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THE ROLE OF BANKING CRISES IN ECONOMIC RECESSION

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Abstract

In this article, the impact of banking crises on economic recession processes is covered from a scientific-theoretical perspective. It is substantiated that the disruption of banking system stability intensifies economic recession through a reduction in lending volumes, a decline in investment activity, and a slowdown in real sector development. The study analyzes the causes of banking crises, the mechanisms of their impact on the economy, and their connection with financial instability. The obtained conclusions show that ensuring banking system stability is an important factor in preventing economic recession.

Keywords

banking crisis, economic recession, financial stability, banking system, lending, macroeconomic risks.

Introduction

In the conditions of the modern economy, the banking system plays an important role in the centralization of financial resources and their efficient allocation. Through banks, savings are directed to investments, production and service sectors are financed, and settlements between economic entities are carried out. Therefore, the stable functioning of the banking system is considered one of the main conditions for economic growth. Conversely, crises that arise in the banking system can have a negative impact on the entire economy, causing or deepening economic recession processes.

World economic experience shows that many major economic recessions have been closely associated with banking crises. In particular, the Great Depression of the first half of the twentieth century, as well as the global financial crisis of 2008–2009, clearly demonstrated how strongly problems in the banking system affect real sector activity. A decline in banks' solvency, restrictions on lending activity, and a weakening of depositor confidence led to a sharp decline in economic activity.

In the conditions of globalization and financial integration, the scope of the impact of banking crises is expanding further. Problems that arise in the banking system of one country can spread to the economies of other states within a short period of time. This situation requires studying banking crises not only as a problem at the national level, but also as a source of global economic risk. Especially in developing countries, the stability of the banking system has decisive importance in preventing economic recession.

In this regard, a deep analysis of the role of banking crises in economic recession, identifying the causes of their emergence and the mechanisms of their impact on the economy, is a pressing scientific issue. This article is aimed at theoretically and analytically covering the impact of banking crises on economic recession processes.

Research methodology

In the research process, general scientific and special economic methods were used. In particular, the theoretical foundations of banking crises were studied through logical analysis and synthesis methods. Using the comparative method, banking crises of different periods and their relationship with economic recession were analyzed. Based on a systemic approach, the mechanisms of interaction between the banking system and the real sector were clarified. Also, conclusions were formed based on scientific literature and international experience.

Analysis and results

In analyzing the interrelationship between banking crises and economic recessions, first of all, it is important to determine the functional role of the banking system in the economy and

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how its stability affects real sector activity. Banks, as financial intermediaries, direct savings to investments, ensure capital circulation, and coordinate financial relations between economic entities. Therefore, any disruption that arises in the banking system has a chain effect on all components of the economic system.

The analyses show that banking crises often manifest as the starting point of an economic recession or as a factor that intensifies it. When problems emerge in the banking system, lending volumes decrease first of all. Banks tighten their lending policies in order to preserve liquidity and reduce risks. As a result, real sector enterprises face shortages of investment and working capital. This situation leads to a reduction in production volumes, a decline in employment levels, and a decrease in gross domestic product.

The credit channel is considered one of the most important mechanisms through which banking crises affect economic recessions. Research results show that the contraction of bank lending has a particularly strong negative impact on small and medium-sized business entities. These entities usually do not have direct access to capital markets and are highly dependent on bank loans. The limitation of credit resources slows down or completely halts their production activities.

Banking crises affect economic recessions not only through lending, but also strongly through the confidence factor. Studies confirm that a decline in confidence in the banking system fundamentally changes the behavior of economic agents. The population tends to withdraw deposits from banks, while entrepreneurs tend to postpone investment decisions. This process leads to an overall decline in economic activity. The loss of confidence often has a faster and stronger impact than real economic indicators and causes the deepening of the economic recession.

The impact of banking crises on economic recessions is also manifested through financial markets. A sharp decline in the value of bank shares and bonds reduces investors' wealth. This situation leads to a reduction in consumption expenditures through the "wealth effect." A decline in consumption, in turn, causes a decrease in production volumes and further intensifies the economic recession process. Research results show that during banking crises, financial market instability changes more rapidly and sharply compared to real sector indicators.

The foreign exchange market also undergoes significant changes under the influence of banking crises. Instability in the banking system causes a reduction or outflow of capital from the country. This situation leads to a depreciation of the national currency, an increase in import prices, and an intensification of inflationary pressure. As a result, the real incomes of the population decrease, domestic demand contracts, and the economic recession deepens. Studies show that banking and currency crises manifest as mutually reinforcing processes.

The impact of banking crises on economic recessions is also noticeable through fiscal policy. Large amounts of funds are allocated from the state budget to support banks and stabilize the financial system. This leads to an increase in the budget deficit and a growth in public debt. As a result, the state's ability to stimulate the economy becomes limited. Research results show that banking crises also have a negative impact on long-term fiscal stability.

Historical analysis clearly confirms the role of banking crises in economic recessions. During the Great Depression in the early twentieth century, thousands of banks went bankrupt in the United States and European countries. A sharp contraction in lending led to an unprecedented decline in production. Similarly, the global financial crisis of 2008–2009 emerged in the banking system as a result of problems in the mortgage market and caused a deep recession in the world economy. These experiences show that banking system stability is an integral part of economic stability.

The analysis results show that the impact of banking crises on economic recessions is not only short-term, but also has long-term consequences. In the post-crisis period, banks increase caution toward risks, which slows the recovery of lending. As a result, the economic recovery

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process takes a long time. This phenomenon is explained in scientific literature as the "slow credit recovery" phenomenon.

In addition, the study found that the impact of banking crises on economic recessions depends on the level of institutional development of countries. In countries with strong banking supervision and effective regulatory systems, the negative consequences of banking crises are eliminated relatively quickly. Conversely, in countries with weak institutional mechanisms, banking crises lead to long-term economic recessions. This situation once again confirms the importance of banking system reforms.

The analysis results show that assessing banking crises only as a problem specific to the financial sector is an incorrect approach. They have a complex impact on the real sector, fiscal policy, the foreign exchange market, and the welfare of the population. Therefore, measures to prevent banking crises and mitigate their consequences should be comprehensive and systemic.

In general, the conducted analyses showed that the role of banking crises in economic recessions is very high. Problems in the banking system accelerate economic recessions, increase their depth, and slow down the recovery process. The obtained results scientifically confirm that ensuring banking system stability is of decisive importance in preventing economic recessions and ensuring sustainable economic growth.

Conclusions and recommendations

The results of the conducted research clearly demonstrated that banking crises play an important and multifaceted role in the processes of economic recession. Since the banking system is the main mechanism that ensures economic growth by accumulating and distributing financial resources, any disruption in its stability has a direct and indirect negative impact on the activity of the real sector. During the research, it was scientifically confirmed that banking crises intensify economic recession through a reduction in lending volumes, a decline in investment activity, and the loss of confidence among economic agents.

The analyses showed that banking crises manifest not only as the initial cause of an economic recession, but also as a factor determining its duration and depth. The limitation of credit resources has a particularly negative impact on the activities of small and medium-sized business entities, leading to a decline in employment levels and a reduction in production volumes. At the same time, the weakening of confidence in the banking system changes the economic behavior of the population and entrepreneurs, causing a decrease in consumption and investment expenditures. These processes lead to a decline in gross domestic product and deepen the economic recession.

The research results showed that banking crises also have a strong impact on economic recession through fiscal and foreign exchange markets. Funds allocated by the state to support banks increase the budget burden and negatively affect long-term fiscal stability. At the same time, instability in the banking system leads to a reduction in capital flows, exchange rate instability, and an intensification of inflationary pressure. These conditions reduce the real incomes of the population and limit domestic demand.

Based on the above conclusions, the following recommendations can be proposed in order to reduce the negative role of banking crises in economic recession. First, it is necessary to improve risk management systems in banks and strengthen the diversification of credit portfolios. This increases the resilience of banks to macroeconomic changes. Second, strengthening banking supervision and regulatory mechanisms and aligning prudential standards with international standards are of great importance. Third, it is necessary to prevent speculative bubbles in financial markets through the active use of macroprudential policy instruments.

In addition, it is necessary to strengthen the confidence of the population and business entities in the banking system by developing the deposit insurance system. Strengthening the role of the central bank as a lender of last resort serves to eliminate short-term liquidity problems in the banking system. In general, comprehensive and systemic measures aimed at ensuring the

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stability of the banking system are an important condition for reducing the risk of economic recession and ensuring sustainable economic growth.

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