

Term paper on global economic crisis

[Business](#), [Marketing](#)



According to the first scenario, Sowell talks of the housing boom, which affected most parts of the United States. Peculiar situation arise which changed housing economics in the United States for the first time- ever increasing supply of housing units. The reasons, notes the author was the fact that the mortgages were unregulated, making it easy for most people to enter in to the housing business.

The drop in interest rates of mortgages in this scenarios, also lead to the housing boom. Individuals who never had sufficient collateral were also allowed to get subprime loans. The issue was that everyone demanded housing and the supply was ever increasing. Even if one was not able to cover the total cost of the house, he or she was allowed to make a down payment. People took savings from sale of their existing homes as secondary and went ahead to buy the housing property.

Though housing property in California still remained to be the most expensive in the US, the ever rising middle class resulted to higher demand for housing. The conclusion here was that the unregulated housing market leads to exorbitant costs of housing and high interest rates, which, still were not regulated. There was also little government intervention.

In the second scenario, there was the creation of credit default swap, which saw the banning of collateralized debt obligation and hence ended the financial crises due to unregulated market structure. The book also highlights biggest losses due to market failures.

Most disasters in the past many years are known to have originated from both developed and developing countries. This always happens because of sudden turnarounds in capital flows, and from wobbly domestic financial and

economic policies. The difference is, the present worldwide economic crisis started from the U. S. The continued increase property prices especially the house prices behind the exaggerated accommodative financial rule and careless lending levels during 2002-2006 together with economical modernism ended up in very high mortgage credit to border currency with original low teaser fees. Price increases started creeping in the year 2004; the Federal Reserve from the U. S withdrew financial accommodation. Cost of mortgage went up in a high speed after interest rates started to edge-up. There was collective demand and productivity on the firm financial rule, which depressed the prices for the houses (Sowell p. 55). The sub-prime borrowers started defaulting in huge number. The default by borrowers resulted in huge loses by banks and shareholders. A large fraction of the investor's capital together with the financial institutions' was lost.

It is hard to understand how the U. S government officials would have used their power to unregulated the markets, causing an indiscipline way of transacting businesses by banks and other financial institutions together with their business partners. According to Lewis, many big organizations including banks committed many foolish illegal things. The unregulated market was a big thing to the financial institutions and their shareholders at first. The freedom to operate without restrictions of any kind in any field of business seemed the best thing to have happened in those particular financial institutions. Little did anyone know that everything would come tumbling down? As much as the result was very promising at first, with profits shooting very high and money coming in, in large amounts, things were to change suddenly (Lewis p. 140).

The regulated markets scenario as depicted in the Big Story book is excellent to all financial institutions since the regulated market strategies will make the interest rates less volatile. Banks will not suffer interest rate downswings on mortgages just as what happened during the housing boom. Government intervention in housing sector is vital, as it will control the forces of demand and supply. What happened during the housing boom became a cost-push inflation, which affected the prices of housing critically. Much as there was rising upper class, the standard of living never changed. This because of money illusions, whereby increase in income of people is curtailed by the respective increase in costs of purchasing particular commodities.

As Lewis puts down, during 2008 after the U. S stock market had crushed and everyone knew about it, it really was not news as such. There had already been a silent crush, in the weird feeder sells where there is no sunshine, and the SEC does not dare or worry to step. The link and property plagiaristic markets where geeks create impassable securities to gain from the despair of lower and middle-class Citizens who are not able to pay their debts. Some few people had the idea that these activities were going to bring disaster eventually. Mainly the global financial crisis was the fault of the U. S government for failing to unregulated the markets. There was no way agreement between banks and individuals who were mainly middle-class citizens would have bore good fruits, although it did for a while, but only to benefit a certain group of people. This was taking place without the government interference. There were no specific limits of the loans being given out with no strict rules from any government agency. When the borrowers could not manage to pay the loans, there was nothing else to save

those particular institutions. They had to collapse or sell out whatever was left, hence affecting the world's economy seriously.

Lewis indicates that banks and loan businesses would be very lucrative because of the boom. People would require loan in order to access good housing and improve their living standards. With the favorable mortgage-backed securities, collateralized debt obligations and credit default swaps, most investors, specifically the housing tycoons like Greg Lippmann of Deutsch Bank, Charlie Ledley and Ben Hockett made a killing.

The lack of insanity in the mortgage sector made banks to fix interest rates, which were not reflective of the real economy. Even people with no collateral accessed the mortgages in the name of trying to increase the client base.

The issue of bond traders is critically tackled in Lewis's book, which actually reaped amazing fortunes together with their investors by their bet against the prime-mortgage sector. In this scenario, CEOs who were incompetent were paid as high as \$ 3 million to operate their companies and poorly established traders could not repay the \$ 250 million loan awarded to them. This brought about lack of confidence in the professionalism of the American banking system. By the moment the sub prime market has developed by 2008, the IMF report indicates that there was a financial doom, which made the US government to lose the sub-prime assets, which had a value of over \$ 1 trillion dollars.

There were also informed people who never wanted to portray the herd behavior. Michael Burry, one-eyed Asperger's sufferer, was the first businessman to realize the insanity in the sub-prime mortgages market. Some investors also changed their line of investment after realizing the situation

was going to give them the worst financial crisis ever, for example the strident Republican, Mr. Steve Heisman, turned from being an investor to a socialist. The Wall Street worst financial games had repercussions in the entire American economy. Talking about those who benefit actually is not correct since the implications were felt by every investor. Those who took advantage of the situation lost money because of the financial aftershocks. The great market crashes on hedge funds implied that future investment prospects in the housing sector deemed to be uneventful even if some daring investors undertook the investment. The risk factor was much inevitable, and therefore the situation at which some investors were overshadowed by their swelling bank accounts never materialized in the long- run.

Housing crises in the US appeared to be inflationary. When every one is accessing mortgage the result will be a boom. Basic economic concepts tell us that the increasing supply of commodities with little money to purchase is deflationary. Businesses will run at a loss, housing sector will not get enough demand to match the supply and the surplus housing will equate to millions lost. The uninformed investment policies during Lewis's time translated to adverse economic effects in other economic sectors like investment and banking. Herd behavior was shown, as foreign investors began fleeing from US to invest elsewhere. The implication is that in the long-run the housing demand will rise but the housing sector will stagnate because of low investor confidence.

As Thomas Sowell writes in the housing boom and burst, he gives the fact that the crisis happened in a very simple way. " Behind all the mysterious

securities and complicated economic dealings are simple, monthly advance housing payments from millions of house buyers all over the country.” When some of the house buyers discontinued the payment either by option or by necessity, there was a change from boom to bust. The property that had witnessed an unparalleled flare-up of increase unexpectedly saw a disastrous fall. Eventually the common citizens ended up unable to pay for his/her \$1000 or \$2000 mortgage payments every month. The question by Sowell is “ why did so many monthly mortgage payments stop coming?” the simple answer is, that there are no payments taking place because during the housing boom a time where interest rates were at historic lows, most of the people given the mortgages were those whose hopes of repaying were very low and poor. The banks are to blame also for undertaking risky transactions, as much as the government policies directed them to do so. In addition, the political groups are to blame for politicizing the economy (Sowell p. 88). Since the government was trying to employ a strategy in which everyone would be able to afford a house, it ordered that loans be given to people who in real sense, were not able to afford. The banks were forced to create more mortgages to increased number of clients who were risk. Later on when things were back to normal, and interest rates went up, the payments also went up. A large number of citizens could not afford to pay and they all stopped making payments. When banks experience the hit, the financial institutions had to make a decision. They reduced the prices of the houses drastically, and the market was affected on the spot. Sowell goes on to blame the U. S politicians for coming up with a plan to solve a problem that never existed. This unrealistic plan has left the whole country and even parts

of the world with painful experiences. Sowell has promised that there is possibility to getting out of this particular mess. He says the economy can be let to sort itself out in the absence government intervention (Lewis p. 92). Lewis in the other hand believes that many readers will be disappointed to find out how the rich investors acquired their wealth and fame, but he needs every one to remember that wealth is created and destroyed daily by the money matters. The free market spirit together with private enterprise and financial skill is the one factor that makes the globe rotate. Once shareholders realize that the markets have dropped, funds begin to flow into affordable securities, moving prices up. As market assembles, more and more shareholders invest in these assets pushing the prices into a huge market. In the end, these investors exceed the limit of their capital and adjust the price over a maintainable stage.

I think that the send scenario from Lewis's point of view is the best for creations of effective allocation of investible funds and the second scenario from Thomas' point of view would be best for financial institutions such as commercial banks, investment banks, and brokerage. In addition, the second scenario is the best for both borrowers and homeowners. In Lewis book he points out how some people can get very rich not through the right and usual procedure of acquiring wealth, but by using and interfering with economic markets. Lewis would like people to learn something about what transpires in the minds of the giants and their organizations, as he gives an example of the future market crisis. Wants people to know this are the people and organizations that would lure the common person into getting into promising deals, which are actually meant to benefit them and not the

normal man. In the process of wanting to gain big time, they end up hurting the entire economy either on regional or international level. (Lewis p. 100)

Works Cited:

Lewis, Michael. *The Big Short: Inside the Doomsday Machine*. New York, NY: Penguin Books, Limited, 2011. Print.

Sowell, Thomas. *The Housing Boom and Bust*. New York, NY: Basic Books, 2010. Print.