

# What causes an economic downturn

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## Economic Downturn

What causes an economic downturn? Support with the findings from the two articles and other sources you would like to use.

### Articles Used:

1. Meghan Loftus, Economist Discusses Causes of Global Economic Downturn. Says countries must find right mix of capitalism, government intervention.
2. Melinda Smith, US Economic Downturn Causes Anxiety, Mental Stress Among Jobless

### Solution:

The current economic crisis that has been present in the global economy has causes a great pause on the economic growth of countries. There have been a number of reasons for the issues and the crisis that has been faced by the US government (Loftus, 2008). These include:

- a) Increased Debts: There has been an increase in the amount of indebtedness of the people of the country. This increase in the number of debts has led to the vulnerability and the collapse of the housing bubble as well. This has in a number of ways led to the economic downturn becoming worse.
- b) Growth of the Housing Bubble: The year 2006 has seen a number of people refinancing their properties to be able to pay lower interest rates. The customers have also been noted to have taken out a second mortgage as well. These were steps taken by the house owners to extract as much money as possible. This however has lead to the increasing the housing bubble and leading the house prices to decrease. Once this hit the country, the

borrowers were not able to pay for the interest rates and neither were they able to refinance the homes. This led the borrowers to default and led to foreclosures from the banks due to delinquency (Smith, 2009).

c) Sub – Prime Lending: Sub prime lending basically refers to lending to people with higher risks, i. e. with low credit ratings. Post the IT bubble burst in 2000 the Fed had reduced the interest rates, and also agreed to provide loans to people with low credit ratings (even below 620). Post the borrowers receiving the loan amounts, and with the lowered interest rates, there was a sudden hike in the prices of the real estates of the country. This led to the sub prime borrowers to be able to borrow even more. This extra borrowing became a burden for the sub prime borrowers and the number of defaulters had grown to a great extent (Waring, 2007).

d) Banking Sector Issues: Shadow Banking systems is referred to when non – bank financial institutes provide for loans to businesses to operate. With the increasing ‘ Shadow Banking System’ in the country, the NY Federal Reserve Bank placed a freeze on the funds. This led to major companies needing to sell off the long term assets at much lower prices to be able to meet up to the short term loan payments. This left the system completely shaken up and also left a huge damage on the regular banking systems and the credit cycles.

Conclusion:

A combined effect of all the above factors together has led the country to move into complete recession. As far as even in 2008 various articles, writers had refused to use the term recession for the US economy (Khan, 2008).

However, the country has now faced recession and has been in the negative

economic growth for over two or more consecutive quarters. The country has been faced with negative growth in the past year. The above mentioned factors each by themselves play a very small role in the economy however culminated together they have led to the decline of the economy.

### Bibliography

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