The First Global Financial Crisis of the 21st Century

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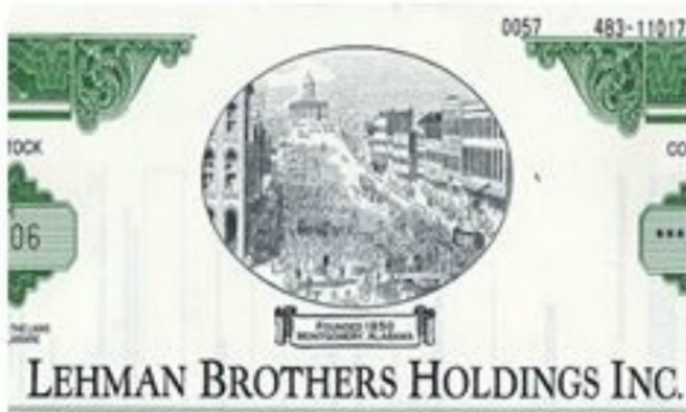
INTRODUCTION

Turner (2009) has termed the financial crisis of 2007- 2008 as the worst after the collapse of Wall Street and the Great Recession during 1920s as-well-as 30s and is still called as "the largest crisis in the financial entrepreneurship history".

The crisis began in U.S. with the burst of housing bubble leading to:

- Bailout of banks by national governments.
- Collapsing of Banks such as, *Lehman Brothers Holding Inc., Bear Stearns, Fannie Mae and Freddie Mac, Merrill Lynch, IndyMac, Washington Mutual* and many others being acquired by other institutions.
- Crisis spread in the global economy resulting downturns in stock markets around the world.



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Financial Instruments and Factors

Srivastava (2015) stated that ,the enormous losses experienced by the financial organizations such as Lehman Brothers, AIG, Bear Stern and many others were produced through extreme level of derivatives dealings. The dramatic increase of credit distribution to subprime mortgage lending were boosted by **credit derivatives**. After the mortgage initiation among the house owners and the local bank, the mortgages were traded via **securitization method.** Securities were later cut up to tranches, and traded as the financial instrument titled, **Collateralized Debt Obligation**. Additionally, **Credit Default Swaps**; comparatively newfound invention of credit derivatives instruments, was also a leading factor for the difficulties of the financial crisis.

Other Factors that caused the crisis

Political issues - Deregularities in political issues. politicians watched widening of house ownership like a policy to cope with the increasing credit-imbalance leading to riskier house loan lending.

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Inadequate management of bank funds, and a flexible fiscal policy increased mortgage lending, which resulted to the credit-crisis

outbreak of financial invention - communication and information-technology advancement helped banks to advance tradable securities easily

Easy-money monetary policy taken by the Federal Reserve of U.S. resulted in lower interest rates on U.S. treasury bills triggered housing-bubble burst

Worldwide economic developments in the past two decades increased GDP percentage globally, leaded to more investment in housing industry

Financial Crisis

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Securitization

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Securitization is described as a trade of resources to bankruptcy-isolated special purpose firms. The bankruptcy-isolated special-purpose-vehicles are termed as SPVs. According to **Hull (2012)**, Securitization is a procedure exercised by banks to produce securities from mortgages and other revenue-generating assets. The securities are then traded to shareholders. This procedure eliminates the mortgages from the balance sheets of banks' and allows the bank to magnify their loan offering more rapidly than they would be capable of.