European Journal of Molecular & Clinical Medicine

ISSN: 2515-8260, Volume 09, Issue 07, 2022

FINANCIAL SHOCKS: WHAT ARE THEY AND HOW TO PREVENT THEIR EMERGENCE?

Sanjay kashyap[1], Aakanksha singh[2], Ritika uke[3],Manmohan patel[4]and Shilpa Sharma[5]

[1]Student, Faculty of Commerce and Management, Kalinga University, Raipur

Email:sanjaykashyap21102001@gmail.com

[2]Student, Faculty of Commerce and Management, Kalinga University, Raipur

Email: akanshasinghsingh620691@gmail.com

[3]Student, Faculty of Commerce and Management, Kalinga University, Raipur

Email:ritikauke005@gmail.com

[4]Student, Faculty of Commerce and Management, Kalinga University, Raipur

Email: ankushpat333@gmail.com

[5]Assistant Professor, Faculty of Commerce and Management, Kalinga University, Raipur

Email: Shilpa.sharma@kalingauniversity.ac.in

ABSTRACT:

While the effects of financial crises on the economy as a whole, particularly on the poor, have been well-studied, this is not the case for the poorest members of society. This paper looks at the effect of three distinct financial crises on low-income people's ability to get by. Currency crises appear to be the most damaging to the poor, followed by banking crises, when using a variety of estimation techniques and accounting for a lagged dependent variable. Although urban corporations felt the brunt of the crisis at first, rural households were also impacted and in some cases experienced greater losses. Overall, fewer children are enrolled in school and fewer people are using health care services, but the effect on children's diets seems to be mixed.

1. Introduction

A financial shock is a drop in the economy's nominal variables caused by unexpected and unanticipated disruptions in the financial system. Some examples of financial shocks are the 2008 stock market crash, the 2008 (Mohanty et al., 2021) global financial crisis, and the devaluation of the dollar. So, the real economic activities in the economy suffer when there are financial shocks.

Individuals' actions in forming projections about an economic variable's future are described by the term "rational expectation." The theory posits that before forming future expectations about the economic variable at hand, people take into account their past experience, their own human rationality, and the given information (Vikram et al., 2022).

The formation of expectations for the future inflation rate (IR) may take into account past periods in which the IR was higher than expected, as well as self-rationality depending on future income, product preference, and other given information such as the availability of probable substitutes for the products in question. Therefore, individuals should have expectations that maximise welfare given all relevant factors.

2. Review of Literature

Incorporating nonlinearities and financial instability into macroeconomic models has made strides in recent theoretical literature. Some structural models, such as those developed by Kiyotaki and Moore (1997) and Brunnermeier and Sannikov (2014), show how endogenous systemic risk can emerge as a result of the decisions made within the model. Collateral constraints are crucial for the spread and amplification of information in Kiyotaki and Moore's (1997) model.

Recently, several authors have expanded on a traditional macroeconomic model by including a more complex financial sector. The health of a financial intermediary's balance sheet has effects on the institution's ability to borrow and lend money, and thus on economic activity. A decrease in a bank's profitability caused by depreciation in the worth of its liquid assets

The bank's ability to lend money depends on the quality of its loans. Collateralized lending will be impacted by the decline in asset prices. When banks see their net worth fall, they reduce the amount of money they accept in deposits. Two recent studies by Gertler and Kiyotaki (2010, 2015) and Gertler and Karadi (2013).

The ability of nonbank financial institutions to replace banks as providers of lending and liquidity will also play a role in determining the bank capital channel's significance (see, for example, Durdu and Zhong, 2019).

3. Effects of Financial Crises

A financial crisis is characterised by a sharp drop in asset prices, the inability of businesses and consumers to meet their debt obligations, and a lack of liquidity among financial institutions. Many people think of a "panic" or "bank run" when they hear the words "financial crisis," picturing investors fleeing the market or emptying their savings accounts out of fear for the value of their holdings.

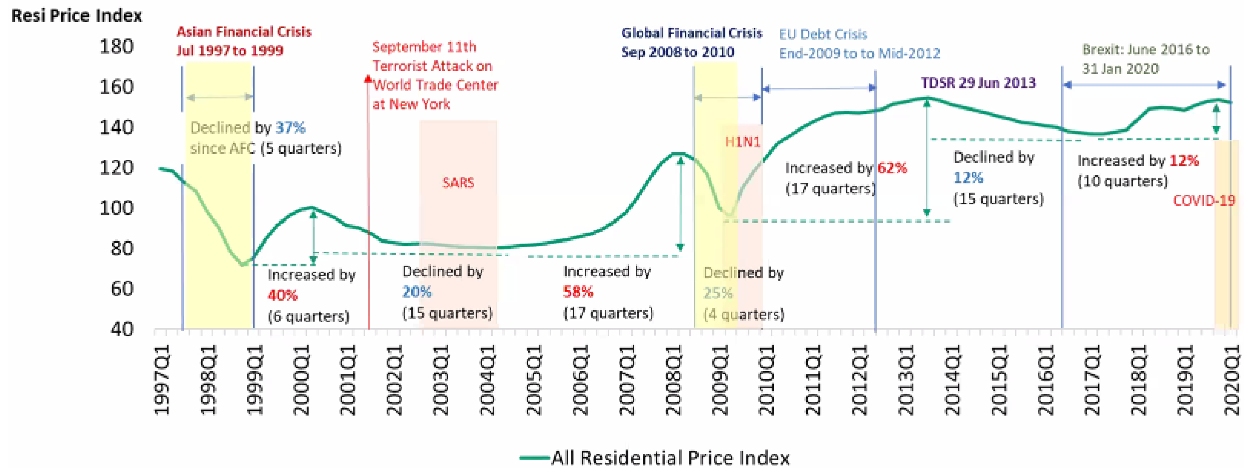

Image 1: Economic Crisis

2008-2009 saw the worst global financial and economic crisis since the Great Depression of the 1930s. Progress towards the Millennium Development Goals and other internationally agreed development goals was severely hampered by the rapid global economic downturn. One of the most significant social effects of the crisis has been an increase in unemployment, a decrease in disposable income, and an increase in vulnerability.

Changes in household spending patterns are one way that families try to weather economic storms, but these measures can have long-lasting consequences for children's health, education, and development, contributing to a cycle of poverty that can be passed down through the generations.

Despite the difficulties, the current situation presents an opportunity to advance society by implementing universal social protection, reevaluating the social effects of globalisation, and ensuring more inclusive and long-term economic growth.

It's clear that even though this crisis has spread worldwide, it's impacting various nations in very unique ways. Ranking countries by the decline in their GDP and passing judgement on their "economic model" has become a popular pastime. Regardless of the above, one must still wonder if a decline in GDP is the right metric to use when comparing the effects of the crisis across countries. The Gross Domestic Product measures the overall output of a country's economy. Consumer spending power and job security have far greater impacts on people's daily lives than

GDP figures do. Changes in consumption and employment rates should be more indicative of the crisis's effects than GDP growth or decline.

The long-term growth trend of productivity is essential for measuring and analysing potential output. Potential output is the maximum level of output that could be achieved by the potential labour force (assuming some natural rate of unemployment) and the capital stock that can be employed, without inflating away wealth, given the current state of technology and the level of human effort.

4. Conclusion

Demand was boosted, and further output and job losses were averted, thanks to policy actions taken over the past decade. The banking industry is now safer as a result of reforms to the financial regulatory system.

Some of these policies, however, had major unintended consequences. The prolonged ultra-low interest rate environment in advanced economies has aided in the accumulation of financial vulnerabilities, especially outside the regulated banking sector. As public debt continues to rise and fiscal reserves are depleted in many economies, it is critical that they be fortified as soon as possible against the next economic downturn.

References

Brunnermeier, M. K. and Y. Sannikov (2014). A macroeconomic model with a financial sector. *American Economic Review* 104(2), 379–421.

Durdu, C. B. and M. Zhong (2019). Understanding bank and nonbank credit cycles: A structural exploration. Technical report, Board of Governors of the Federal Reserve System (US).

Gertler, M., N. Kiyotaki, and A. Prestipino (2020). A macroeconomic model with financial panics. *Review of Economic Studies,* 87(2), 240–288.

Girdhar,R., Khan,J.S.,Mohanty,D.,Sahu,P.K.,andShiekh.Y.(2022).Global Research on Green Finance: A Bibliometric Analysis, *World Journal of Management and Economics*, 15, 3, 3-9.

Kiyotaki, N. and J. Moore (1997). Credit cycles. *Journal of Political Economy,* 105(2), 211–248.

Matta, R., Kochhar, K., Mohapatra, A. K., & Mohanty, D. (2022). Board Characteristics and Risk Disclosure Quality by Integrated Reporters: Evidence from Indian Banks. *Prabandhan: Indian Journal of Management*, 15(5), 27-42.

Mohanty, D., Khan, J. S., & Mohapatra, S. R. (2021). Impact of Macroeconomic Variables on Indian Stock Market. *Empirical Economics Letters*, 20, 27-36.

Pandey, S. K. (2022). A Study on Digital Payments System & Consumer Perception: An EmpiricalSurvey. *Journal of Positive School Psychology*, 6(3), 10121-10131.

Sharma, S. (2022). An Analytical Study Of Financial Performance Using Ratio Analysis Of Public SectorEnterprises With Special Reference To “SAIL” Post COVID 19. *Journal of Pharmaceutical Negative Results*, 1481–1498. https://doi.org/10.47750/pnr.2022.13.S07.213

Vikram, Mohanty, D., & Agrawal, A. (2022). The outbreak of COVID-19 pandemic and its impact on volatility of Indian stock market: evidence from top ten stocks of Bombay Stock Exchange. *African Journal of Accounting, Auditing and Finance*, 8(1), 91-105.