

Impact of the financial crisis on lehman brothers



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The impact of the financial crisis that leads to the bankruptcy of the Lehman Brothers.

Abstract

The 2007-2008 financial crisis can be defined as the collapse of the world financial market and it is the economy financial meltdown since the great depression. The financial crisis begins in the United States of America and spread to other part of the global economy in different countries. During this time, it affects many institution and other business such as the collapsing of some banking institutions one of which is the Lehman Brother. These banking systems in America and abroad suffers severed economic losses which forced them into bankruptcy. The economy was in the worst condition than ever and businesses was basically reluctant in combating this devastating financial crisis. The governments put fort strategic plans that will help stabilize the economy condition, they try to assisted the banking system from collapsing but financial crisis continued for many years as a worldwide recession in the European Union and debt crisis. Even though the government intervention was prolonged this was not sufficient for some of the banking institution. On September 15, 2008, the Lehman Brothers filed for bankruptcy due the collapse of the financial system. This paper is written to show the causes of the financial crisis and what strategic strategy the feds took to combat the situation. It also looks at the how the 2007-2008 financial crisis trigger the bankruptcy of the Lehman Brother.

Keywords:(Financial meltdown, Lehman Brothers, Bankruptcy, Recession).

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The Lehman Brothers was one of the largest investment banking institution in the United States of America. During the financial meltdown of the 2007-2008 financial crisis the state of the chaotic economy was in such a devastating condition. There were many sustainable factors that was used to help stable the economy, but even though several financial institutions were saved by the government proactive strategies, the bankruptcy and collapse of the Lehman Brothers remains a tragedy and instead of following protocol of rescuing the Lehman Brothers company the government sat back and allow the Lehman Brothers to fail. The seemingly triggers and panic of the crisis was basically hidden losses.

Causes of the 2007-2008 financial crisis

One of the primary cause of the 2007-2008 financial crisis was the overflowing of the housing sector in the United States of America that rises in 2005-2006 and because of this, the mortgage rate become default and people cannot pay their mortgage. According to Fried (2012), due to this situation, the banks commence in providing more credits to home owners resulting in higher interest rate and increase housing price. The rise in the housing price seen in the United States in earlier years following the financial meltdown was as a result of the amount of credit made available that was driven by the enormous cashflow of foreign currency into the country. The real estate market also struggled in the United States because of the increase of the real estate standards and careless consumer spending (WEB:

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2012, Fried). During this time it was very easy for individuals to retrieve loans such as credit card, car loan, mortgage etc., which results in the unexpected debt of loan lending among banking institutions and consumers. There was also a rise in the collateralized debt organization and mortgage securities that obtained their value from mortgage payments. This makes it easier for investors from all over the world to invest in the housing sector and as the housing price went down, the financial institutions that borrow money to invest went down and report huge losses.

Secondly, another factor that is responsible for the 2007-2008 financial crisis was the existence of easy credit obtained by consumers. In the previous years before the financial crisis, the Fed decreased the federal vault requirement to 1.0% from 6.5%. This was primarily to rebel against the danger of deflation in the economy, but this aggressive move along with other factors create an increase in the demand of financial assets and therefore, increase housing price while reducing the interest rate (WEB: 2012, Fried).

Another reason behind the financial crisis was the sublime lending by financial institutions such as the banking systems. The rapid increase in the real estate's industry created intensive rivalry among mortgage lender competitors and the quantity of creditworthy borrowers dwindled and this made many lenders institutions feel comfortable in extending credits to borrowers. The government also subsidized business enterprises who maintained minimal underwriting standards during the previous years before the financial crisis. As this happened, it increases the chances of the mortgage standards to decrease and risky loans.

Some of the statistical figure release by the international monetary fund (IMF), there was some major banking institution that incurred losses of more than one trillion from bad loans assets credits and there would be greater losses if the Fed didn't do something to assisted these banking institutions. The financial meltdown as led to the bankruptcy of many mortgage institution lenders and because of this several banking systems went under pressure and some was taken over by government institutions. Several of these institutions are Lehman Brothers, Citigroup, Merrill Lynch, etc.,

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The article entitled " Crash Course" there was no doubt that the downfall of the investment bank the Lehman Brothers was a major cause of the financial crisis meltdown. There were doubtable reasons circulating as to why the government allow the financial institution to collapse, because the government bailed out other institution such as JPMorgan Chase, and Bear Sterns. Nevertheless, several months down the line of the same year the Lehman Brothers was left all alone where they had to file for bankruptcy because the Fed slowly declined to rescue them from the financial crisis (WEB: 2013, Crash Course).

According to Thomas and Hirsh (2009), on September 2008, the Lehman Brothers filed for bankruptcy, this move nearly caused the collapse of the financial system. President Bush expressed his opinion of the economy going down when he stated that " this sucker could go down" (Mason, 2009, p. 28). Many concur that the bankruptcy of the Lehman Brothers could change everything for the country. Economist believed that the failure of the

Lehman Brothers has a huge impact on the economy and before it happens the recession was under control, but after the collapse of the investment bank the economy was altered (Lucas, 2009, p. 67). According to a well know economist, “ everything fell apart after the Lehman Brothers went over the cliff, because no financial institution was safe” (Blinder, 2009).

It was said by the Treasury Secretary that the failure of the Lehman Brothers had led to a systematic crisis where the credit markets frozen and banks significantly had to limit interbank lending, because the assurance of the institution was extremely compromised throughout their financial system. He further explained that the financial system was on the verge of collapsing due to the preexisting of the economy downturn. Many believed that the bankruptcy of the Lehman Brothers was primarily due to the inconsistency and lack of planning in the policies that was applied to the Lehman Brothers in the 2008 crisis. One of the stipulating rumors of why the Lehman Brothers filed for bankruptcy was that they didn't enforce foreseeable risks in the system and the firm's risks taking shrank. The Feds on the other hand, didn't intervene instead they let the investment bank collapse and they sent a message stating that the firm needs to take responsibilities for their lack of planning and failure to take risks.

The Feds reaction to the financial crisis

Based upon the 2007-2008 financial crisis, the Fed government implemented the Emergency Economic Stabilization Act of 2008, which is also known as the U. S. bailout plan in cases as critical as the financial crisis. With this plan the United States Secretary of Treasury is authorized to used seven hundred

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billion dollars (\$700) to help assist businesses during financial crisis especially securities backed by mortgages as well as supply liquid cash to banks to ensure that depositors don't lose their savings. Majority of the funds will be put into banks and other financial institutions to bailout businesses in distressed. The 2008 Act will not only assist locals, but also international businesses worldwide. The plan was implemented to bail out and improve the liquidity assets to stabilize the economy. Upon the implementation of the bailout plan the American economy started to recover because companies such as General Motors that was on the brink of bankruptcy showed improvement by recorded revenues and increase in profit margins.

Conclusion

Many people believed that the 2007-2008 financial crisis could have been handle differently and it could have been avoided if the Feds had taken actions. The bankruptcy of the Lehman Brothers during the financial crisis has impacted the financial system drastically and the fed government did not bail out the bank because of their lack of planning and risk taking pertaining the preexisting economy crisis. The fed believes that if the Lehman Brothers had initiate proper planning and develop strategic policy then they could have avoided the bankruptcy. The federal government also believe that because the Lehman Brothers was in financial problem from previous years before the 2007-2008 financial crisis and they didn't do anything to help the firm, during the crisis they were not willing to take action and prevent themselves. During the crisis it took a large portion of taxpayer money to bail out the economy.

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