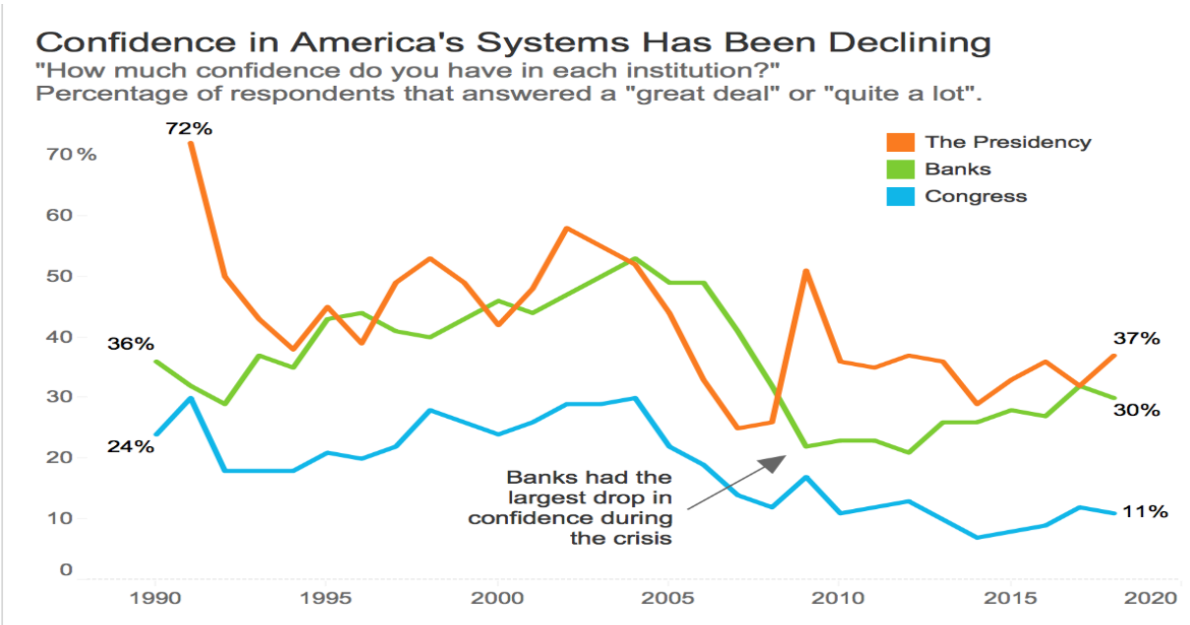
Housing Crash 2008

INTRODUCTION

Between 2007 and 2010, there was a global financial crisis known as the US subprime mortgage crisis that had an impact on the 2007–2008 global financial crisis. It began when US home prices sharply dropped following the burst of a housing bubble. When U.S. home prices declined steeply after peaking in mid-2006, it became more difficult for borrowers to refinance their loans. Securities backed with mortgages, including subprime mortgages, widely held by financial firms globally, lost most of their value.

Concerns about the soundness of U.S. credit and financial markets led to tightening credit around the world and slowing economic growth in the U.S. and Europe. The crisis had severe, long-lasting consequences for the U.S. and European economies. The U.S. entered a deep recession, with nearly 9 million jobs lost during 2008 and 2009, roughly 6% of the workforce. The number of jobs did not return to the December 2007 pre-crisis peak until May 2014. You know what, it means that it took almost 7 years for the US to recover the workforce it had back in 2007. U.S. household net worth declined by nearly $13 trillion (20%) from its 2007 pre-crisis peak, recovering by 2012, for the housing net worth it took 5 years to recover.



Europe also continued to struggle with its own economic crisis, with elevated unemployment and severe banking impairments estimated at €940 billion between 2008 and 2012

PRIOR CAUSES

Several other factors set the stage for the rise and fall of housing prices, and related securities widely held by financial firms. In the years leading up to the crisis, the U.S. received large amounts of foreign money from fast-growing economies in Asia and oil-producing/exporting countries. This inflow of funds combined with low U.S. interest rates from 2002 to 2004 contributed to easy credit conditions, which fueled both housing and credit bubbles. Loans of various types (e.g., mortgage, credit card, and auto) were easy to obtain and consumers assumed an unprecedented debt load.

The complexity of these off-balance sheet arrangements and the securities held, as well as the interconnection between larger financial institutions, made it virtually impossible to re-organize them via bankruptcy, which contributed to the need for government bailouts. Some experts believe these shadow institutions had become as important as commercial banks in providing credit to the U.S. economy, but they were not subject to the same regulations.These institutions as well as certain regulated banks had also assumed significant debt burdens while providing the loans described above and did not have a financial cushion sufficient to absorb large loan defaults or MBS losses.

INITIAL CRISIS FORMATION

Between June 2007 and November 2008, Americans lost more than a quarter of their net worth. By early November 2008, a broad U.S. stock index, the S&P 500, was down 45% from its 2007 high. Housing prices had dropped 20% from their 2006 peak, with futures markets signaling a 30–35% potential drop. Total home equity in the United States, which was valued at $13 trillion at its peak in 2006, had dropped to $8.8 trillion by mid-2008 and was still falling in late 2008.Total retirement assets, Americans' second-largest household asset, dropped by 22%, from $10.3 trillion in 2006 to $8 trillion in mid-2008. During the same period, savings and investment assets (apart from retirement savings) lost $1.2 trillion and pension assets lost $1.3 trillion. Taken together, these losses total $8.3 trillion. Denice A. Gierach, a real estate attorney and CPA, wrote: ...most of the commercial real estate loans were good loans destroyed by a really bad economy. In other words, the borrowers did not cause the loans to go bad, it was the economy. The crisis had a significant and long-lasting impact on U.S. employment. During the Great Recession, 8.5 million jobs were lost from the peak employment in early 2008 of approximately 138 million to the trough in February 2010 of 129 million, roughly 6% of the workforce. From February 2010 to September 2012, approximately 4.3 million jobs were added, offsetting roughly half the losses.

Several steps were taken to deregulate banking institutions in the years leading up to the crisis. Further, major investment banks which collapsed during the crisis were not subject to the regulations applied to depository banks. In testimony before Congress both the Securities and Exchange Commission (SEC) and Alan Greenspan claimed failure in allowing the self-regulation of investment banks. Joseph Stiglitz said "Members of the Right tried to blame the seeming market failures on government; in their mind the government effort to push people with low incomes into home ownership was the source of the problem. Widespread as this belief has become in conservative circles, virtually all serious attempts to evaluate the evidence have concluded that there is little merit in this view."

The crisis can be attributed to several factors, which emerged over a number of years. Causes proposed include the inability of homeowners to make their mortgage payments (due primarily to adjustable-rate mortgages resetting, borrowers overextending, predatory lending, and speculation), overbuilding during the boom period, risky mortgage products, increased power of mortgage originators, high personal and corporate debt levels, financial products that distributed and perhaps concealed the risk of mortgage default, monetary and housing policies that encouraged risk-taking and more debt, international trade imbalances, and inappropriate government regulation.

Excessive consumer housing debt was in turn caused by the mortgage-backed security, credit default swap, and collateralized debt obligation sub-sectors of the finance industry, which were offering irrationally low interest rates and irrationally high levels of approval to subprime mortgage consumers due in part to faulty financial models. Debt consumers were acting in their rational self-interest, because they were unable to audit the finance industry's opaque faulty risk pricing methodology. The Financial Crisis Inquiry Commission reported in January 2011 that: "... mortgage fraud... flourished in an environment of collapsing lending standards and lax regulation.

The number of suspicious activity reports – reports of possible financial crimes filed by depository banks and their affiliates – related to mortgage fraud grew 20-fold between 1996 and 2005 and then more than doubled again between 2005 and 2009. One study places the losses resulting from fraud on mortgage loans made between 2005 and 2007 at $112 billion. "Predatory lending describes unfair, deceptive, or fraudulent practices of some lenders during the loan origination process."Lenders made loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities

Actions taken to overcome the problem

President Barack Obama and key advisers introduced a series of regulatory proposals in June 2009. The proposals address consumer protection, executive pay, bank financial cushions or capital requirements, expanded regulation of the shadow banking system and derivatives, and enhanced authority for the Federal Reserve to safely wind-down systemically important institutions, among others.The Dodd–Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010 to address some of the causes of the crisis. President Obama declared the bailout measures started under the Bush Administration and continued during his Administration as completed and mostly profitable as of December 2014. As of January 2018, bailout funds had been fully recovered by the government, when interest on loans is taken into consideration. A total of $626B was invested, loaned, or granted due to various bailout measures, while $390B had been returned to the Treasury. The Treasury had earned another $323B in interest on bailout loans, resulting in an $87B profit.

CONCLUSION

While nobody can argue that federal housing policy has been perfect, government support of mortgage lending and liquidity in mortgage markets has provided real benefits to consumers and the economy. Federal housing policy promoting affordability, liquidity, and access is not some ill-advised experiment but rather a response to market failures that shattered the housing market in the 1930s, and it has sustained high rates of homeownership ever since. With federal support, far greater numbers of Americans have enjoyed the benefits of homeownership than did under the free market environment before the Great Depression.

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Student ID : 201923250

Name : Kobilov Ilkhomjon