How does financial crisis affect currency

Finance

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Introduction

With the United States sub-prime mortgage market collapsing, the global financial system underwent a period of unprecedented turmoil from December 2007 to June 2009. The crisis, also referred to as the mortgage mess or mortgage meltdown, was publicly known when a steep rise in home foreclosures in 2006 spiraled out of control and triggered a national financial crisis that went global within a year.

The crisis shook the stock market, brought down consumer spending, made the housing market plummet and caused foreclosures numbers to rise. It caused dissension among consumers, legislators and lenders, spawning furious debates over its causes and solutions. The levels of blame on the causes of the disaster were assigned partly to financial institutions, consumers, credit agencies, government housing policies, and regulators. The most proximate cause, however, was the rise in subprime lending (Blinder, 2013).

Discussion

It was difficult to understand how the collapse of the sub-prime mortgage threatened to collapse the US financial system and the economy. The governments had to inject trillions of taxpayers’ dollars into the financial systems and still, especially in the US, people lost their homes, savings and jobs. The collapse of the housing bubble was the spark that ignited the chain of events that eventually brought the fall of the 2008 crisis. The collapse was fueled by easy and available credit, low interest rates, toxic mortgages, and scant regulations. This means that there were trillions of dollars embedded in

the risky mortgages throughout the system. As the mortgage related securities got sold to the investors around the world, packaged and repackaged, there was a lot of money embedded in the risky business. Markets and financial institutions that had been exposed to these mortgages and that had borrowed heavily against them suffered losses worth billions of dollars in the mortgages, as well as their related securities. The losses were magnified by synthetic securities and other derivatives not only in the US, but also around the globe. Through this, the trading ground was brought to a halt and the stock market plummeted, plunging the economy into a deep recession.

The effects of the financial crisis were universal mainly due to the financial markets being globalized, as well as the existence of technology, which transformed the speed, efficiency and complexity of financial transactions and instruments. Many great economies reported the worst market declines after the twin towers' crisis of September 11th, 2001. The fears of the spread of the massive losses on loans made to US's home buyers loans was the main reason for the market declines in these foreign economies (Dolezalek, 2012).

There was a sharp increase in counterparty and liquidity risks in core money and credit markets in the crisis. This means that the cost of raising a dollar or a Euro through a foreign exchange swap increased significantly as institutions were forced to raise funds in other currencies, which would then be swapped into Euros or dollars.

Conclusion

The crisis, which is the biggest since the great depression shows clearly how an economy can be both a demon and an angel at the same time, and how

the US and the EU, who control 30% of the world economy, cannot command the global economy alone. Countries like the Great Britain and Japan, which are closely attached to the US financially, faced most damage unlike those like China whose relations to the county are not very close (McLean & Nocera , 2010).

References

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