive to external shocks. These changes, though challenging, need to be put into practice if a nation is to avoid crises and develop sustainably.

3. Empirical Analysis

3.1. Economic Impact of the GFC on Brazil

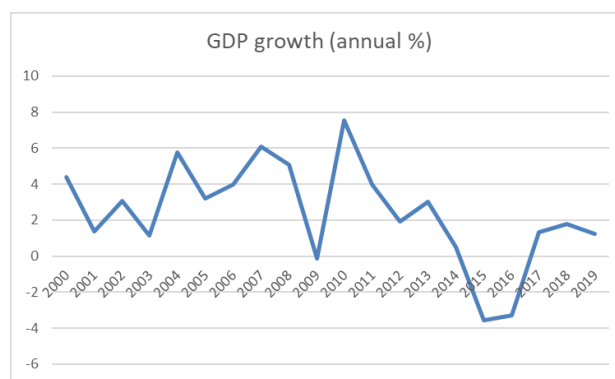


Figure 1. Brazil GDP Growth 2000-2019 (Source: World Bank Database)

The graph illustrates Brazil's annual GDP growth rates from 2000 to 2019. During the Global Financial Crisis (GFC) of 2007-2008, GDP growth dropped sharply from around 6% in 2008 to nearly -1% in 2009. Recovery was significant, with GDP rebounding to around 7% by 2010. However, the recovery was uneven, with fluctuations and a notable downturn around 2015-2016 before stabilising post-2016.

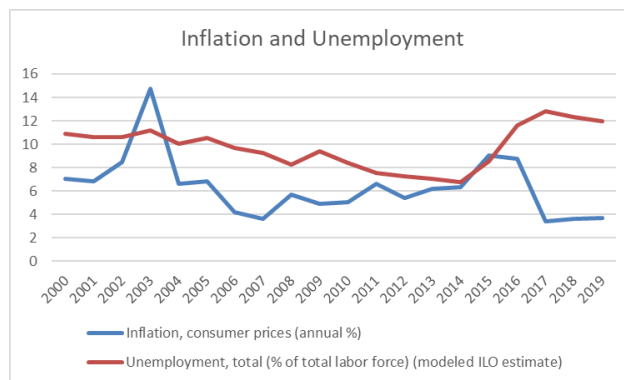


Figure 2. Brazil Inflation and Unemployment 2000-2019 (Source: World Bank Database)

Inflation peaked at 14% in 2003, gradually declining to 6-7% during the GFC and further to below 4% by 2019. Unemployment, stable at around 10% pre-GFC, surged to 12% by 2016, remaining high at 11-12% subsequently.

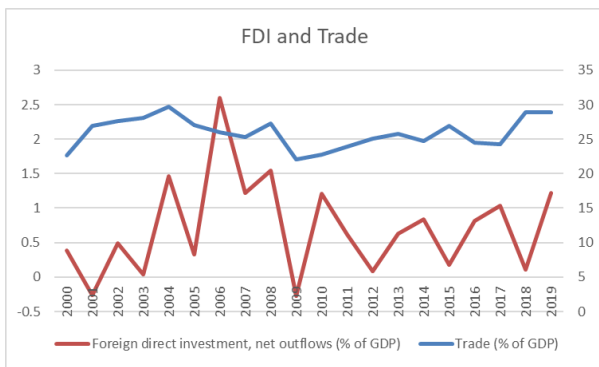


Figure 3. Brazil FDI and Trade 2000-2019 (Source: World Bank Database)

FDI net outflows dropped significantly during the GFC, reflecting reduced investor confidence. While trade as a percentage of GDP also declined during the crisis, it recovered gradually, stabilising above 25% post-GFC. These patterns indicate the ability of Brazil to restore and maintain trade levels post-crisis indicates a certain level of resilience in its trade sector, driven by its strong agricultural and mineral exports. However, the more pronounced adverse impact on FDI suggests that while trade relationships were able to bounce back relatively quickly, investor confidence took longer to rebuild. This divergence underscores the importance of stable economic policies and investor-friendly reforms to attract and retain foreign investment, especially in times of global economic turmoil.

3.2. Economic Impact of the GFC on India



Figure 4. India GDP Growth 2000-2019 (Source: World Bank Database)

The graph illustrates India's annual GDP growth rates from 2000 to 2019. During the Global Financial Crisis (GFC) in 2008, India's GDP growth sharply declined from around 9% in 2007 to approximately 3.9% in 2008. However, recovery was swift, with growth rebounding to nearly 8.5% by 2010, driven by strong domestic consumption and proactive government policies. Despite this rebound, growth rates fluctuated in subsequent years due to ongoing economic challenges and external shocks.

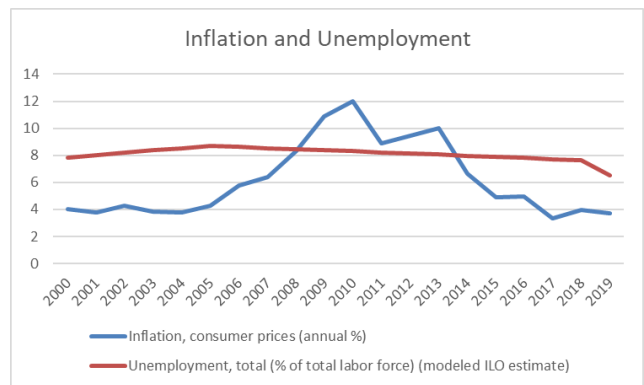


Figure 5. India Inflation and Unemployment 2000-2019 (Source: World Bank Database)

The graph also shows inflation and unemployment trends. Inflation peaked at around 12% in 2010 but gradually declined to about 4% by 2019. Unemployment remained stable at around 8-9% until 2011, then declined to approximately 5% by 2019. These trends indicate that while inflation was significantly impacted by the GFC, unemployment rates improved gradually post-crisis.

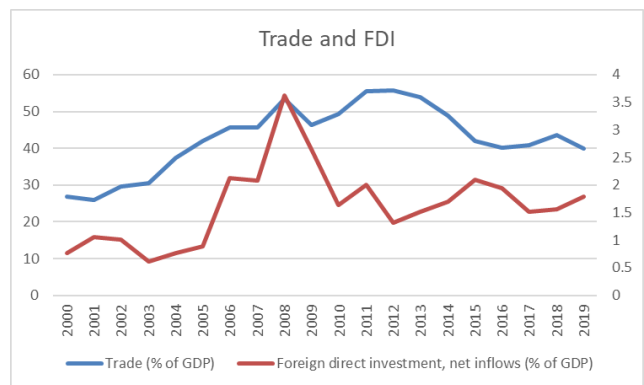


Figure 6. India Trade and FDI 2000-2019 (Source: World Bank Database)

Trade and foreign direct investment (FDI) net inflows, as percentages of GDP, showed significant growth until the GFC, with trade peaking at 55% and FDI at nearly 4% in 2008. Both declined sharply during the crisis but gradually stabilised post-GFC, with trade around 40% and FDI around 2% of GDP. These trends highlight the severe impact of the GFC on both trade and investment flows, with a gradual recovery in the following years.

3.3. Policy Responses in Brazil

Brazil's central bank applied a number of monetary policy tools with the aim of reducing the negative effects of the Global Financial Crisis so that the citizens would be protected from the economic disaster. Some, for example, are deep cuts in the interest rates to boost the economy by reducing the cost of borrowing. Consumers are more confident in their economic prospects as the unemployment rate has fallen (da Silva, Sales, & Gaglianone, 2013). Injection of money liquidity was a prevention step banks were given so that lending could go on as usual. This is what the intervention of the central bank in the foreign exchange market achieved: It pushed the Brazilian real up to its regular level after a collapse during economic difficulty, and this led to inflation (Moessner & Allen, 2010).

At that time, its fiscal policy was powerful enough, and the domestic stimulus of the country was aimed at the economic recession. The government inaugurated a pretty large fiscal

stimulus package with the aim of expanding infrastructure spending in order to fight unemployment and economic temperatures (ILO, 2009). Along with the tax rebates to the private sector, consumer spending was also designed. For instance, temporary tax cuts were applied to automobile and construction sectors, which were particularly hard hit by the crisis. Fiscal stimulus provided Brazil's economy ample room and helped it withstand the global fallout, producing local demand subsequently (Wise, Armijo, & Katada, 2014).

Structure and policies on financial stability and resilience were reinforced by Brazil, which involved fiscal and monetary policies at the same time. Banking risk was reduced as financial legislation was imposed. Supervision of banks and risk management strengthened. The Brazilian institutions placed economic diversification as a key strategy to cope with the drop in the aggregate demand that happened globally in an attempt to reduce the inherent dependence on commodity exportation, which was subject to global price fluctuations (Macalos, 2021). A healthy and resilient financial sector is the primary aim of the reforms, which in turn focuses on the promotion and maintenance of sustainable economic growth in the long term.

3.4. Policy Responses in India

The RBI has, in turn, used multiple policy tools like open market operations, refinancing of funds, repo rate changes, Liquidity Adjustment Facility (LAF), Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) in dealing with the onslaught of the global financial crisis. The central bank has also used it as a stimulus for borrowing and investment. The central bank was cutting the repo rate from 9% in October 2008 to 4.75% by April 2009. The RBI provided substantial liquidity support through open market operations and reduction of the cash reserve ratio (CRR), which was lowered from 9% to 5% during the same period. In this way, funds liquidity (or shocks faced by banks) would be absorbed, and banks could lend these funds to productive sectors (Subbarao, 2009).

The most major fiscal stimulus programmes in India were those whose primary purpose was the resumption of economic activities. It is not limited solely to the stimulation of consumer demands and also to higher investments in roads and road improvement. Models of various public welfare programs, including employment guarantee schemes, have been one of the keys supports to the people directly getting income assistance from these programs and the biggest beneficiaries (Ghosh, 2014). The surging of the economy is one of the factors that helps public funds flow, and they come mainly from tax cuts and investments that are widely in the production of cars and estates. Taking into account the demand of the internal market and encouraging economic recovery, these factors were welcomed.

The Indian government, which was undergoing many structural reforms, did its best to take the policy measures aimed at the crash to revive the economy. Without a doubt, the mortality of financial markets can be prevented via the implementation of reforms, which are the regimes of good governance and personal banker risk management. In order to exploit the advantage that crop product brings about the reduction of services and manufacturing industries, it has developed. (Patnaik, 2012). One of the reasons for such programs is the large demand for exports and foreign capital.

3.5. Comparative Analysis of Policy Responses

The uncertainties of the economic policies of the Brazilian and Indian governments made a clear difference between their economic stabilisation and recovery. Brazil's monetary policy, which involved a significant reduction in the interest rates and fiscal stimulus covering such areas as infrastructure development and tax incentives, was necessary to cushion the country against the GFC damages and ensure economic recovery was on the agenda (Wise, Armijo, & Katada, 2014). During the aftermath of the crisis, GDP bounced back fast beyond expected because of the measures above, which included a rate cut down, provision of capital support and public investment in infrastructure and social welfare (Ghosh, 2014). Contrary to Brazil, while profiting from the stimulus effects, India has had a quick recovery due to the fact that it has strong internal consumption.

India also executed the policy utilising an almost identical strategy. The two economies were effectively supported by the implementation of powerful fiscal and monetary stimulations. Infrastructure and incentive taxes for industrial development in Brazil are used in India, where social welfare and rural areas have developed with output stability (ILO, 2009; Subbarao, 2009). The Brazilian governance reforms were aimed at precision in the process of financial regulation and diversification of the economy, while those of India were concerned with overseeing the regulatory regime and stimulating manufacturing and services sectors (Patnaik, 2012).

Policies affect the situation of the economy in the long term, one of the most important factors being stability and growth. As a consequence of financial reforms and diversification, Brazil's economy became less commodity-dependent, producing constancy in the growth rate (Cohen, 2012). India's economic growth was fostered and stabilised by implementing the regulatory structure by improving regulations and diversifying the economy (Patnaik, 2012). Following the crisis, the two countries enhanced their banking institution systems, and this encouraged them to create savings for future use, which made the countries financially sound.

4. Conclusion

The empirical analysis showed that both Brazil and India applied appropriate monetary and fiscal policies to the Global Financial Crisis, which in turn led to their economic recovery. The scheme of Brazil was based on investments in infrastructure and tax incentives, while India's was about social welfare programs and rural development. The two countries also carried out major structural reforms, which resulted in the improvement of financial stability and economic diversification. These steps led to the stability of economies and sustainable growth paths after the crisis.

The main lesson that policymakers in emerging markets should learn is the necessity of timely and targeted interventions, which include interest rate adjustments, liquidity support, and fiscal stimulus. The structural changes are the root of the long-term stability. Future research will probably focus on the long-term efficiency of these structural reforms and on the methods that will help developing countries lessen the effect of the future global financial crisis. Besides, the comparison of the policies of the other developing countries could be a way of acquiring more knowledge on the diversity of the policy responses and their

consequences.

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