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Research on the Causes of the International Financial Crisis and Its Impact on the Stock Market: An Analysis Based on the Subprime Crisis

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Abstract: The subprime crisis is widely recognized as the most extensive and impactful financial crisis since the 21st century. The stock market at that time was the most affected area. This article uses the PEST analysis framework, examining the subprime crisis from political, economic, social, and technological perspectives to understand how the stock market was affected and what were the main causes. Based on the study, it can be concluded that the main political cause of the subprime crisis was the Federal Reserve's missteps in policy. The primary economic causes were the lowering of borrowing thresholds and the bursting of the housing bubble. Lack of risk awareness among American investors was a significant social factor contributing to the crisis. The technical shortcomings of subprime financial products were also a critical factor. The impact of the subprime crisis was multi-faceted. Politically, it led to a decline in social credibility for the US government. Economically, it resulted in the rise of economic protectionism and catch-up economies. Socially, it contributed to high youth unemployment and increased essential spending for low-income families. Technologically, the subprime crisis accelerated the development of the fourth industrial revolution.

Keywords: PEST, Stock Market, Subprime Crisis

1. Introduction

International financial crises appear periodically throughout human history, often delivering heavy blows in various aspects. The stock market is invariably the most affected. During the 1930s' international financial crisis, also known as The Great Depression, the stock market crashed first. Similarly, in the 1998 Asian financial crisis, stock markets in some Southeast Asian countries experienced initial disruptions. These examples illustrate how international financial crises can significantly impact global stock markets, leading to a decrease in companies' market value and the daily income of residents.

At the beginning of the 21st century, a massive international financial storm swept through the global financial market. This international financial storm, referred to in this essay as the Subprime Crisis, was symbolized by Countrywide Financial Corp, the largest U.S. subprime lender, scaling back its lending operations. In about three years, the global stock market was severely impacted, with half of its value evaporating. As the most significant financial storm since the beginning of the 21st

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century, it has had profound implications for the future world situation. There are numerous lessons to be learned from the stock market during that time.

The purpose of this study is to examine the causes of the international financial crisis and its impact on the stock market, with a focus on the Subprime Crisis of 2008. This paper employs the PEST analysis framework, analyzing the subprime crisis through its political, economic, social, and technological dimensions. If this study identifies useful or logical insights, they may inform solutions for managing future international financial storms.

2. Literature Review

The literature most relevant to this study examines the impact of the financial crisis on the financial market. After the subprime crisis, China's financial market has gradually accelerated the pace of opening up, and the real economic system between China and the United States has become more interconnected. This growing connection is the core factor promoting the continuous increase in the interconnection of financial markets between the two countries [1]. In 2008, the international financial crisis caused by the subprime mortgage crisis in the United States quickly spread worldwide, affecting stock markets everywhere. In China, the stock market was deeply impacted, experiencing a prolonged downturn [2]. After the subprime crisis, the world began to rethink its financial system [3]. The financial crisis caused by the subprime mortgage crisis has seriously affected the financial systems of various countries [4]. Based on this, studies examine the main channels through which the financial crisis affects the trend of China's stock market and analyze its impact, ultimately drawing conclusions and providing relevant suggestions [5].

Another segment of the literature relevant to this study examines the factors influencing financial markets. Shen et al. use listed companies on the Shanghai and Shenzhen Stock Exchanges that underwent restructuring, high stock dividend distribution, earnings forecast increase, or loss in 2009 as samples to empirically analyze the factors affecting insider trading in China's stock market [6]. It is observed that the Asian market has a greater impact on the systemic risk of our stock market than the European and American markets. The influence of various stock markets on systemic risk is constantly changing, and systemic risk transmission requires a certain amount of time. Furthermore, systemic risk can be indirectly transmitted through interconnected stock markets [7]. Du begins with the background and causes of the crisis and briefly analyzes changes in the global capital market after the crisis from three perspectives: capital flow, financial assets, and the debt market, based on a substantial amount of data [8].

Finally, the literature examining the causes of financial crises is also relevant to this study. Due to the changing global political and economic landscape, the frequency of financial crises is increasing, highlighting the fundamental role of risk within the financial sector as the cause of economic crises [9]. The financial crisis that occurred worldwide in 2008 exhibits many new characteristics compared to previous financial crises worldwide. This is attributed to the new development of capitalism [10].

According to the essays above, the literature can be categorized into two main areas: (1) research topics related to the stock market during the subprime crisis, analyzed using the PEST framework from various dimensions (political, economic, social, and technological), and (2) studies that explore the causes of financial crises, linking these factors to the broader context of global economic and political changes.

3. The Main Reasons of the Eruption of the 2008 Subprime Crisis

PEST analysis was first proposed by Francis Aguilar, who introduced the concept of "ETPS" in his 1967 book Scanning the Business Environment. This framework critiques the theoretical underpinnings of the external economic environment of enterprises. The PEST model was further

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developed and refined by Gerry Johnson and Kevan Scholes in Strategic Management in 1999. The model identifies P (political), E (economic), S (social), and T (technological) factors as critical elements in strategic external environment analysis. It provides a comprehensive overview, evaluating the impact of these factors on strategic objectives and strategy formulation of enterprises across four dimensions.

3.1. Political Reasons

The mistake of American monetary policy. Since the aftermath of 9/11, the Federal Reserve (FED) began to implement an accommodating monetary policy and cut interest rates over several years. At the beginning of 2001, the interest rate in America was approximately 6.25%. However, by the end of 2001, it had decreased to 1.75%. By the end of 2003, the interest rate had fallen to 1%, the lowest in American history, and remained at this rate through 2004. The prolonged period of low interest rates provided a beneficial environment for the development of the real estate market. However, from 2004 to 2006, the FED began to raise interest rates multiple times. The interest rate increased sharply from 1% to 5.25%. This policy change led to a significant rise in the cost of real estate loans that many borrowers could not afford, resulting in a decline in house prices and eventually contributing to the subprime mortgage crisis. The frequent and erratic adjustments in interest rates by the United States since the 21st century can be viewed as a flawed monetary policy, which was a key policy point leading to the outbreak of the subprime mortgage crisis in 2008.

3.2. Economic Reasons

Low lending standards and a housing bubble bursting. During the boom years of the real estate economy, financial institutions significantly lowered their loan conditions. Loans were extended to individuals with poor credit histories, increasing the pool of borrowers. As a result, more and more people took out loans to purchase real estate. When the subprime crisis erupted, bubbles in the financial markets, particularly in real estate, were quickly deflated. Many homes rapidly devalued, and many subprime loans went unpaid, leading to a sharp increase in the risk of loan defaults and non-performing assets. Ultimately, the subprime crisis emerged, plunging the global economy into recession.

3.3. Social Reasons

American investors did not understand the risks associated with subprime securities. Financial institutions marketed risky subprime mortgages as high-interest products to attract consumers. The trust in these financial products, combined with a desire to get rich quickly, led American consumers to splurge on them. Many invested in subprime securities, believing them to be safe. As a result, the stock market plummeted during the subprime crisis, causing substantial losses for many investors, even those who did not directly hold these risky products. American investors lacked a strong sense of risk control and were drawn to quick profits without careful research, leading to widespread bankruptcy and involvement of global investors. The subprime crisis thus represents a significant failure of opportunism in the market.

3.4. Technical Reasons

The development of asset securitization technology in the United States was not fully mature. Financial institutions packaged bad assets that should not have been in the market and marketed them to consumers, revealing the immaturity of asset securitization in the U.S. While securitization reduces risky assets to some degree, it transfers those risks to consumers who bear the consequences of asset

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depreciation. At the time, many financial institutions sold bad assets at inflated prices to earn large profits. Moreover, there was no effective risk isolation mechanism in the market to protect consumer property from potential threats and risks. As a result, American investors, and even global investors, faced massive losses during the subprime crisis, particularly those who invested significant sums in the stock market.

4. The Main Influences on the Stock Market Taken by the 2008 Subprime Crisis

4.1. Political Influences

Decrease in government credibility and changes in international relations. During the subprime crisis, the U.S. government allocated significant taxpayer money to help Wall Street firms rescue their companies. However, retail investors perceived this as a bailout for Wall Street at the expense of Main Street, prompting demonstrations to express their disappointment with the government's actions. Moreover, the subprime crisis exacerbated international relations as the U.S. shifted its economic burden to the rest of the world. This led to many countries being forced to assist America in addressing the economic and financial pressures it was facing, such as the sharp decline in the stock market. The resulting actions caused widespread international backlash, damaging the United States' global image.

4.2. Economic Influences

Economic catch-up in developing countries. After the subprime crisis, several developed countries' GDPs were surpassed by some developing countries' economies, which gradually fell behind. For example, Japan, once the world's second-largest economy, was overtaken by China by 2010. To date, China remains the world's second-largest economy and the largest developing nation. This highlights how the subprime crisis invigorated the global economy; long-term, stable economic development does not solely rely on developed nations' growth. Developing countries, like China, can also contribute significantly. As a result of this economic shift, China's stock market achieved rapid growth, becoming the world's second-largest stock market. Chinese A-shares were subsequently included in international indexes such as MSCI and FTSE Russell.

Rising trade protectionism. During the subprime crisis, many countries imposed high tariffs on imported goods to protect their manufacturing industries from economic downturns. These protectionist measures often led to retaliatory tariffs from other countries. The U.S., aiming to protect its own industries, was met with resistance from other nations, intensifying the impact on global trade. The resulting American sanctions reduced profits and increased costs for companies, prompting them to lower stock prices. This led to significant financial losses for retail investors. Thus, the harm caused by trade protectionism was widespread, affecting not only U.S. markets but global finance and economic relations.

4.3. Social Influences

Rising youth unemployment rates and a significant impact on low-income families. During the subprime crisis, companies either faced huge losses or had to conserve their original capital, resulting in widespread workforce reductions. Whether a company was large or small, many reduced their employee numbers to cut costs, leading to a sharp increase in youth unemployment rates. Additionally, the subprime crisis raised the prices of daily necessities, exacerbating the already poor living standards of low-income families. These families struggled to afford rent and other essential bills, and their minimal savings in the stock market could potentially be lost entirely. The hopes of achieving wealth through investment were shattered by the crisis.

4.4. Technical Influences

The advancement of the fourth industrial revolution. In the aftermath of the subprime crisis, the economy saw a rapid rise, allowing many high-tech companies to secure funding for new technological developments. This surge in economic activity was crucial for the fourth industrial revolution. After the crisis, the development of new technologies accelerated, particularly in fields like cross-border e-commerce and intelligent technology. In China, for instance, the stock of Antarctic Electronic Commerce recently saw its value increase by the maximum allowed limit in just two days, reflecting the high demand and low-risk tolerance in these new sectors. This indicates that the subprime crisis played a pivotal role in accelerating the fourth industrial revolution.

5. Conclusion

This paper examines the causes and impacts of the subprime crisis on the stock market. The Federal Reserve's incorrect interest rate policy was the catalyst for the crisis, exacerbated by low lending standards and the bursting of a housing bubble. The lack of understanding among American investors regarding subprime financial products and the incomplete development of asset securitization technology were critical factors. The crisis led to a significant decline in U.S. government credibility, negatively impacting the stock market. China experienced an economic catch-up, with the fluctuation of A-shares being crucial to the global stock market direction. The rise of trade protectionism and the suppression of free markets affected global stock markets. The subprime crisis also led to increased youth unemployment and elevated daily costs for low-income families. Moreover, it significantly contributed to the advancement of the fourth industrial revolution.

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