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The Causes and Ramifications of the 2008-2009 Meltdown of the Financial Markets on the Global Economy

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Abstract

The sub- prime mortgage crisis of the summer of 2007 was the first salvo of the impending global meltdown of the financial markets. This study presents a brief review of the factors that led to the collapse of the financial markets and the magnitude of the damage it caused around the globe. It then discusses the measures that need to be taken to stabilize the markets and to create conditions for the resumption of growth. It examines the prospects for financial markets recovery and economic growth in the emerging economies of Asia, Europe and Latin America, with a special reference to BRIC countries, Turkey, and the Middle East. It emphasizes the linkages between nations' economies and asserts that economic growth cannot be sustained by individual or block of countries, without an overall global effort, to reign in greed and unethical conduct by the operatives of financial markets.

Keywords: Sub-prime mortgage; Financial Engineering; Off-Balance-Sheet Income; Market Regulation.

JEL Classification Codes*:* F3, G1.

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Introduction

The rapid growth of the emerging economies of Asia, especially since 2002, raised hopes among development experts that from now on an economic downturn in the developed West would not result in a protracted recession because the emerging Asia would be able to cushion the fall. Thus, when the sub-prime mortgage crisis hit the U.S. in the summer of 2007, it did not appreciably slow down the pace of growth in the economies of the emerging countries.

The picture changed dramatically in the last quarter of 2008 with the collapse of the financial markets in the U.S., and the U.K., followed by crises in other developed countries of Europe and Japan. The percentage declines in the securities markets indices of the developed as well as the emerging markets have been quite severe, to say the least.

This paper examines the causes, extent and ramification of the crises in the global financial markets with a view to decipher the varied paths that a recovery of the markets would likely to take. It asserts that some of the emerging markets, such as Brazil, China, India, and possibly Turkey, are likely to weather the crises better, yet very unlikely to enjoy the rapid rate of growth that they got accustomed to in recent years. It suggests that the economies that are based on exports of oil, gas, and other commodities, are likely to face an uphill battle in achieving a sustained level of economic growth in coming years.

2. A Review of the Causes of the Financial Markets Collapse

This study tries to show that the financial markets crash has been in the making for decades as the U.S. Federal Reserve System, Fed, essentially loosened its monetary policy in favor of “free market” i.e., letting the financial conglomerates dictate the course of policies, under the Chairmanship of Alan Greenspan and his conservative Republican mentors in the White House and the US Congress. The nail in the coffin of safe monetary policy was hammered in with the enactment of the Financial Services Modernization Act of 1999, which allowed banks to engage in all aspects of financial markets, e.g., investment banking, securities trading, and insurance from which they were barred under the Glass-Steagall Act of 1933.

The sub-prime mortgage crisis that ushered in the first wave of financial crisis in July 2007 in the U.S. should have been a clear signal to the financial markets operators to rein in the excesses they have become accustomed to in recent years of financial engineering. Instead, they have been cheered on by the financial “experts” and the media—some claiming that the Dow Jones Industrial Average (DJI) might reach as high as 36,000 (Begley, February 23, 2009)! It seemed as though the financial markets’ wizards along with the Wall Street operators had come up with a miracle package of structured investment vehicles, SIVs, complete with investment grade ratings and insurance that could generate high profits for themselves and their clients. As it turned out, it did not work for long.

Let us briefly summarize the causes of the meltdown of the financial markets in the U.S., the U.K. and the EU in general, before elaborating on their ramifications on the global markets. Perhaps a recent comment by the Dalai Lama on the crisis encompasses the gist of the problem quite well—"…this global economic crisis was caused by: One, too much greed. Second, speculation. Third, not being transparent… These are the moral and ethical issues." (Hamm, May 18, 2009: 16). A second brief statement that captures the theme is, "The crash has been blamed on cheap money, Asian savings and greedy bankers. For many people, deregulation is the prime suspect." (The Economist, October 18, 2008: 79-81). These need some elaboration.

2.1. Sub-Prime Mortgage and the Nature of the Greed

At the aftermath of the tech bubble burst and the September 11, 2001 terrorist attack on the World Center Towers in New York, the Federal Reserve board of Governors, Fed, embarked on a series of interest rate cuts to rejuvenate the depressed economy. This policy of loosening of interest rates to encourage borrowing and investing worked too well.

As building boom ensued, the cheap mortgage rates attracted buyers, some of whom normally would not be qualified for loans for lack of sufficient income and /or poor credit history. The financial institutions, nonetheless, qualified such borrowers for the mortgages because by now they have learned how to shift the credit risks through securitization to greedy and /or obtuse investors (Coy, February 11, 2008; Barnes, September 4, 2007; Bennett, May 5, 2007; Bernanke, May 17, 2007; Grant, January 30, 2008; and The Economist, January 24, 2009).

Three forces worked in tandem to make otherwise unqualified borrowers to secure mortgages. Mortgage brokers and, some financial institutions themselves, qualified such borrowers to get the loans by falsifying credit histories and /or income so as to earn fees and commissions and to unload their real estate inventories; while the borrowers thought that they could easily sell their newly acquired real estate at a higher price at the booming market and make a quick profit (even paying up the prepayment penalty that such sub-prime mortgages required), if they could not make the monthly payment. Slackened underwriting standards, with practically no oversight by regulators, made it possible for lenders to sell real estate without down payments from the buyers (Mayer, Pence, and Sherlund, 2009). What the borrowers did not count on was that if interest rates rose the lenders would adjust the monthly payments higher to reflect their costs (such loans were based on adjustable rates, ARM). And this precisely came to pass when the Fed started raising rates to combat the fear of inflation in June 2004 and raised it 17 times by 2006 to a high of 5.25% (Bernanke, January 17, 2007).

As the mortgage rates climbed, the marginal borrowers could no longer afford the adjusted sky rocketing installment payments and since rapidly falling or stagnating prices made the equity on the property fall below the outstanding debt, they defaulted on their loans. Lenders got stuck with properties whose prices crashed as the rate of foreclosures of real estate climbed rapidly. The financial institutions that financed the sub- prime mortgage loans by securitizing the mortgages now faced double jeopardy—they could not sell the real estate nor could they pay the promised returns to the investors in mortgage backed securities, MBS, and the collateralized debt obligations, CDO. Incidentally, some of the MBS and CDO received AAA rating from the rating agencies, and insured by the conglomerate financial institutions that were ushered in by the Financial Institutions Modernization Act (FIMA) of 1999. The panic among the investors to unload these securities essentially wiped out their values and hastened the sub-prime mortgage crisis.

2.2. MBO, CDO, SIV, Derivatives, and All Types of Financial Engineering and their Role in the Meltdown of Financial Markets

Financial engineering, a by-product of the advent of mathematical modeling by such stalwarts as, Myron Scholes, Robert Merton and Black, that showed how to use share prices for valuation of derivatives (The Economist, January 24, 2009: 10-11) unleashed the creation of new hybrid securities that promised hefty returns to investors. In the absence of clear regulation of such speculative securities, it was easy for unscrupulous investment bankers, with eager help from equally greedy insurance and other financial services firms, to create, secure investment grade ratings, insure, and market these instruments to individuals and institutional investors. While it is complicated enough to estimate the relative riskiness of a traditional corporate bond based on the performance of the underlying firm,

> "…the performance of securities created by tranching large asset pools is strongly affected by the performance of the economy as a whole. In particular, senior structured finance claims have the features of economic catastrophe bonds, in that they are designed to default only in the event of extreme economic duress. Because credit ratings are silent regarding the state of the world in which default is likely to happen, they do not capture this exposure to systematic risks. The lack of consideration for these types of exposures reduces the usefulness of ratings, no matter how precise they are made to be." (Coval, Jurek, and Stafford, Winter 2009, p. 23).

To complicate the financial markets further, the secretive hedge funds appeared on the scene, attracting billions of dollars from rich investors and/or institutions. Since all derivative securities are based on the value of basic equity shares, notes and bonds, and real estate mortgages, it was very clear that the sub-prime mortgage crisis of 2007 would eventually create havoc on the entire financial system.

The inability of the housing sector to unload the foreclosed real estate in the market place rapidly depleted not only the prices of the of their own securities but also of the derivative securities that eventually brought down the financial giants, such as, the Lehman Brother on July 8, 2008 and huge losses to Merrill Lynch, Citigroup, Bear Stearns (acquired by JPMorgan Chase on March 5, 2008), AIG, Goldman Sachs, and Morgan Stanley (Newsweek, December 29, 2008/January 5, 2009: 16), to name just a few.

2.3. Lure of "Off Balance Sheet" Income and Unethical Conduct of Financial Intermediaries

Off balance sheet activities, such as, loan commitment fees, loans sold, recourse, futures, forward, swap, and option positions, that are not clearly visible to the readers of financial statements, grew in importance for financial institutions since the FIMA of 1999. At the end of December 2008, the notional value and fair value of derivatives alone of all U.S. banks stood at over 200 trillion dollars, of which interest rate derivatives accounted for over 164 trillion dollars (Federal Reserve Bulletin, June 2009: A73, Table 2). Such transactions are highly lucrative for banks, but these are highly risky. When a transaction goes sour and bank has to honor its commitment, the loss has to be made up through drawing down of the bank's equity, which usually not adequate to cover such demands. The result is bankruptcy or bailout by the Government.

When the credit swap and other financial institution, FI, guaranteed/insured instruments were demanded to be liquidated by investors in fall 2008, the FI could not meet their obligations. This caused the great meltdown of the financial markets in fall 2008. The U.S. Government let the giant Lehman Brothers go under while forcing some FI to be bought by others, and rescuing others, such as, AIG, Citicorp, through extending billions of dollars of public money through the Troubled Asset Relief Program, TARP, that was hastily enacted in late 2008. The ripple effects of the crisis in the financial markets quickly spread through the U.S. and the global markets.

3. Global Impact of the U.S. Financial Markets Meltdown

3.1. On Exchange Market Indices

The impact of the collapse of the U.S. financial markets on the securities markets around the globe was instantaneous. Table 1 gives the market data for selected months for a number of countries' exchanges between 2006 and 2008. An examination of the data in Table 1 shows that from the end of the third quarter of 2007 to the beginning of January 2009 all the major financial market indices lost significant amount of their values as the extent of the sub-prime mortgage crisis began to be felt across the globe.

The decline in the indices were the largest for RTSI, Russia, followed by SSEA, China; Hang Seng of Hong Kong; BSE Sensex of India; ISE of Turkey; NIKKIE of Japan; CAC of France; JSX of Indonesia, DAX of Germany, KOSPI of South Korea; FTSE, S&P, and IBOV of Brazil; DJIA of U.S., and KLSE of Malaysia. Table 2 presents the data for declines in these indices. It also presents the data on the percentage changes in the indices between January 2 and June 3, 2009.

Between January 2 and June 3 RTSI, BSE Sensex and JSX of Jakarta more than made up the losses in the indices. This is followed by Shanghai SSEA, Hang Seng of Hong Kong, and ISE of Turkey—all experienced recoveries of almost half of their losses. If the exchange indices are alone taken into consideration, it seems that the emerging economies of Asia and Turkey are faring better from the recovery efforts from the financial market meltdown. The U.S. financial institutions which were mainly responsible for creating the financial crisis saw the least recovery so far. Slightly better performance is shown by FTSE, still better by CAC and DAX (See Table 2 for details).

Table 1: Index of Market Closing Prices of Exchanges of Selected Countries

Index	6/1/06	10/2/06	1/3/07	6/1/07	10/1/07	1/2/08	6/2/08	1/2/09	6/3/09
DJIA	11150	12081	12622	13409	13930	12650	11350	8078	8675
S&P	1270	1378	1438	1503	1549	1379	1280	832	932
BSE	10609	12962	14091	14651	19838	17649	13462	9101	14871
CAC	4966	5349	5608	6055	5848	4870	4435	2849	3309
DAX	5683	6269	6789	8007	8019	6852	6418	4179	5055
FTSE	5833	6129	6203	6608	6722	5880	5625	4052	4383
HS	16268	18324	20106	21773	31353	23456	22102	12960	18577
ISE	31951	36390	36630	44332	53970	42539	35090	25056	35722
JSX	1310	1583	1757	2139	2643	2627	2349	1344	2011
KOSPI	1295	1365	1360	1744	2065	1625	1595	1093	1415
KLSE	915	988	1189	1354	1414	1393	1187	880	1055
NIKK	15505	16400	17383	18138	16738	13592	13481	8066	9742
SSEA	1672	1838	2786	3821	5955	4383	2736	1994	2917
RTSI	1495	1614	1843	1898	2223	1907	2303	535	1127
IBOV	36630	41932	59490	65018	65318	59490	65018	39301	53480

Note: BSE for BSE Sensex, India; H.S. for Hang Seng; ISE for Turkey; JSX for Jakarta, Indonesia; KOSPI for South Korea; KLSE for Malaysia; NIKK for Nikkei; SSEA for Shanghai; RTSI, Russia; and IBOV, Brazil
Source: 1) Yahoo! Finance and Thompson ONE data sources.
2) The Economist, June 6, 2009, p.94

Table 2: Percentage changes in the selected Indices between October 2007 and January 2009, and between January 2009 and June 3, 2009.

Index	Percent Change October 2007 to January 2009	Percent Change January 2009 to June 3 2009
DJIA	-38	7.4
S&P	40	12
BSE	-54	63

CAC	-51	16
DAX	-48	21
FTSE	-40	8.4
HS	-59	43
ISE	-54	42.6
JSX	-49	49.6
KOSPI	-47	29.5
KLSE	-38	19.9
NIKKIE	-52	20.8
SSEA	-67	46.3
RTSI	-76	110.1
IBOV	-40	36.1

Source: Estimated from Table 1

3.1. On Economic Growth

Growth in the GDP during the first quarter of 2009 when the full impact of the financial markets plunge of the last quarter of 2008 was felt, were dismal all around. This can be seen from the data in Table 3.

Table 3: Economic Indicators of Selected Developed and Emerging Economies

Country	Gross Domestic Product			Industrial Production latest month	Unemployment Rate %
	1st Q. 09	Change[1]	2009[2]		
U.S.	-2.5	-5.7	-2.8	-12.5 Apr	8.9 Apr
Japan	-9.7	-15.2	-6.7	-31.2 Apr	5.0 Apr
China	6.1	na	6.5	7.3 Apr	9.0 '08
U.K.	-4.1	-7.4	-3.7	-12.4 Mar	7.1 Mar
Euro Area	-4.8	-9.7	-4.1	-20.2 Mar	9.2 Apr
France	-3.2	-4.7	-2.8	-15.8 Mar	8.9 Apr
Germany	-6.9	-14.4	-5.5	-20.3 Mar	8.3 Apr
Italy	-5.9	-9.4	-4.4	-23.8 Mar	6.9 '08
Spain	-3.0	-7.4	-3.5	-14.0 Mar	18.1 Apr
Russia	-9.5	na	-5.0	-16.9 Apr	10.2 Apr
Sweden	-6.5	-3.6	-4.6	-22.9 Mar	8.3 Apr
Turkey	-6.2 Q.4	na	-4.5	-20.9 Mar	16.1 Q.1
Hong Kong	-7.8	-16.1	-5.8	-10.3 Q.4	5.3 Apr
India	5.8	na	5.0	-2.3 Mar	6.8 '08
Indonesia	4.4	na	2.4	1.6 Mar	8.4 Aug.
Malaysia	-6.2	na	-3.0	-14.3 Mar.	3.0 Q.4
Singapore	-10.1	-14.6	-8.8	-0.5 Mar	3.2 Q.1
South Korea	-4.3	0.2	-6.0	8.2 Apr	3.7 Apr
Taiwan	-10.2	na	-6.5	-19.5 Apr	5.8 Apr
Thailand	-7.1	-7.3	-4.4	-9.7 Apr	1.9 Mar
Brazil	1.3 Q.4	-13.6	-1.5	-14.8 Apr	8.9 Apr
Mexico	-8.2	-21.5	-4.4	-6.7 Mar	5.3 Apr

Note: na= not available; [1]Change from previous quarter; [2]forecast for 2009
Source: The Economist, June 6, 2009, p.93

Among the developed countries the decline was most severe for Singapore, followed by Taiwan, Japan, Hong Kong, Germany, and Sweden. Among the emerging economies the worst performer was Russia, followed by Mexico, Thailand, Malaysia, and Turkey. China, Brazil, and India—the three most promising emerging countries all saw growth in their economies.

Table 3 data show that the countries that expect to see economic expansion in 2009 are China, India, and Indonesia. Significant declines are expected in the service economy of Singapore, Japan, Taiwan, South Korea, Hong Kong, Germany, and Russia.

As it happens, these economies depend heavily on exports for their GDP growth.

3.3. On Trade and FDI

Reliable data for trade and FDI during 2008 through the first quarter of 2009 are not available at this writing for all the countries discussed here. What is quite clear though is that both shrank considerably as a result of the financial crisis. Taiwan experienced 18.1 % decline in exports between April 2008 and April 2009. Trade accounts for 63.9 % of its GDP. For the same period, Singapore lost 13.0 % of exports (exports as % of GDP is 198.7 %); Malaysia 7.6 % (82.9 % of GDP); South Korea 8.1 % (50.5 % of GDP); Thailand 3.9 % (72.0 % of GDP); and China 3.5 % (28.3 % of GDP) (Pilling. May 27, 2009, p.6).

Between January 2008 and January 2009, the approximate decline in the value of **merchandise exports** (in percentage) for some of the countries under study, were as follows (The Economist, May 28, 2009, p.80):

India (16)	U.S. (21)	Brazil (25)	Turkey (26)	Germany (29)
France (30)	Mexico (31)	U.K. (31)	South Korea (32)	Italy (32)
China (35)	EU (35)	Japan (36)	Indonesia (37)	Russia (43)

Russia's merchandise exports' decline reflect more on the declining prices of oil during the second half of 2008 than on the collapse of the financial markets. Impact of the latter was felt more seriously on Japan and Germany—the 2nd and the 3rd largest developed countries of the world.

According to the United Nations Conference on Trade and Development, UNCTAD, sources (UNCTAD, February 4, 2009), FDI flows peaked in 2007 to 1.8 trillion dollars. It was expected to fall by around 20 % by the end of 2008, with a further decline in 2009. Some data are available for value of cross- border mergers and acquisitions for 2008. Worldwide cross-border M&A value declined from $1.6 trillion in 2007 to $ 621 billion (www.unctad.org). For China—the largest recipient of M &A funds among the emerging economies in recent years--there was a decline from $82 billion in 2007 to $34 billion in 2008. This sort of decline was also experienced by the developed economies of Europe and North America.

4. Restoring Financial and Economic Stability

The reaction of the governments, especially that of the U.S. and U.K., to the financial markets collapse, was rather swift. Within days of the collapse of the Lehman Brothers, the U.S. enacted the Troubled Assets Relief Program, TARP, doling out billions of dollars to financial institutions in trouble. In addition, the country's central bank, the Federal Reserve System, loosened the monetary policy and extended generous amounts of cheap loans to the troubled FIs. Similar measures were taken by the Bank of England and the British Government to assist and prop up its FIs. These stop gap measures and those enacted by the German, Japanese, and other governments and banking authorities, stemmed the tide of the slide of the markets for now. Let us explore what are the long term prospects of recovery and growth in selected countries and regions of the world.

4.1. The Developed Economies of the West and the East

4.1.1. The U. S. Case

The major catalysts for the financial markets collapse were the process of mortgage origination and securitization of questionable mortgages as safe investment instruments (Jaffe, Lynch, Richardson, and Nieuwerburgh, 2008, pp.7-8). The overhaul of this system requires strict new regulations, and regulators to enforce them. Despite the urgency to repair the system, vested interests in business as well as their supporters (read clients) in the U.S. Congress have so far thwarted meaningful legislations.

One of the major obstacles for reform of the financial system is the general perception by the populace that any regulation by the government is tantamount to the promotion of socialism at the expense of the market economy. Yet, it is the lack of regulation and a 'free for all market capitalism' that brought the downfall of the FIs. One example of this would be the Bernard Madoff's hedge fund, nay the "Ponzi scheme," that siphoned off $50 to $68 billion investors money without a trace (Newsweek, Dec. 29, 2008/Jan.5, 2009).

The Madoff affair showed how lack of clear cut regulation can damage the confidence of the investing public. It is particularly appalling that someone who was the chief of the NASDAQ and who hobnobbed with the 'who's who' of the financial industry leaders, members of the high society, stalwarts of the entertainment industry and high government officials, including some members of the Congress, would hoodwink them their trusts. Hedge funds managers did not have to report their activities to any regulators and, as such, they could do whatever they pleased, as long as their clients did not bother to find out what is amiss. So "Madoffs" of the Wall Street speculated at will to fill their personal coffers and, in the process, millions of investors found their nest eggs essentially evaporated.

It will take significant measures to convince the investing public that they can safely invest in securities and that their hard earned money would not disappear in the hands of the unscrupulous money managers. The naked greed of the FI executives, who are more interested in giving each other hefty bonuses even when their institutions are losing money, must be stopped before the economic malice can abate. The reaction of this class, when the U.S. Government told the executives of the borrowers of TARP money to return bonuses paid with the borrowed money, was quite hostile. Their position that they deserved the bonus because it was in their contracts was supported by the rich Wall Street operators. There is very little hope that they would change their modus operandi.

The stimulus package, the American Recovery and Reinvestment Act of 2009 (ARRA was signed into law in February, 2009) that would cost nearly a trillion dollar to the public (the budgetary cost is likely to be over the 2009-2019 period, according to Zacharias, Masterson and Kim, June 12, 2009). Given the opposition to the package by a section of the Congress and some state governors and business groups, it is not clear how successful this program is going to be in generating employment and economic growth. It may be pointed out that this recession has already claimed 7 million jobs through May 2009 (Ibid.). President Obama's Financial Regulatory Reform Proposal of June 17, 2009, if implemented, could start the process of rebuilding the foundation of the U.S. financial markets. Whether or not it would rejuvenate the growth in the economy remains to be seen.

4.1.2. The U.K Case

The financial markets of the U.K. have more close working relationship with those of the U.S. than the rest of the EU and the Euro area. One of the earliest casualties of the sub-prime mortgage crisis of the U.S. was the Northern Rock that needed to be bailed out on September 13, 2007. Since then it bailed out Bradford & Bingley Plc, Lloyds Banking Group Plc, and the Royal Bank of Scotland Group Plc. The financial bailout of U.K. banks is likely to total some 1.4 trillion pounds, equaling the GDP of the country (CFD.net.au, June 15, 2009)!

Unlike the U.S. the U.K. has had experience with stricter governmental regulation of the financial institutions. The U.K. Government is likely to face less resistance from the FIs and the business in general than the U.S. Yet, the crisis that it faces is formidable. Until the global trade and the economy recover, it is hard to predict how soon it will take the financial markets to rejuvenate profits and growth.

4.1.3. The Euro/EU Area Case

Although the Euro area's FIs faced less contagion from the sub-prime mortgage crisis, it has not been immune to the banking crisis altogether. The area financed subprime countries (i.e., former communist countries of Eastern Europe) and subprime companies (Ewing, Matlack, Stecker et al, March 9, 2009). The problems vary from country to country. The collapse of Lehman Brothers brought a sharp decline in the Euro area stock markets, "… credit markets seized up, and business confidence plummeted…the European Union's economic problems are almost as diverse as its 27 members, ranging from slumping exports in Germany and Eastern Europe to anemic consumer spending in France to property bubbles in Britain, Ireland, and Spain." (Ibid., p.38).

Unlike the Federal Reserve of the U.S. and the Bank of England in the U.K., the European Central Bank, ECB, has fewer policy tools to formulate and implement a single comprehensive policy for its member countries. What suits the interests of Germany, the largest and the richest economy of the EU, does not necessarily suits either France, or Italy, or Spain, although they agree with each other on the need for a new market watchdog, causing irritation for the U.K. (Cohen and MacDonald, June 18, 2009). The ECB now thinks that the Euro zone banks faces $283 billion more losses before 2011 (Atkins and Mallet, June 16, 2009, p.1).

The former East European countries, besides needing billions of dollars in bank bailout, facing virtual drying up of capital flows from the larger EU economies. Besides, decline in exports from Germany has affected these economies also badly because some of them were the suppliers of parts to such corporate giants as Volkswagens and BMW.

The shrinkage in the demand for consumer goods from the richer EU member countries also causing a havoc to the economies like Latvia, Poland, Slovakia, and Hungary (Ewing, et. al. 2009). The individual euro zone countries cannot improve their competitive position by cutting exchange rates to bolster exports and gain economic growth (The Economist, June 13, 2009, p.5)

4.2. The East Asian Developed Countries Case

This group includes Japan, South Korea, Singapore, and Taiwan. Japan is the world's second largest economy after that of the U.S. and it is most likely to remain so for quite a while. Data in Tables 1-3 show that the Group of Four was badly affected by the financial markets collapse like the other developed nations. Yet, these countries are likely to recover faster than the West. After all, they have developed the know-how and policy instruments to succeed from their recent past economic crises. The Group of Four has the lowest level of unemployment among the developed countries and sizeable cash reserves, from the past successes in global trade, that can be invested in capital projects for generating economic growth.

4.3. The Emerging Economies Case

Among this group the BRIC countries—i.e., Brazil, Russia, India, and China—have drawn the attention of the world because of their potential economic power. Brazil with rich natural resources, appropriate fiscal, monetary and development policies should be able to weather the global financial and economic crisis better than the other BRIC nations.

Russia is probably the most vulnerable member of the group. Its reliance on oil and gas exports for economic growth will face turbulent periods with the fluctuations in the prices and demand for energy. With a questionable policy of dealing with foreign energy multinationals and the reliance on state managed enterprises, SME, the country's future is at best a question mark.

India, the largest democracy in the world, is basically a poor country with pockets of bright economic regions and enterprises. Its vast population is potentially a large market for consumer goods driven development. However, it faces quite a few serious bottlenecks in the form of inefficient and inadequate infra structure, shortage of energy resources, a debilitating caste system, and an uneven supply of water resources. Whether or not these, on the top of the current global financial crises, would derail the Indian economy remains to be seen. At this point the forecast for 2009 shows a positive growth rate of 5% in its GDP (see Table 2).

China, the largest economy among the emerging nations, had accumulated a vast amount of trade surplus by the time the financial markets collapsed in the developed economies. Yet, it experienced one of the biggest drops of 67% in the SSEA index between October 2007 and January 2009 (see Table 2). The Chinese Government is predicting a 6.5% growth in its GDP (see Table 3). If one would believe in the official statistics coming from China then it would appear that it would soon be the top economy of the world. The fact is China suffers from the same bottlenecks as India minus not so serious infrastructure and caste problems, but additional ones in the form of autocratic government, serious environmental pollution, and disappearing water resources that may cripple agriculture.

Unless the global economy picks up creating renewed demand for exportable goods and services, countries that depend heavily on exports for growth would not see their economy perk up for any length of time. It seems that the world's financial media are very eager to see China become a growth horse again, judging from the coverage the country receives almost on daily basis. One needs to be skeptical about the rosy forecasts about China. China may no longer be the cheapest source of employable labor for the multinational corporations of the world (Engardio, June 15, 2009, p. 54).

4.4. Other Emerging Economies Case

The other emerging countries like Malaysia, Indonesia, Thailand, Turkey, and Vietnam in Asia and Europe, and Mexico in the Western hemisphere, have all been affected by the financial markets crisis in various degrees. Even though each of these countries has its own peculiar economic conditions, how each will fare will depend on how the overall global economy comes out of the current financial crisis. All these economies have the potential to join the club of the "developed world" in foreseeable future.

5. Conclusions

Since the sub-prime mortgage crisis appeared in July 2007, there has been a plethora of publications/analyses of the causes and consequences of the meltdown of financial markets. Some of these make interesting reading (see for example, Philips, June 8, 2009; Porter, November 10, 2008; and Bhide, February 9, 2009). It should have been clear to the FI regulators everywhere that financial engineering with the help of mathematical models could not change the profitability of operations of business entities on whose securities these were initially based, nor could a group of fund managers and their favorite clients amass wealth at the cost of the general investing public for indefinite period of time.

The financial markets meltdown caused global economic recession and it is this global nature of the crisis that makes it very difficult for individual countries to "…grow their way out through higher exports, or to smooth the consumption effects through foreign borrowing." (Reinhart and Rogoff, 2009, p. 472.). It would not be prudent to forecast when and at what speed the current recession would give way to a relatively stable recovery.

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