

# [Article review on the recent financial crisis and its causes](https://assignbuster.com/article-review-on-the-recent-financial-crisis-and-its-causes/)

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## The recent financial crisis and its causes.

Financial crisis is a situation whereby people lose confidence in the banking sector and therefore their investments in many countries is affected. The value of the assets owned by the financial institutions and other investors reduce in value to a great extent (WIEDEMER, 2012). This has adverse effects in the economy of many countries. The recent financial crisis has resulted to many problems in the whole world. According to the article by Gordon and Metric, the major cause of the financial crisis is the increase in debt of various countries. Both public and private debt was behind the cause of the financial crisis.
Financial institutions engaged in massive borrowing in order to finance the investors in the country. The fact that there were many people wishing to acquire loans, the banks were ready to borrow from anywhere to supply the loans. The failure of the government to control these acts made the institutions engage in unreasonable borrowing including overnight borrowing. Specifically, the financial institutions of the developed countries such as United States borrowed money from even other countries so as to finance people in the country who engaged in massive investment. Some of the loanees were not able to repay their debts and hence the financial institutions were unable to repay the loans they had obtained from abroad. Most financial institutions had to merge, taken over by the public sector or closed. Other financial institutions had to seek financial assistance from the government that already had huge amounts of debts. It is clear that these incidences created fear among the people who had deposited their money in the financial institutions. These financial problems are the first to stimulate the financial crisis.
Public debts also were a major cause of the financial crisis. Most governments prepared deficit budged that had to be supplemented by external borrowing. In this case, the amounts collected from taxed were less than the budgetary spending and this necessitated borrowing from the public and the even from other countries. Many people usually like in investing in risk free bonds and therefore they invested in bonds sold by well developed countries. However, these developed countries were forced to help the financial institutions that were facing a lot of problems. Therefore it is possible that since this government spend their borrowed money on areas they had not planned for, it became difficult for them to easily meet their obligations to the investors. This also created fear and hence initiated the financial crisis.
Generally, the cause of the financial crisis can be attributed to the activities of the financial institutions and their government. The greed of the financial institutions in the process of their credit creation is what created the problems they faced leading to their closure, merge or take over. The people were the ones who were mostly affected (PURI, 2012). The graph below shows the increase in credit lending in the United States that initiated the financial crisis.

## Source; US census bureau, Harvard University. State of the nation’s report 2009

On the other hand, it can be seen that the government failed to play its role well in regulating the financial institutions. The government has the power to use the central bank to regulate the activities of other financial institutions. The use of bank rates, reserve ratio requirements and direct controls by the central bank helps to ensure displine in the financial institutions. Failure of the government to control the financial institutions fueled the financial crisis.
The article is of great use for the investors, governments and the financial institutions. Generally, the financial institutions learn the mistakes they made or were made by other institutions so that they problems that were faced during the period can be eliminated in the future. It is important that the financial institutions evaluate the credit worthiness of their customers before lending money. In addition, they should evaluate the economic situations surrounding them before making their investment decisions. They should not be guided by the greed for profits in their investment decisions.
The governments of various countries can learn from this article. The article demonstrates the failures of the governments especially of developed countries. The government should have controlled the financial institutions through bank rates, reserve requirement and direct regulation through their central bank. From the article, the importance of regulating financial institutions by the governments can be seen. In addition, the governments learns the importance of planning well for the money they borrow to avoid future difficulties. The monies borrowed by the government could have been used in activities that would generate funds to repay the borrowed loan. In this case, the expenditure by the government would not generate the revenue to repay the loan and this led to problems when it came to repaying the loan.
The investors also benefit from the article. Critically analyzing the article, it can be observed that the investors did not make wise decisions on the money they borrowed. This is why they were unable to repay their loans leading to the crisis. Those lending their monies to the financial institutions and the government did not evaluate their investments critically and they contributed to the financial crisis (FORREST, 2011). Therefore investors should analyze their investments properly in addition to seeking advice from professionals to ensure proper investment of their funds. Investors should invest their funds at a time when inflation was on the increase and this was likely to lower the value of the assets they were investing in. the investors did not also predict the future demand in the items they invested in future. Therefore when the prices of houses decreased due to low demand as compared to supply, the investors became bankrupt and could not repay their loans. Therefore investors should look at the market and economic conditions before making investment decisions.
The recent financial crisis has created future difficulties in the real estate investment. Many financial institutions that lend money to real estate investors lost when the inflation increased during the financial crisis. Therefore, the financial institutions are very careful to avoid future losses. It is a requirement now that real estate investors convince the financial institutions on the possibility of success of their investment before they can receive funds. Therefore real estate investors should now develop strategies that will enable them access funds to invest if they wish to succeed in future (KLEIN, 2010).
The investors should also reduce the amount of debts they acquire if they are to succeed. They should at least borrow 50 to 60 percent of their mortgage value to avoid the risks of becoming bankrupt (POZSAR, 2011). This is in case of financial difficulties that may reduce cash flows hence making it difficult for the investors to repay their loans.
The financial crisis has had adverse impact on the real estate market. It is believed the high demand for houses and hence increased provision of mortgages was a major cause of the financial crisis. As a result, investors now fear investing in the real estate market currently. In addition, the banks now lack the motivation of providing loans to the investors to construct buildings (WIEDEMER, 2012). To ensure limited supply of the loans, the banks and other financial institutions have implemented high interest rates to ensure that few people borrow mortgage loans.
The effect of this situation is reduced supply of housing in the economy. The houses supplied are very expensive. Generally, people spend a lot of money in order to purchase houses or even rent one. This is due to the panic caused during the financial crisis (KLEIN, 2010). However, the government has realized that this adversely affects the economic development of their countries. This is because this situation has reduced consumption of other goods in the economy.
Many governments are therefore intervening to save their real estate markets. The governments have passed laws that are meant to limit interest rates on mortgages. In addition, attractive conditions are being put in place to attract investment in real estate. Various governments have also engaged in purchase of houses as a way of eliminating panic among the banks, investors and the citizens. Generally, various governments are putting in place measures to encourage investment in real estate markets.

Generally, the financial crisis that has occurred recently has forced the real estate investors to be more careful on their investment to ensure that they do not become victims of bankruptcy. The investors need to evaluate the market and the economic conditions before investment before they risk their funds. This will ensure that the investors are not left with huge loans after their assets have reduced in value.

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