

Outline the way in which a case study country

Business



Outline the way in which a case study country has been affected by the recent financial crisis of 2008 and subsequent recession. By manred Outline the way in which a case study country has been affected by the recent financial crisis of 2008 and subsequent recession. Explore their economic, political and socioeconomic consequences. Assess the intervention and response of the government and evaluate if these have been adequate from your point of view? word count: 1598 The 2008 financial crisis has been viewed as possibly the worst type of crisis to hit the world since the great depression of the 1930s.

It had caused the risk of totally crashing big financial institutions, downturns in the stock market and banks needing bailing out by the government. The USA was “ hit hard” by the crisis and also by the recession which followed.

A recession is defined as 2 consecutive quarters of negative economic growth (Bamtord & grant 2008). In this essay, I will look at how the USA was affected by the financial crisis and the recession, taking particular look at the economic, political and socioeconomic consequences. I will also assess how the US government intervened and whether I believe it was adequate.

It is believed the financial crisis is to have started from the subprime mortgage market. A subprime mortgage is given to borrowers whose credit history is not good enough to receive the conventional mortgage loan.

There is a higher interest rate attached to this loan as there is more risk of default from the borrower (Kimberley Amadeo 2013) In the US a lot people were defaulting on mortgage repayments creating toxic assets. “ Investment

bank UBS had closed the Dillon Reed hedge fund after incurring \$125 million in subprime mortgage-related losses" (Mizen 2008).

As a result, banks had a made a loss on money and had stopped lending out (credit crunch) to businesses and households. The crisis can be seen as a Minsky Moment. A Minsky moment is an abrupt severe collapse of asset values which belong to the credit cycle or business cycle (Bellofiore R & Halevi J. 2011).

Because banks were not lending, Consumption and Investment components of Aggregate Demand (AD) had fallen causing for AD to decrease resulting in negative economic growth, in other words the recession.

Figure 1 : showing percentage of unemployment (y axis) Figure 1 shows that as soon as the recession hit in 2008, the percentage of unemployment began to rise rapidly for the next 2 years. I believe the unemployment rise is due to the fact that firms had started to lay off workers as they could not get the money to pay them. In addition, consumers were also not able to get money to spend on goods and services in the economy resulting in firms losing revenue and once again laying off employees. From this we know that the crisis had affected the US economy with higher unemployment.

Higher unemployment is bad for the US economy because resources are not being put to use.

The longer people are out of work, the more they lose their skills and this will not bring any economic benefits in the long term. Moving on, as the recession increases unemployment, this would cause worry amongst American people

and may cause them to not behave in the norm and would have created low consumer confidence as consumers would be in fear of losing their jobs. Therefore, there would be a higher marginal propensity to save, which means proportion of income saved is higher (Bamford C et al 2008).

Consumers would have prepared for the worst by saving more and spending less and this is not ideal for the economy to pick up as it halts GDP growth. More to this point, the crisis and recession had affected the typical American way of life according to USA today (Nasser et al 2011). Less US citizens are moving.

The share of people who had not changed homes had risen from 83. 2% in 2006 to 84. 6% in 2009. This links back to the low consumer confidence and also because banks simply were not lending so some people could not move even if they wanted to.

Another effect was Delay in marriages. It was the first time ever since the US government had been recording the data proportion of women 18 years and older who were married fell below 50%.

A reason for this could be that many young adults had decided to live together rather than get married. This is an adaptive response by US citizens to the shortage of jobs and economic uncertainty. The share of adults aged 25 to 34 who have never married climbed from 34. 5% in 2000 to 46. 3% in 2009.

Moreover the proportion of homes that own more than one car fell which indicates that wealth is falling for Americans and the proportion of workers

who worked from home rose from 3.9% in 2006 to 4.3% in 2009. This is clear the recession has altered the behaviour and traditions of American people and has gone as deep that it has caused social effects and does not just purely affect the economy. As the 2008 financial crisis and recession was damaging to the US economy, the US public looks for somewhere to put "blame" on for not correcting quickly the bad state of the economy and this was the government.

This was shown in America in the last congressional elections on November 6th 2012.

The democratic government had come into power in the midst of the recession. The democrats had lost the majority of their seats in the House of Representatives in the last election (The Guardian. 2012). This had made things more difficult for the president, Barack Obama, to implement his plans such as the nationalization of health care and is also a possible reason for the cause of the recent federal government shutdown.

For example the congress had failed to pass legislation appropriating funds for the fiscal year of 2014 causing the shutdown. If the US citizens were not "angry" at the democratic government, it would have been more than likely that the democrats would have majority of congress and the legislation would also have been likely to be passed.

This shows the recession has had political consequences for the USA. The recession caused the US citizens to lose some sort of faith in the government and had caused powers to shift in the congress and as an end result it affects plans for the USA today.

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The US government had intervened with the 2008 financial crisis and recession with the Emergency Economic Stabilization Act which is generally known as the bailout. What the bailout had consisted of was for the federal government to purchase up to \$700 billion of illiquid mortgage-backed securities with the aim to improve the liquidity of the secondary mortgage markets and lower possible losses encountered by financial institutions owning the securities. The US government wanted to stabilize the struggling financial system which in turn would stabilize the economy.

The US government needed to bailout the banks as it was looking like many more were about to collapse. If all the banks had collapsed, the economy would have been in an even worse state. Banks are very crucial to the economy as they provide the necessary money for corporations, firms, households, entrepreneurs and by providing money will push forward innovation and investments which will get the economy rolling, hence all good reason of why they needed to be saved from crashing. Moreover, the bailout was needed to improve liquidity. The bad loans had spread and had caused the credit markets to freeze.

Some of America's biggest companies, such as Caterpillar, McDonald's, General Electric, are now having trouble accessing the credit markets" (Shinkle K 2008). These major companies who were non-financial companies had issues financing their normal business operations. If the bailout was not used and the problem of large corporations not being able to access credit was just allowed to continue, it would have caused damage to the economy through all different angles such as decrease in GDP, reduced

exports and unemployment would have risen drastically as firms would not be able to run their day to day operation in their usual way.

I believe the bailout was needed for restoring confidence to investors. As investors lost confidence in big firms such as American International Group (AIG), these companies saw their connection to liquidity and capital markets increasingly harmed and their stock prices fell dramatically. The benefit of buying toxic assets would have brought about liquidity in the markets for those assets and would have increased investor confidence about the current value and situation of financial institutions.

By ridding those toxic assets from institutions would have helped in restoring confidence in the financial markets and allow banks and other institutions to gain money and to enlarge credit to aid economic growth. " Figure 2 In Figure 2 the negative GDP growth shows the recession taking place in 2008. In 2009 after the US government intervened with their bailout, we see the GDP begin to become positive again and remained positive apart from the small blip early on in 2011 but thereafter is consistent positive growth. I believe this is proof that the bailout plan was effective as it removed the economy from recession.

When consumers, firms and investors realised the banks had been " saved", they would have been getting more confident with the economy and would not save as much and start spending more, hence, the GDP growth. To conclude this, it is clear that the 2008 financial crisis and recession had impacted the United States in various ways.

A serious consequence was the impact it had on unemployment by increasing it even more. I also believe the recession resulting in a bad state of the economy had lead to some political shift in the US as the citizens hought a new approach was needed.