

Central causes of the global financial crisis



The global financial crisis of 2007-present caused the largest meltdown of major economies worldwide since the great depression of 1930. It involved the collapse of large investment banks and as a result affected all markets in the western world. A number of books, newspaper articles and media reports have been written in relation to what caused the crisis; due to the vast source of information and discussion on the topic, origins of the crisis could now be misconstrued.

All forms of credible information; accurate financial data, statistics and reports are available to draw a conclusion from as to the cause, but greed was a motivating factor through the use of subprime mortgages and predatory lending. The U. S Government's risk-averse policies on banking regulation gave way for reckless bankers on Wall Street to make quick money by exploiting the population; selling the ' American dream' which created the largest housing bubble and national debt to date.

This essay looks at two types of banking practices practiced during the GFC by investment banks and lenders which contributed to the economic downturn: subprime lending and predatory lending. All Americans wish to achieve the ' American Dream'. The definition of which could differ to individuals but during a press conference by President George W. Bush he clearly relates the American Dream with home ownership.

“ Right here in America if you own your own home, you're realizing the American Dream” (G. W Bush, Remarks by the President on Homeownership, St. Paul AME Church Atlanta, Georgia USA, June 17, 2002). In 2003 the Federal Reserve dropped interest rates to 1% (Labonte & Makinen, 2008)

this caused America to start spending big and the American dream of home ownership; instead of being a myth and something which has been unachievable by millions in the past, all of the sudden was in their grasp, enter subprime mortgages. Prime mortgages were approved for people who qualified on the prerequisites stated on the terms of a loan.

Prerequisites included: down payment, stable income and current assets as collateral in case the borrower defaulted. Subprime mortgages on the other hand did not require any prerequisites of the borrower what so ever.

(Kirchhoff, Block, 2004) To make certain that these types of borrowers would qualify; the government introduced a bill granting the down payment to be paid by the government. (U. S. Department of Housing, 2010)

Nevertheless, these people with shaky credit and possible history of past defaults were now new home owners, living the American dream.

Unbeknown to them it was to be short lived because in 2006 the Fed raised interest rates back close to 6% (Labonte & Makinen, 2008) pushing loan repayments through the roof forcing them to foreclose their properties. So how many people applied and were granted subprime mortgages? In June 2008 there were 27 million subprime housing loans outstanding (Rhan, 2010) leaving the government with a 4. 6 trillion dollar debt. Rhan, 2010) In 2010 after the main storm of the GFC passing, closer review of the types of people who applied for these toxic loans has become evident and a banking practice which was highly used during the GFC has come to light: predatory lending.

Lenders forcing loans onto a population vying to live the American dream through home ownership, who in effect, could not afford it. In its definition,

predatory states: as out of greed or to take advantage of consumers

(Dictionary, 2010) Predatory lending was rampant during the global financial crisis and is legal in every state in the U. S except for North Carolina (, 2008) Whilst interest rates where down, predatory lenders preyed upon America's minorities, people of Black and Hispanic decent. (Kirchhoff, Block, 2004) These home loans came with higher than usual interest rates and due to stressful periods in people's lives; paying high lawyer fees during divorce proceedings or extensive medical bills due to prolonged illness, people signed for the loan anyway. (, 2008) With an inflated rate of return, in a few years these loans became unserviceable.

Why did financial institutions lend a product with such high interest knowing that some people would eventually default? They proceeded because it made them money from loan fees when initially writing the loan.

(, 2008) The lenders would make their money on fees and then sell the mortgages to other Investment banks like Fannie Mae and relinquish full responsibility. (, 2008) If the loan went into default, it would be the Investment banks problem not the original lenders. (, 2008) To avert the snide practice of predatory lending in the future, the U. S government implemented legislation to curtail it.

(Kirchhoff, 2004) Once again, why would lenders complete such practices if not for greed? Lenders took advantage of vulnerable individuals, during a crisis point in their lives and weak financial regulations, passed by Government. (McLaughlin, 1999) However, predatory lending was just spot-fires in a much larger problem.

The problem was now an inflated housing market (a housing bubble) on borrowed money (Labonte & Makinen, 2008); since most loans went into default and house prices plummeted after the bubble burst, it created a national debt of 4.6 trillion dollars. (Rhan, 2010) This forced America and the rest of the western world into the greatest recession since the great depression. These two examples, may only seem like small issues in the overall scheme of things, but practices such as this created the larger problem overall and lie in the reasons why the global financial crisis happened.

All misbehaviour is driven by greed. It is evident that Wall Street Investment banks took the opportunity of lowered interest rates offered by the Fed and a weak financial regulatory system and stretched the proverbial rubber band by misbehaving and creating toxic financial instruments: subprime mortgages. They drove their product by means of predatory lending until the rubber band snapped. As a result, the American dream eluded millions and continues to be a pipe dream, far from reality, for the majority of middle-America.