

Credit crunch



Credit Crunch Introduction The current credit crunch came at an unexpected time, in the last year in the month of August, which led to the economic crisis. " As far as the financial markets are concerned, August 9 2007 has all the resonance of August 4 1914. It marks the cut-off point between " an Edwardian summer" of prosperity and tranquillity and the trench warfare of the credit crunch - the failed banks, the petrified markets, the property markets blown to pieces by a shortage of credit" (Special report: Credit crisis - how it all began, 2008). The major reasons for the credit crunch are the unwise policies implemented by the banks and the government. This paper briefly analyses the major reasons for the credit crunch started in the last year.

Reasons for credit crunch

The major reason for the current financial crisis is the unwise lending habits of the financial institutions like banks. " Banks found ways to increase the number of mortgage loans through strategies such as interest only mortgages, 100% mortgages and lending to people with poor credit histories" (Who is to Blame for Credit Crunch?). American public have the habit of spending all the money they earned without saving anything for the future. When they are need of money they approached the banks and the banks were ready to give them loans as much as they required, without assessing their financial capabilities. Banks never calculated that an economic crisis like the current one may happen in near future. The banks thought that the global economy is a renewable source. They consider it as an ocean of wealth which will never be exhausted. The allocation of resources in the case of a bank is mainly the loans of different forms to the customers. This allocation has not been done properly by the banks. They

have allotted loans to all the people irrespective of the financial strengths of the customers. They have not conducted any reviews to assess the financial setups of the customer at present and also they failed to forecast the future. On the other hand, the greedy customers accepted all the offers from the banks with both hands. They have approached the banks for everything and the banks were ready to fulfill their dreams. The banks were too focused on selling their goods or services rather than buying the goods or services. They thought the success of banking business rest on selling rather than purchasing. They never bothered too much about the returns against the services they provided. In their opinion, American economy was capable of facing any challenges or threats from the external world. Once the balance between the services and goods sold and bought were destroyed, financial crisis came into the picture.

" The gap between base rates and bank rates has increased as the banks seek to increase the profitability of their loans. The cost of arranging a fixed rate mortgage has increased significantly" (Problems of Credit Crunch). The banks reduced the interest rates on mortgages which encouraged the people to go for buying expensive houses, flats, and cars. Moreover congress has given tax reduction to those who were buying expensive houses in order to stimulate the real estate sector. In other words, mortgages have been encouraged by both the government and the banks and the public readily accepted the offer put forwarded by the banks and the government. "

Washington failed to rein in" the two government-sponsored entities, the Federal National Mortgage Association (" Fannie Mae") and the Federal Home Loan Mortgage Corporation (" Freddie Mac"), both of which ran into trouble by underwriting too many risky home mortgages to buyers who have been

unable to repay them" (Factcheck.org)

Government or the congress did nothing to control the unhealthy lending habits of the banks. Government also failed to analyze the economic situations properly. Government trusted the abilities of the banks in analyzing the financial situation and did nothing either to control or stop the heavy mortgages given by the banks; instead government encouraged banks to do so.

Conclusions

Government should control the banks and their lending habits to avoid further financial crisis. Proper housing and good jobs, strengthening public education and providing health care for all families will improve the situation. Subsidized loan is another solution. "The real lesson is not that we need to find even cleverer people to take over the world of banking. It is that we would be more likely to avoid mistakes if we could breed them a little stupider" (Davis)

Works cited

1. Davis, Evan. 2009. "The rocket scientists of finance". 11 November 2009.
2. "Problems of Credit Crunch". 2009. 11 November 2009. 3. Special Report: Credit Crisis - how it all Began". 2008. 11 November 2009. 4. "Who is to Blame for Credit Crunch?". 11 November 2009.