

# [What caused the 2008 global financial crisis?](https://assignbuster.com/what-caused-the-2008-global-financial-crisis/)

The world’s most extreme and dangerous global disaster since the great depression of 1929 took place in 2008 as the world’s economy faced its downfall (Havemann 2012). For a few major financial institutions, there only options were to collapse or be nationalised as for many others they were able to endure on only with help from the state. The 2008 crisis affected major financial canters across the entire world (Reinhart & Rogoff, 2009) as it took a fatal impact on major institutions leaving the world to watch and fear for the future.  Many argue who it is to take the blame for this infamous crash, was it due to the sub-prime loans created by the bank? Or another stock market crash? Or was it simply just a horrible event that was unavoidable?

The crisis of 2007- 2008 revealed itself in several stages (Roubin &Mihm, 2010) In a period during the early 2000s it was every Americans dream to own their own property, during the years of 2001-2004 banks allowed to this dream to be fulfilled as they were offering mortgages to anyone, they were called sub-prime loans (Buruno 2017).  The crisis began to present itself within the United Stated as the housing bubble burst and the development of mortgage defaults predominantly those relating to subprime mortgages that had been consistently extended in increasing numbers as the bubble was to hit its climax with those of the less credit worthy of borrowers (Samuelson 2015). The stability of many institutions was increasingly affected with their exposure to these mortgages and also the financial products tied to these mortgages. It wasn’t until 2006 as the house prices began to fall that we saw the first sign of trouble. Traditional mortgages made it compulsory for there to be a substantial down payment but due to the increase in house prices, leading mortgage investors began to generate subprime loans for people who wouldn’t normally be able to purchase homes as banks would permit for people to take out loans 100 percent or more of the value of the homes, and realtors didn’t recognise there were too many homeowners with questionable credit. During the build-up to the crisis it was not just the market and governing failures that were incentives to the extreme risk taking that took place. Also, significant in a mass amounts of countries were the macroeconomic environment of cheap credit that took place before 2007 (helleiner 2011). In the past low interest rates have frequently acted as an incentive for financial bubbles, as it was encouraging excessive dept. accumulation and leverage, performed the same role in the lead up to the crisis, as they acted as a type of type that set in action many of the market processes. Errors made by central banks such as the U. S federal reserve which is rumoured to have made their interest rates stay too low in this period (Taylor, 2009) are being particularly blamed for the cheap credit environment by many analysts. However, many other focus more on taking an international view and looking into the role of international capital flows and global inequities. These defaults gradually took a toll on economic institutions with exposure to these mortgages as well as financial goods linked to these mortgages (Taylor, 2009). The crisis only increased as in May and June 2007 we saw the first of many hedge funds collapse and by august, serious concern broke out in money markets about the exposure of a wide range of financial products. Britain experienced its first bank run (northern rock) since the nineteenth century causing panic to break out by mid-September (Helleiner, 2011).

In the early 2000s the federal reserve sustained the short-term interest rate low for a prolonged period of time, due to the extremeness of the recession and the extreme burst of the tech bubble. This overlapped with a global saving surplus as developing countries and commodity-producing nations gathered large financial reserves. Many investors were unsatisfied with the low returns so they started to undertake more risk by chasing higher returns anywhere they could be found. In the period of time from 1990 to 2006 the house prices increased at a steady pace and therefore home-ownership rate rose to a record high of 68. 6% of households by 2007.  For several years, worldwide economic markets entered a period in time which came be to called the “ great moderation”, this is because of the above-average returns and below average validity established by a wide variation of asset classes (Helleiner, 2011). This was due to short-term interest rates being negative meaning that the cost of money for banks was zero. During the housing boom, there was a common acceptance amongst society that the home prices wouldn’t go down and they could only go up. If true, the negative possibilities of borrowing and lending against housing were insignificant. That liquidity and a fundamental sentiment of economic confidence stimulated American households to borrow and American banks to lend, and therefore resulting in runaway debt (Bruno, 2017). Homebuyers could finally enjoy their American dream of owning their own home and Lenders were covered as they both believed that the collateral would forever be worth more tomorrow than today (Samuelson 2015). For those who borrowed and couldn’t make their cost they had the option to refinance on better terms or sell. The building mindset for many that the desire for bigger and better homes, resulted in a permission mortgage market that for dew members of society crossed the line into unethical or illegal behaviour.  Once the certainty that the home prices would not decline finally was seen to be false, the prices on mortgage-backed securities dived. This dive promoted huge losses for many large banks and other financial institutions. These costs soon linked back to other asset classes, fuelling a mass loss of assurance in the financial health of those banks (Samuelson 2015).

In an attempt to calm the market down the use of great doses of liquidity failed as the crisis only fell deeper in march 2008 one of the U. Ss’ major institution investment bank Bear Stern required the U. s authorities to save it. On the 15 th January 2000 word of a severe drop in the profits of the citigroup banking caused an extreme dive of the New York stock exchange. An enormous fall in share prices seemed to have taken place in all major world marked and to only then be followed by a series of collapses on the 21 st January. There was a total loss of market confidence in 2008 as three changed in September took place. During the initial days of the month, the U. S government positioned two-giant- government-sponsored mortgage lending agencies, Fannie Mae and Freddie Mac (“ Fanni and Freddie”), under the form of public losses they were experiencing (Nielsen, 2019). By the middle of the month, events reached their climax as the U. S investment bank Lehman Brothers was forced into bankruptcy. Shortly after the bankruptcy American International Group (AIG) one of the largest insurance companies in the world had to be rescued and nationalised by the U. S government large financial institutions collapsed as the stock markets took its fall all around the world and even the wealthiest of nations had their government need to come up with a plan to rescue their financial systems. it was at that point the severity of the crisis began to be felt much more strongly beyond the North Atlantic region (helleiner 2011). Due to the struggles that came with the crisis, U. S and European banks were required to take back their international loans, which then caused a credit freeze which then brought the global financial system to the threshold of an absolute downfall. triggering substantial financial difficulties and debt crisis in countries that had been relying deeply on goods from overseas. International trade credits also dried up, causing exports and imports to a halt in many sectors and countries. Financial infection was felt exceptionally strong in countries whose financial procedures were already exposed because of home-grown housing bubbles, financial excesses and or large current accounts deficits. The impact of the financial crisis continued until it spread globally through numerous spill overs operating through the “ real economy” such as failing exports, commodity prices and settlement payments. Countries that were also affected by the extremeness of the crisis were Iceland, Britain, Germany, Ireland, Spain the Baltic, Dubai, Singapore, Australia and New Zealand. By the late winter of 2009 the central banks attempted to ease some of the panic surrounding the markets with actions combined with fiscal stimulus. Luckily these extreme actions by the many governments around the world finally helped avoiding a complete global financial collapse, however the credit freeze saw the economy be forced into the worst recession with word war ii.

Financial crisis in many of the developing countries for the past 20 years have been continuously caused by the large inflows of foreign capital, which in turn created cheap credit conditions and therefore contributed to the financial bubbled that took place within the U. S. Leading up the crisis of 2007-2008 many of the worst effected countries had a similar experience (Buruno 2017). The united states experience was one that is most significally important for the global system as it absorbed enormous sums of foreign capital before the crisis from a mass amount of countries in Asia, Europe and the Middle East with large current account surpluses and high saving. The long-term interest rate and fixed mortgage rates continued to stay low even after the federal reserve began to rise from the U. S financial bubble because those capital inflows drove down the cost of credit within the United States. It can be said that inflows contribution to the U. S financial bubble not only at the cumulative macroeconomic level but in a larger direct fashion in financial assets for foreign investors to obtain were MBSs, specifically the “ agency” bonds issued by Fannie and Freddie, as many of the foreign consumers assumed to be backed by the U. S government (sester 2008, p28; Thompson 2009).  As easy as it is to blame the misfortunate events that take place on someone else’s hunger or deceitfulness. If the wall streets bad behaviour was the only problem that took place the cure would be easy as it would only take a stricter regulatory policing that would be able to catch hazardous characters and practices before they are able to cause any damage. This opinion seems to be that for many of the public and many “ experts”. However, the matter at hand is much deeper. It developed from years of economic growth, beginning in the 1980s with the continuing errors made by many within the growth of the housing bubble to the fall of the stock markets, the cause of the crisis cannot be pin pointed to one thing but to many.

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