

Recession of 2007 essay

[Economics](#), [Budget](#)



The recession of 2007 was the worst economic crisis this country has experienced since the Great Depression.

Millions of people lost their jobs and their homes from the recession. This was caused in part by the housing bubble. Banks were giving out loans to whoever wanted one and the housing prices began to rise. When people were not able to pay their mortgages, they sold their house and made a profit.

When the Federal Reserve raised the interest rate, people began to default on their mortgages and could no longer make a profit from selling their home. The recession got so bad that the unemployment rate more than doubled and the stock market suffered as well. The Dow Jones fell to a twelve year low of 6, 547. 05. The government tried to help by lowering the interest rate and implementing a fiscal stimulus package, but that still did not completely solve the problem.

Through a second phase of quantitative easing, the government is hoping to get the economy flourishing again. The Recession of 2007 Introduction The recession of 2007 was the worst recession this country had experienced since the Great Depression in the 1930's. Millions of jobs and millions of homes were lost. Many financial institutions went bankrupt and the government spent hundreds of billions of dollars to slow the recession.

Causes The cause of the recession can be traced back to the housing prices falling. From the 1950's to the 1970's, Savings and Loan institutions and Banks would give people traditional thirty-year fixed mortgages face to face. The loans would be used to purchase homes. In about the 1980's, the rate of

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homes increased. This was attributed to the “ American Dream” of purchasing a home and raising a family in it. The role of Government Sponsored Enterprises increased. The main Government Sponsored Enterprises were Fannie Mae and Freddie Mac.

Fannie Mae is known as Federal National Mortgage Association. It was established in 1938 during the Great Depression as a federal agency. In 1968, the agency was chartered by Congress as a private shareholder owned company. Fannie Mae’s purpose is to expand the secondary mortgage market by securitizing mortgages into mortgage backed securities. Fannie Mae) The Federal Home Loan Mortgage Corporation is commonly known as Freddie Mac. Freddie Mac was created in 1970 as a Government Sponsored Enterprise.

The purpose of Freddie Mac is to expand the secondary mortgage market by buying and pooling mortgages and selling them to investors as mortgage backed securities. (Freddie Mac) Mortgage backed securities were bought from lenders, mortgage originators, and banks. Since these institutions were able to get these loans off their books, they were able to issue more mortgages. The increased mortgages meant that there were more opportunities for Government Sponsored Enterprises to pool these mortgages and sell them off to investors as more mortgage backed securities.

This would continue throughout the 1980’s and into the 1990’s. In the late 1990’s, housing prices increased greatly. Lenders and Loan Originators started giving out more and more loans and the world capital market was

flowing with money. More and more loans were sold as mortgage backed securities and more loans were given out to more homebuyers.

This was known as the housing bubble. The housing bubble is when housing prices get so high that they will not be able to sustain that level due to income levels. (National Public Radio) In 2001, Enron energy trading company collapsed. Many people lost tons of money that they had invested in Enron. To help the economy, the Federal Reserve lowered the interest rate, but lowered the rate way too much. The rapid decrease in the Federal Funds Rate would eventually lead to inflation. To avoid inflation, the Federal Reserve to increase the rate. As William Martin, Federal Reserve Chairman until 1970, would say, they “ took the punch bowl away just as the party gets going.

” This means that the low interest rates caused the economy to flourish, but the Federal Reserve raised these rates to slow the economy. Before the interest rates were raised, people could sell off their homes if they could not make the mortgage payments and would make money on the loan. With the increased interest rates, people could no longer pay off they loan when they sold their homes and people would default on their mortgages. With risky loans and subprime lending, many financial institutions began to take losses.

The foreclosure rate increased and mortgage backed securities became worthless. Many institutions began to panic, such as bank, Washington Mutual, AIG, Bear Sterns, and Lehman Brothers, and eventually began to fail because a large part of their business was the mortgage-backed securities

that were now worthless. Fannie Mae and Freddie Mac, although the government bailed them out, even went bankrupt.

The credit markets froze and the recession started. Dow Jones Industrial Average, [http://www. javerages.](http://www.javerages.com/)

com/ The recession caused a drop in international trade and an increase in the unemployment rate. The Dow Jones Industrial Average began to drop. On March 9th, 2009, the Dow Jones hit a twelve year low of 6, 547. 05.

(Dow Jones) The government had to step in and help fix this major problem. Ben Bernanke's famous quote saying if the government did not react, there would be no economy to fix come Monday. This event took place on a weekend when most people are off work.

One way the government stepped in to help the troubled economy was through fiscal policy. Fiscal Policy Through Fiscal policy, the government issued a \$787 billion fiscal stimulus package designed to pump money into the struggling economy and stimulate the economy. (New York Times) The government did not stop there though; they also used monetary policy to help aid the recession. Monetary Policy Through monetary policy, the Federal Reserve bought mortgage backed securities and the monetary based began to increase. Now banks have a lot of excess reserves and inflation is under control. Since the Federal Reserve cannot lower the interest rate any further, it began conducting phase two of quantitative easing. Through quantitative easing, the government is buying \$600 billion worth of government bonds hoping to stimulate the economy. (National Public Radio) The increase in

money supply will allow banks to increase their reserves and give out more loans.

People getting more loans means more money is being exchanged and helping the economy. Evaluation of Fiscal and Monetary Policies The government had to help the economy through monetary and fiscal policy. If the government stood back and let the economy fix itself, then the recession would last many years longer.

Many republicans opposed the fiscal stimulus package however. They believed the price was way too high and the government was running up debt that was unaffordable. The current Nation Debt is at \$13. 7 trillion and that is always increasing. (Federal Budget) Impact of the Recession The recession has greatly impacted the United States economy.

As of now, the current unemployment rate sits at 9. 6%. This is an improvement since last year however.

Since December of 2009, the number of nonfarm payroll employment has climbed by 874, 000. Before the recession started, the unemployment rate was at 4. %. That is more than a 200% increase in the unemployment rate. (Bureau of Labor Statistics) Conclusion The recession of 2007 was the worst this country has seen since the Great Depression of the 1930's.

Unemployment more than doubled and the Dow Jones nearly dropped by half.

Many financial institutions failed and went bankrupt and the government had to bail out Fannie Mae and Freddie Mac to avoid even more recession side

effects. Had the government stood back and let the economy fix itself, we would be in the same recession many years from now. The government has to step in and speed up the recession to avoid a longer recession. Like in the Great Depression, fiscal and monetary policy helped speed up the recession and get the economy going again. This recession has taught our banks to wise with whom they give out loans to. They cannot continue giving loans to people with no income, no job or no assets. They will default on their mortgages and the government would have to step in again.

Although government intervention may have helped the struggling economy, the government will decide to recoup the money it used for the fiscal stimulus package. Through taxes, the government will get that money back and we will feel the effects. Works Cited Bureau of Labor Statistics. Washington D.

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