Effects of financial panics on economy

Literature, Russian Literature

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Financial Panics are fears that a financial institution foresees as a threat to their services, and have a huge effect on economy. Financial panics can result from an expected financial crisis that markets foresee in the future depending on monetary policies existing in the market before a crisis appears. Though businesses may seem to be big enough to fail, some problems may complicate the ability of public officials to manage the crisis. The following essay shows how economics can change due to financial panics.

Crisis in economics can result from different factors like events that touched off the crisis and the finance system structural weaknesses. The statement by Bernanke talks about financial crisis in the market and the prospective causes (Bernanke 1). The statement prospects that the financial crisis resulted from significant losses from residential mortgage loans given to subprime borrowers. The potential for losses are large especially with outstanding funds in the subprime mortgages (Bernanke 2). However, apart from mortgage loans, lack of government's crisis-response plans can result to severe financial crises, which adversely affect the broader economy. When banks run short of funds, depositors in the bank, and lenders in the commercial market, place the highest value on safety and liquidity (Bernanke, 2). According to Gary Gorton, when banks find funding costly and difficult, investors pull back funding and affect the country's economy. For example, a medium-sized German bank announced to receive extraordinary support from the government and German banks association to meet its obligations. This resulted from inability of its Rhineland off-balance sheet to roll over the asset-backed commercial paper it issued in U. S market to fund its asset-backed securities (Bernanke 2). Commercial paper investors became concerned about the bank's ability to meet its obligation and withdrew their investments. The financial panics the investors experience makes them withdraw their investments from the bank, affecting the economy.

Shortfalls in the private sector amplify effects of financial panics on economy. Bernanke's article concludes that they amplified the causes of the crisis, posing threat to financial and economic stability (Bernanke, 12). Lack of timely and effective government action affects the possibility to contain the severity of financial disruptions and their economic effects (Bernanke 18). The government's panic of losing finances of the too-big-to-fail firms calls for its support to prevent the firm from going into liquidation. This is because its liquidation largely affects the entire economy (Bernanke 20). Christina's article talks of Depression in the United States. The main topics include the causes, the start, the worsening, and the end of the Depression. The topics are of importance because they help to study the market Depression in America effectively. Domestic factors contribute a lot to economic changes. As Romer points, until the start of the third year of American Depression, domestic factors were the main cause of American output decline (Romer 25). A series of panics caused decline in aggregate demand in the United States, which moved the economy down leading to progressively worsening unemployment and deflation.

Financial panics affect a nation's economy when the nation introduces monetary policies to stem speculation in stock market. The monetary policy caused recession in the U. S in mid 1929 (Romer 26). A country can set policies to curb foreseen financial challenges in the market, but instead turn to affect the economy. Stock market crash in America caused consumers to become nervous and stopped buying irreversible durable goods, which resulted to Depression (Romer 29). The recession worsened when the Federal Reserve failed to intervene due to sweeping of undiversified and overextended rural banks by banking panics (Romer 32). However, a nation can control financial panics and deter negative changes I the economy. The depression ended after Roosevelt administration supplied money tremendously after 1933 (Romer 39).

The article by Silber talks of shutting and reopening of banks due to financial panics where President Franklin Delano Roosevelt declares a nationwide Bank Holiday (Silber 19). The main topics in the article include; the cause if the crisis, reason for suspension, the solution to the crisis, and people's response after the holiday. The holiday resulted from Michigan Governor William A. Comstock declaration after Ford and Ballantine failed to arrive at a solution to prevent the Union Guardian Trust Company from failure (Silber 21). The financial crisis resulted from a number of reasons. First, the commercial banks had a weakened capital position making them vulnerable to more drains. Secondly, the demand for gold exacerbated the public's demand for currency during February and March 1933, and thirdly, by March 1933, the gold drain at the New York Federal Reserve Bank reduced its gold reserve ration to 24 percent (Silber 23).

To solve the crisis, the Emergency Banking Act gave the president the mandate to regulate all banking functions in emergency periods including foreign transfers. This is the reason why the president declared a banking holiday to save the bank from those financial panics (Silber 24). After reopening the banks, depositors anxiously deposited their hoards for consecutive days. This shows the faith they had in the new banking system after end of the holiday (Silber 27).

Conclusion

Financial panics bring many changes to economy. The holiday banking brought a temporal stop to financial services because the nation feared financial failures on the bank. The depression in America caused economic changes and fears that called for action of the government to deter failures in the financial market (Romer 39). The financial crisis reported by Bernanke resulted from fears of finances in mortgage loans. In summary financial panics can affect the economy as financial services can come to a stop to prevent crises, thus affecting the economy.

Works Cited

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