



2007-2009

Financial Crisis

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HISTORY

Introduction

The **financial crisis of 2008**, or **Global Financial Crisis**, was a severe worldwide **economic crisis** that occurred in the early 21st century. It was the most serious financial crisis since the **Great Depression** (1929). **Predatory lending** targeting low-income homebuyers, excessive risk-taking by global **financial institutions**, and the bursting of the **United States housing bubble** culminated in a "perfect storm." **Mortgage-backed securities** (MBS) tied to American **real estate**, as well as a vast web of derivatives linked to those MBS, **collapsed in value**. Financial institutions worldwide suffered severe damage, reaching a climax with the **bankruptcy of Lehman Brothers** on September 15, 2008, and a subsequent international **banking crisis**.

The **2007 financial crisis** is the breakdown of trust that occurred between banks the year before the 2008 financial crisis. It was caused by the **subprime mortgage crisis**, which itself was caused by the unregulated use of derivatives. This below timeline includes the early warning signs, causes, and signs of breakdown. It also recounts the steps taken by the **U.S. Treasury** and the **Federal Reserve** to prevent an economic collapse. Despite these efforts, the financial crisis still led to the **Great Recession**.



Timeline

Financial Crisis 2007-2009



Timeline

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2007

17 Dec

Delta financial corporation Filed bankruptcy

2008

18 Jan

Stock market fell, A bond insurance company was downgraded

2008

15 Sep

Lehman Brothers files bankruptcy protection

2008

24 Oct

World's stock exchange worst declines

2008

6 Dec

The **2008 Greek riots** began

2008

20 Dec

FED funds rate was lowered to zero percent



Timeline

Financial Crisis 2007-2009

2009

13 Feb

Obama signed the American Recovery

2009

10 Apr

Time magazine declared "More Quickly Than It Began, The Banking Crisis Is Over"

2009

1 Jun

NBER declared June 2009 as the end of U.S Recessions

2009

15 Jun

GM files bankruptcy & Large banks repay bailout funds

2009

11 Dec

Home prices have dropped 28% from their 2006 peak

2010

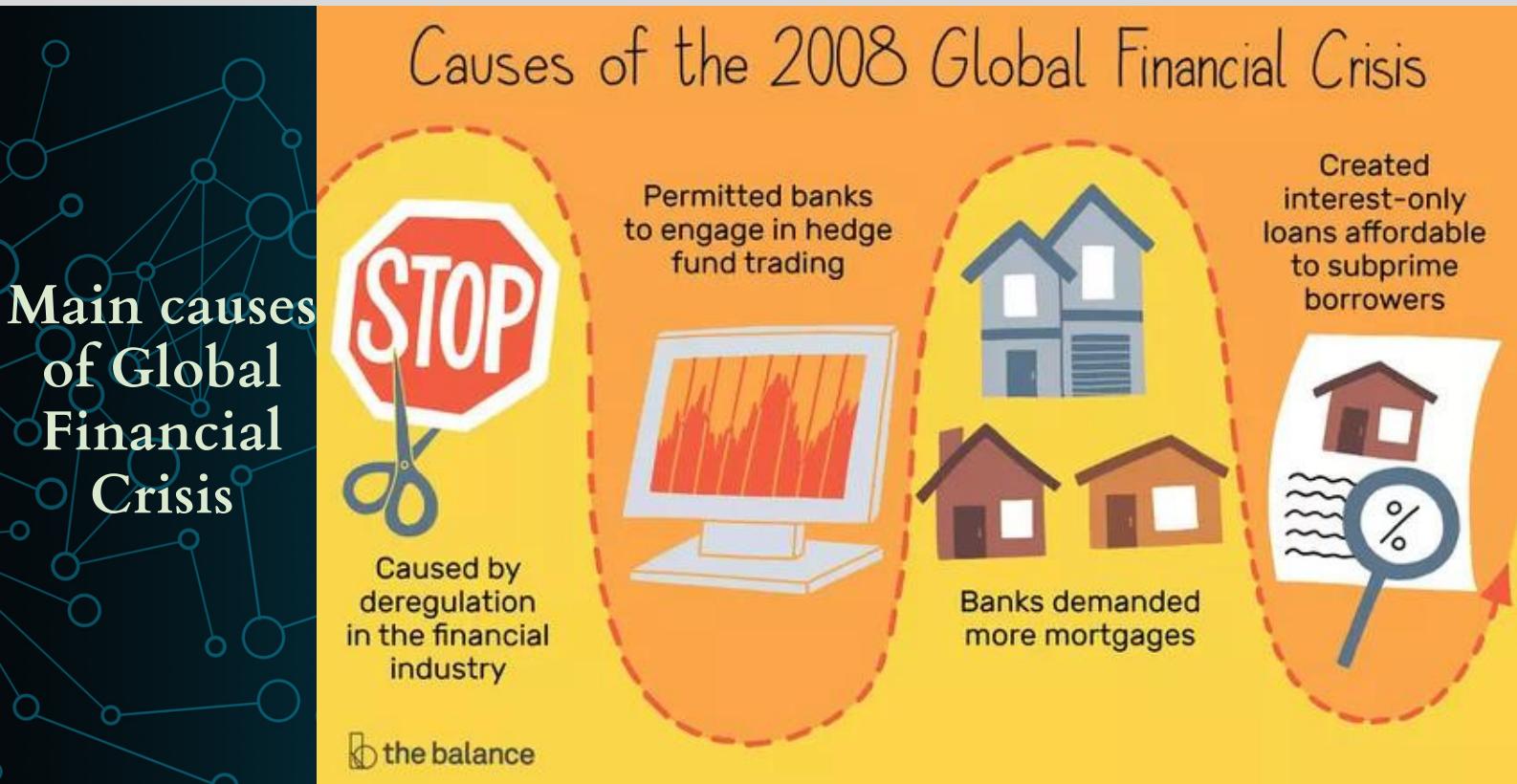
22 Jan

President Obama declared on "the markets are now stabilized, and we've recovered most of the money we spent on the banks"

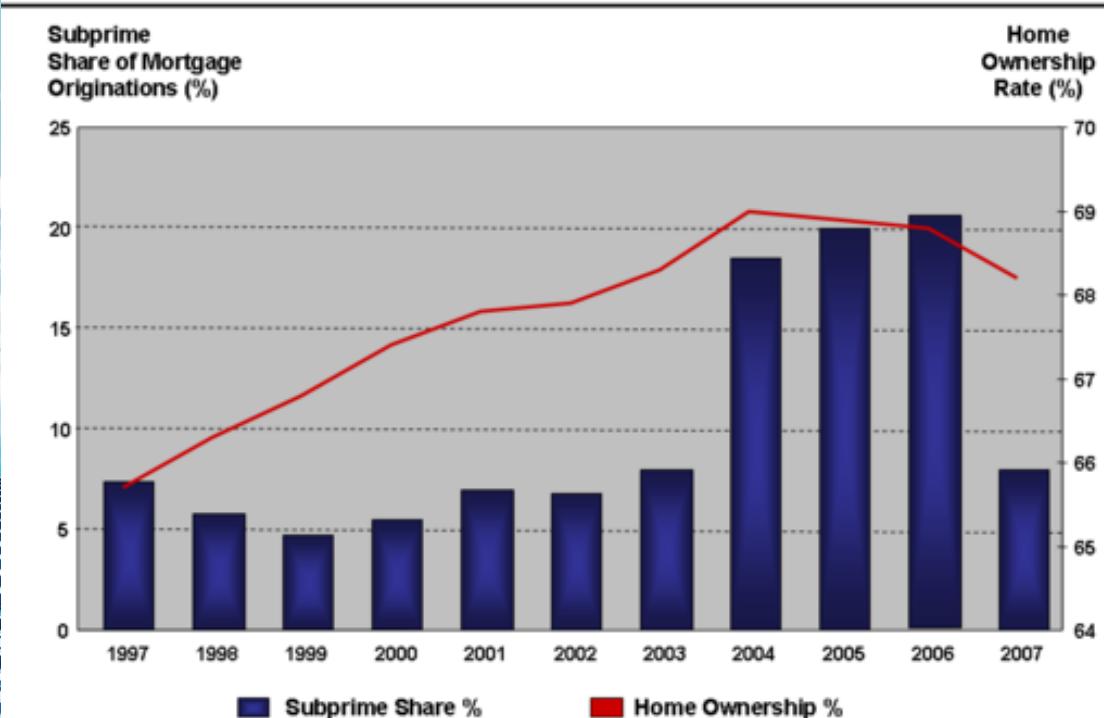


Causes of Financial Crisis

While the causes of the bubble and subsequent crash are disputed, the precipitating factor for the [Financial Crisis](#) of 2007-2008 was the bursting of the [United States housing bubble](#) and the subsequent [subprime mortgage crisis](#), which occurred due to a high default rate and resulting foreclosures of [mortgage loans](#), particularly adjustable-rate mortgages



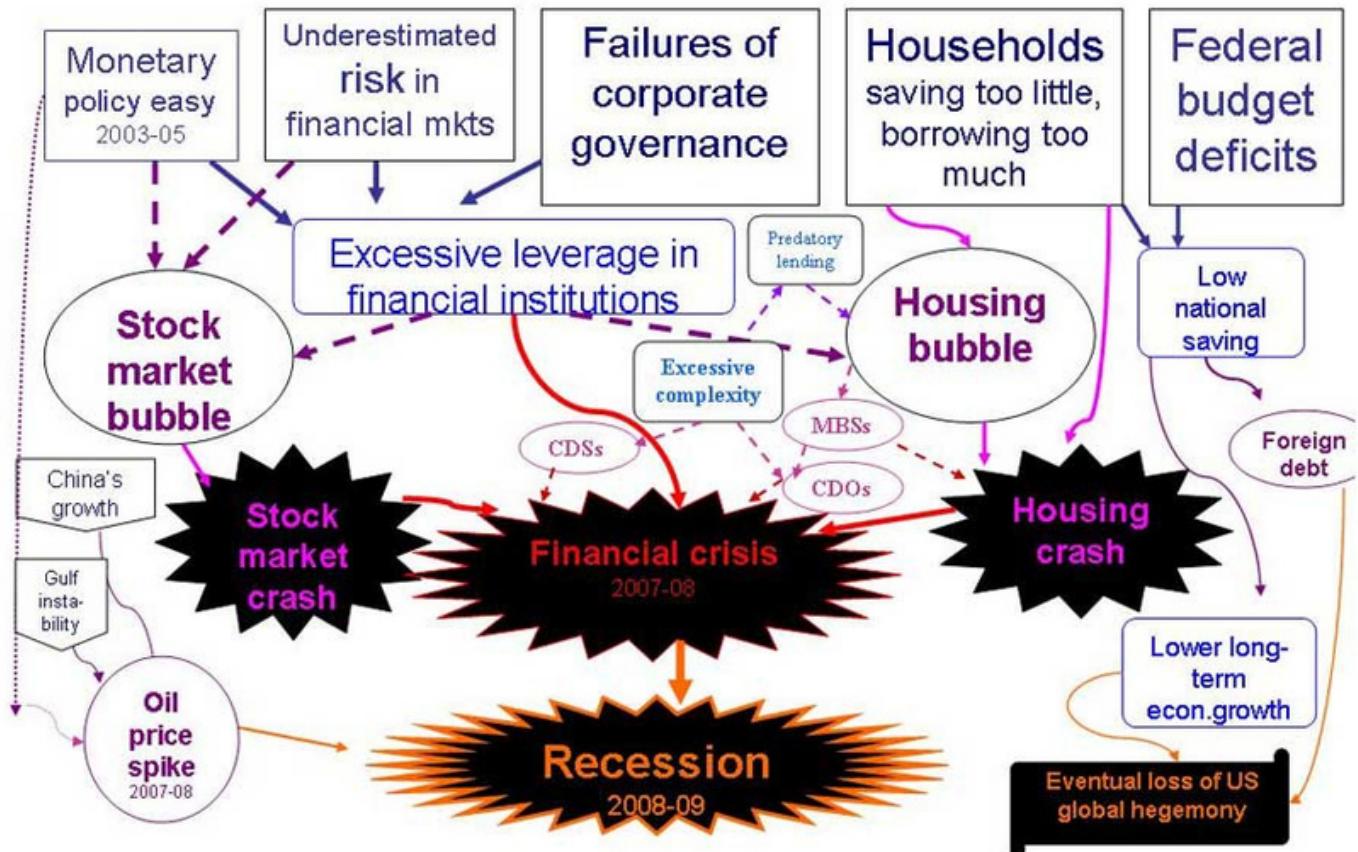
U.S. Subprime Lending Expanded Significantly 2004-2006



Sources: U.S. Census Bureau; Harvard University- State of the Nation's Housing Report 2008

Origins of the financial/economic crises

<https://www.hks.harvard.edu/fs/jfrankel/blog/images/NewmemberscongrCrisisorigins.jpg>



Other Causes of Financial Crisis

One lending
Burst of the housing bubble
Credit conditions
And fraudulent underwriting practices
Predatory lending
Deregulation and lack of regulation
Excessive debt burden or overleveraging
Financial innovation and complexity
Inaccurate pricing of risk
And collapse of the shadow banking system
Commodity prices
Ecological crisis of capitalism
Alternative banking model: resilience of credit unions

2008 GLOBAL FINANCIAL CRISIS



extreme risk-taking in a favorable macroeconomic environment

increased borrowing by banks and investors

regulation and policy errors





Effects of Financial Crises

The **housing prices** saw a steep fall of more than 31.8%. Though the **US economy** came out of recession after 2 years, the impact was still prevalent. The **unemployment** saw an all-time high and stayed more than 9% even after two years.

A huge part of the population lost their money, homes and livelihood. Most of them even lost their pension money. In short, this crisis proved to be worse than the **great depression**.



India, at that time, was less dependent on the US economy and therefore was less exposed to its negative side. However, it wasn't completely guarded against the huge bomb that took the entire **financial market** of the US into dust.

The **GDP of India** fell from 9% to 7.8% in 2008. Approximately \$12 billion worth of investors withdrew from the stock markets, and they're a huge fall was witnessed. Also, the **trade** and **fiscal** deficit were hurt badly.



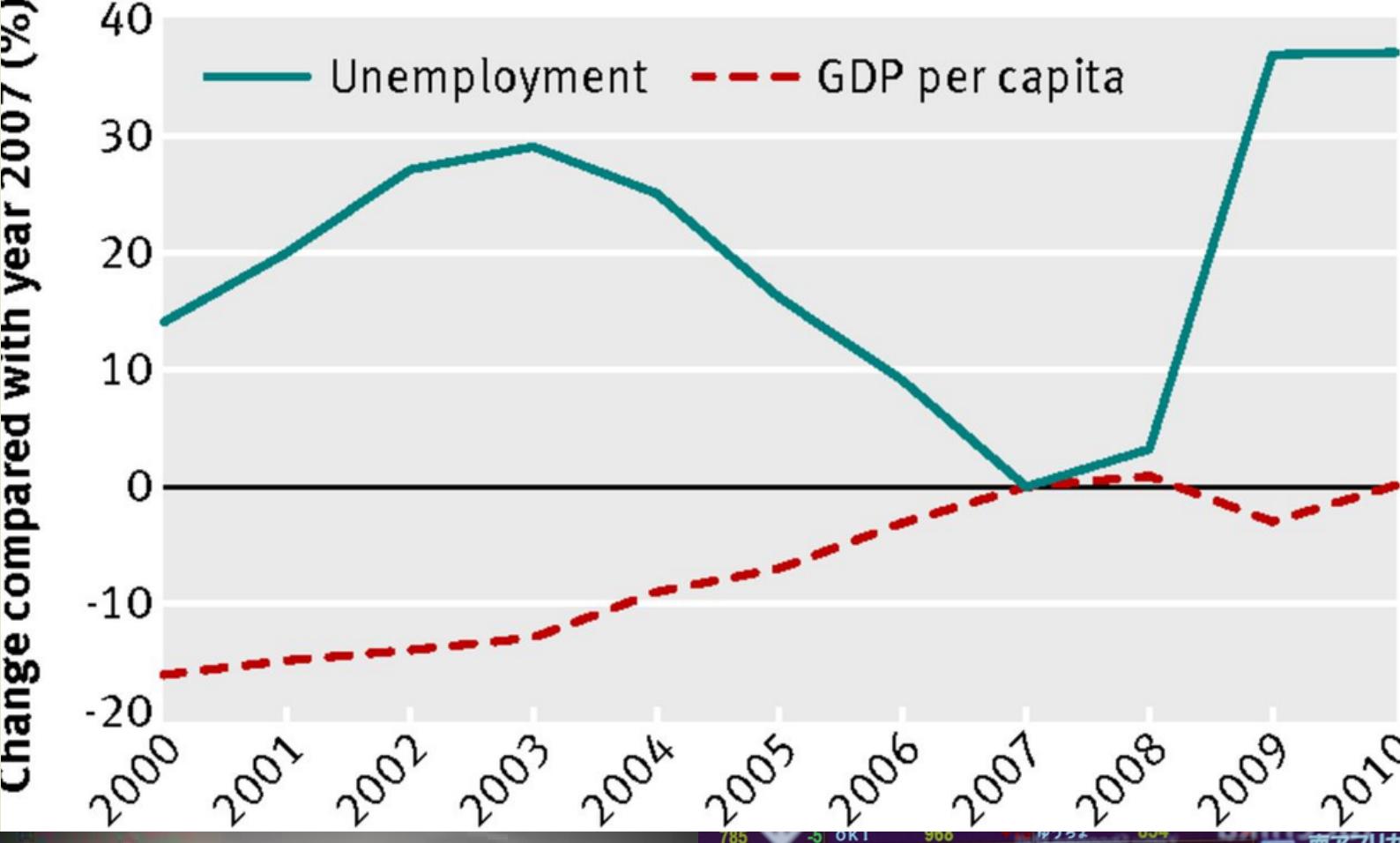
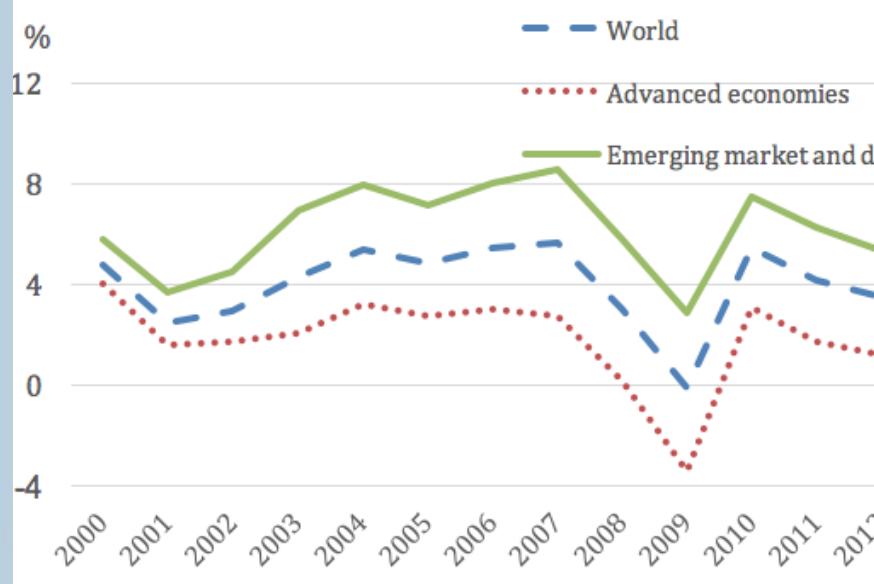
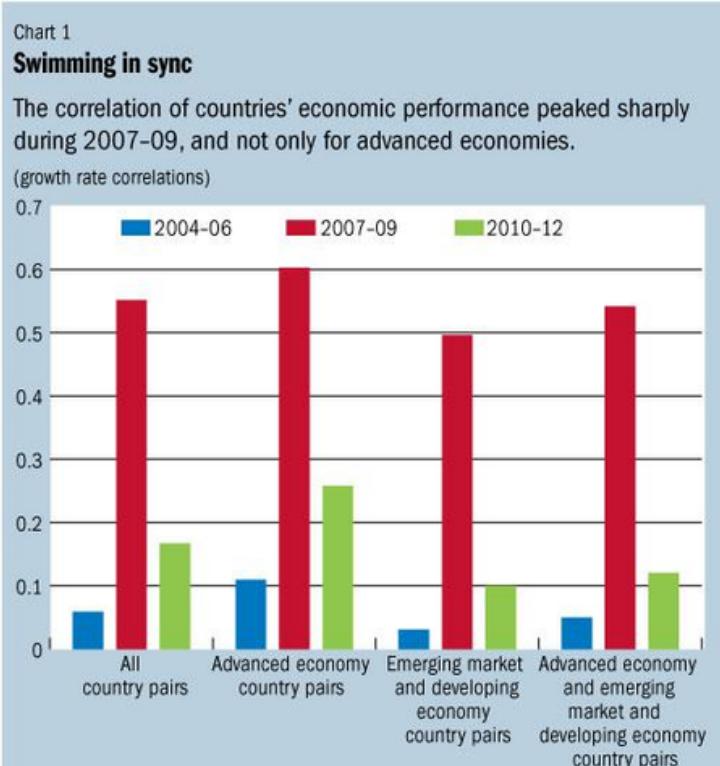
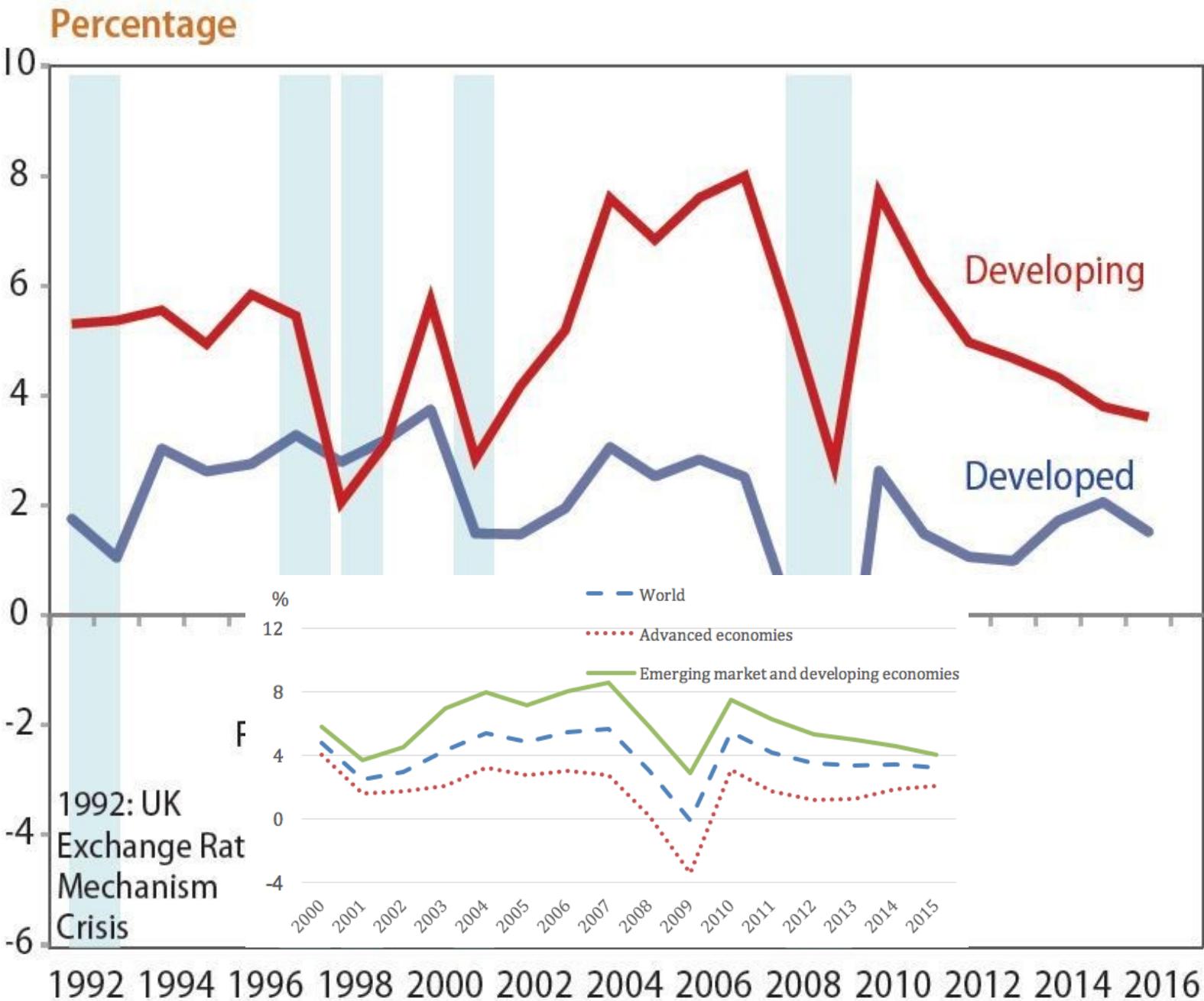


Figure 1: World GDP growth, 1998-2015



Subprime mortgages

THE **SUBPRIME MORTGAGE** CRISIS WAS A KEY COMPONENT OF THE 2008 FINANCIAL CRISIS THAT LED TO THE **GREAT RECESSION**. IT CAME ABOUT AFTER YEARS OF EXPANDED MORTGAGE ACCESS DROVE UP **HOUSING DEMAND** AND PRICES AND EVENTUALLY LED TO A **REAL ESTATE BUBBLE**.



Lenders took on greater risks, too, approving subprime mortgage loans to borrowers with poor credit, no assets, and—at times—no income. These mortgages were repackaged by lenders into **mortgage-backed securities** (MBS) and sold to investors who received regular income payments just like coupon payments from bonds. But consumer demand drove the housing bubble to all-time highs in the summer of 2005, which ultimately collapsed the following summer.

The **subprime mortgage crisis** didn't just hurt homeowners, it had a ripple effect on the global economy leading to the **Great Recession** which lasted between 2007 and 2009.⁹ This was the worst period of economic downturn since the Great

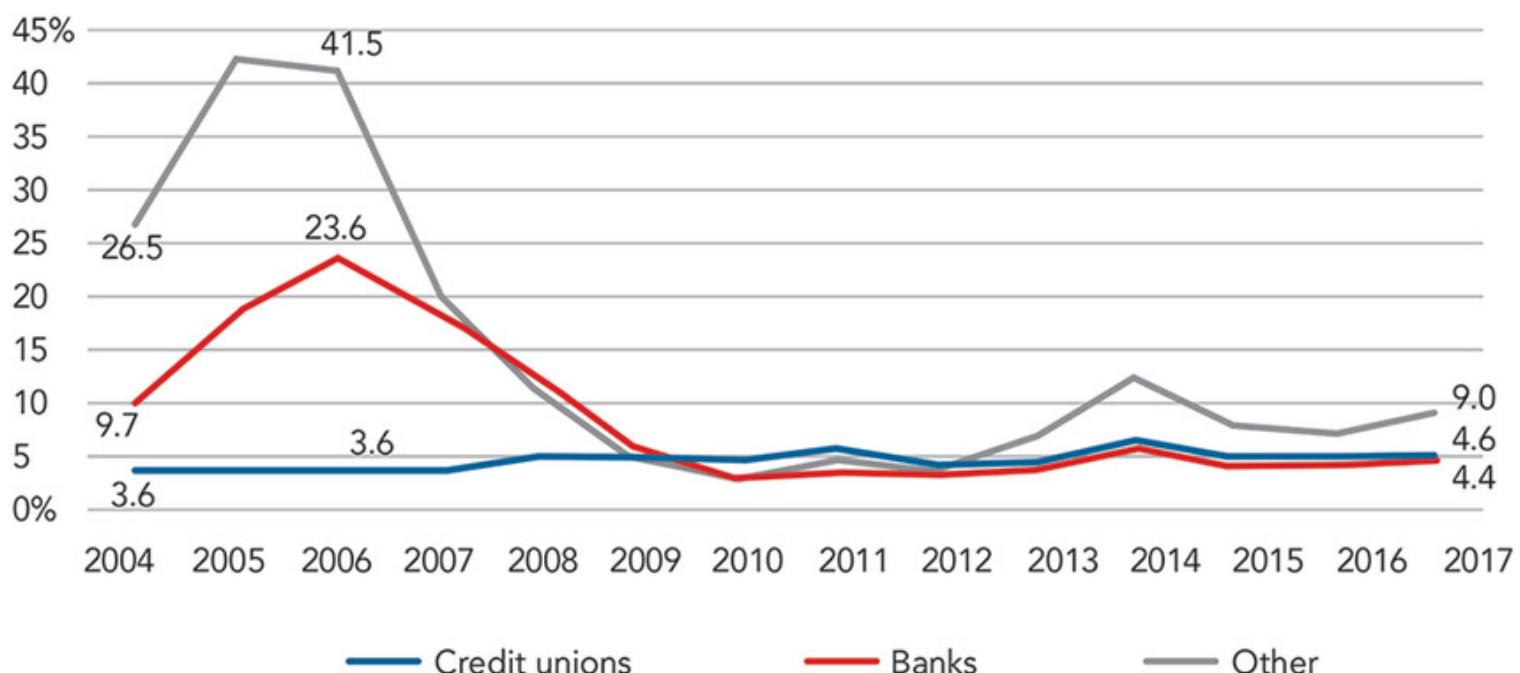
The Biggest Culprit: The Lenders

That's because they were responsible for creating these problems. After all, the **lenders** were the ones who **advanced loans** to people with **poor credit** and a high risk of default.



Subprime mortgage originations

(as a percent of total mortgage originations)



Source: HMDA



What caused the economic collapse 2008? It was the subprime mortgage crisis.

— Rush Limbaugh —

AZ QUOTES



CDOS

- A **COLLATERALIZED DEBT OBLIGATION (CDO)** WERE A LEADING CAUSE OF THE GREAT RECESSION BUT NOT THE ONLY CAUSE
- A **CDO** IS A FINANCIAL INSTRUMENT THAT PAYS INVESTORS FROM A POOL OF **REVENUE-GENERATING SOURCES**.
- A DECLINE IN THE VALUE OF CDO'S UNDERLYING COMMODITIES, MAINLY MORTGAGES, CAUSED **FINANCIAL DEVASTATION** DURING THE FINANCIAL CRISIS.



Understanding the Role of CDOs in the Great Recession

Although CDOs played a leading role in the **Great Recession**, they were not the only cause of the disruption, nor were they the only exotic **financial instrument** being used at the time.

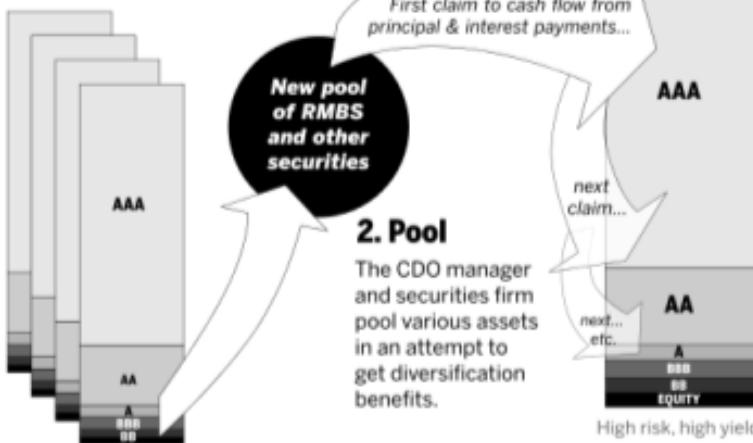
CDOs are risky by design, and the decline in value of their underlying commodities, mainly **mortgages**, resulted in significant losses for many during the financial crisis. As borrowers make payments on their mortgages, the box fills with cash. Once a threshold has been reached, such as 60% of the month's commitment, **bottom-tranch investors** are permitted to withdraw their shares.

Collateralized Debt Obligations

Collateralized debt obligations (CDOs) are structured financial instruments that purchase and pool financial assets such as the riskier tranches of various mortgage-backed securities.

1. Purchase

The CDO manager and securities firm select and purchase assets, such as some of the lower-rated tranches of mortgage-backed securities.

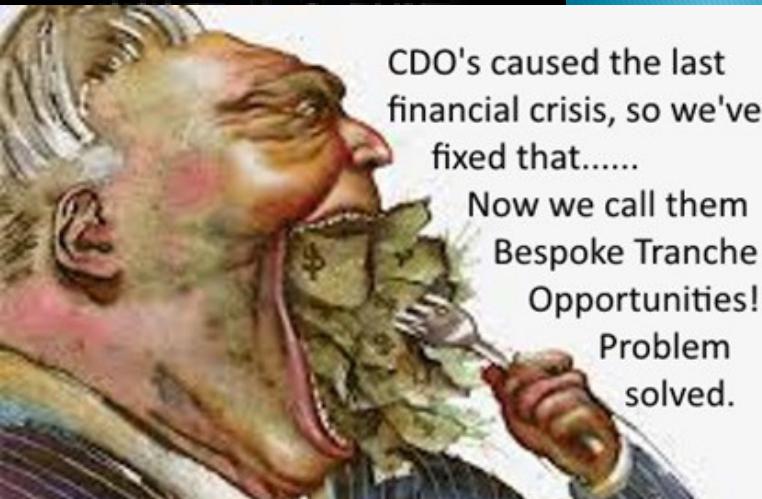
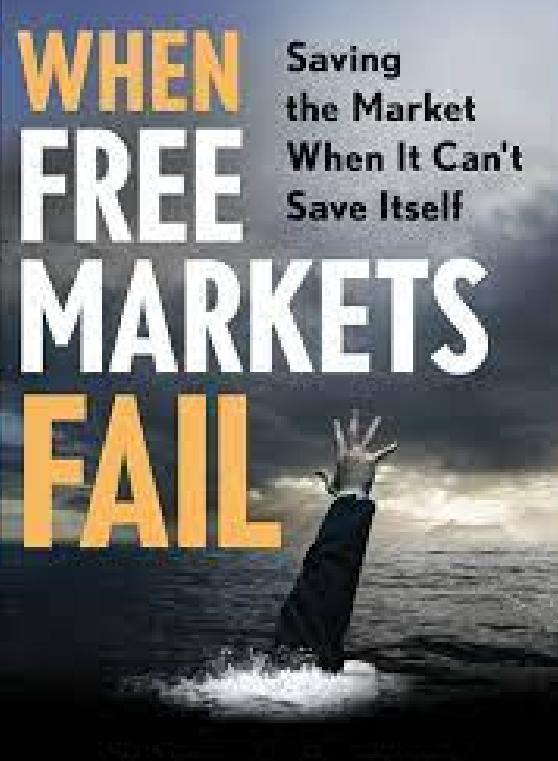


3. CDO tranches

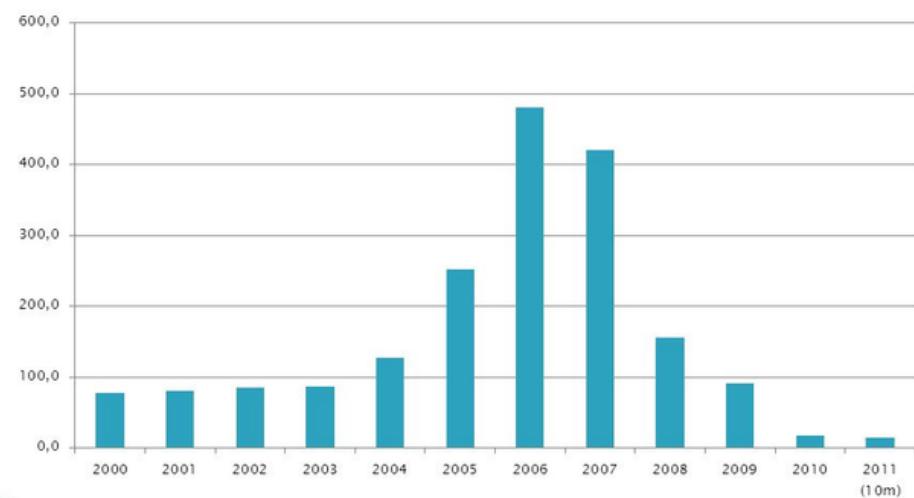
Similar to mortgage-backed securities, the CDO issues securities in tranches that vary based on their place in the cash flow waterfall.



- **CDOs** proliferated through the shadow banking community in the years leading up to the **Great Recession**.
- During the Great Recession, the **collateralized debt markets** collapsed as millions of homeowners defaulted on their **mortgage loans**.

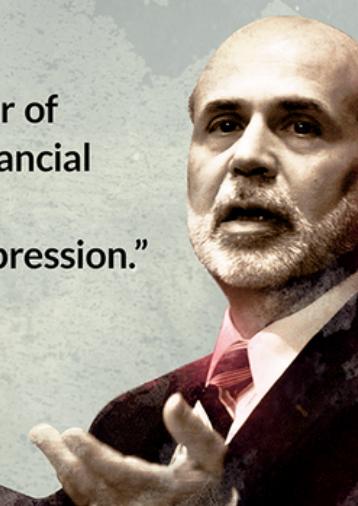


Global CDO issuance



Vinod Kothari: Terrapinn Securitisation World, London, Dec 2011

“September and October of 2008 was the worst financial crisis in global history, including the Great Depression.”





Questions? Contact me.

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