Financial Crisis and a monetary stimulus by US Federal Reserve Harvard Case Solution & Analysis



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What happened?

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Course

 Housing Bubble-Between 1998 and 2006, the price of the typical American house increased by 124%.

During the two decades ending in 2001, the nazional median home price ranged from 22 to 3.1 since price ranged from 22 to 3.1 since price to 4.0 in 2004, and 4.0 in 2006 Their housing bubble cold in many homeowness suffering their homes at lower lateral prices, or financing concurries spending by taking out second mentgages secured by taking out second mentgages secured by the price appreciation.

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Actions Taken

The discount rate were reduced to 1% and 1.75%, respectively. Central banks in England, China, Canada, Sweden, Switzerland and the European Central Bank (ECB) also resorted to rate cuts to aid the world economy But rate cuts and liquidity support in itself were not enough to stop such a widespread financial meltdown.

The U.S. government then came out with National Economic Stabilization Act of 2008, which created a corpus of \$700 billion to purchase distressed assets, especially mortgage-backed securities. Different governments came out with their own versions of bailout packages, government guarantees and outright nationalization.

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Northern Rock

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What happened?

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Causes

During the two decades ending in 2001, the national median home price ranged from 2.9 to 3.1 times median household income. This ratio rose to 4.0 in 2004, and 4.6 in 2006 This housing bubble resulted in many homeowners refinancing their homes at lower interest rates, or financing consumer spending by taking out second mortgages secured by the price appreciation.

1.Housing Bubble-Between 1998 and 2006, the price of the typical American house increased by 124%.

Consequences

Fail in output: The 56 trillion to \$14 trillion base estimate of lost output following the crisis depends or assumptions about the economy's trend mad growth and whether an oil-price shock in 2008 might have caused a mild recession anyway. The settimate of the apprepair cost of the crisis covers 2008 to 2023, when puttal it assumes to follow them to 2023, when puttal it assumes to follow them to \$2023, when puttal it assumes to follow them to \$100.000 to \$100. 2023, when output is assumed to fully return to

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What happened?

- The financial crisis happened because banks were able to create too much money, too quickly, and used it to push up house prices and speculate on financial markets Banks created too much money
- Every time a bank makes a loan, new money is created. In the run up to the financial crisis, banks created huge sums of new money by making loans. In just 7 years, they doubled the amount of money and debt in the economy.
- Banks started questioning the viability of their counter-parties. They and other sources of wholesale funding began to withhold short-term credit, causing those most reliant on it to founder.

Subprime mortgage- lending and easy borrowing condition inflated the housing bubble.

Fram 2000 to 2003, the Federal Reserve lowered the federal funds rate target from 6.5% to 1.0%. between 1996 and 2004, the U.S. current account deficit increased by \$650 billion, from 1.5% to 5.5% of GDP Trade deficits required the U.S. to borrow money from abroad, in the process bidding up bond prices and lowering interest rates.

3. Deflation of the housing bubble-The Fed then raised the Fed funds rate significantly between July 2004 and July 2006. This contributed to an increase in 1-year and 5-year adjustable-rate mortgage (ARM) rates, making ARM interest rate resets more expensive for homeowners.

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Consequences

Fall in output: The \$6 trillion to \$14 trillion base estimate of lost output following the crisis depends on assumptions about the economy's trend rate of growth and whether an oil-price shock in 2008 might have caused a mild recession anyway. This estimate of the aggregate cost of the crisis covers 2008 to 2023, when output is assumed to fully return to trend.

Decrease in capacity: Non-farm payrolls fell by more than 8.7 million, or 6.3 percent, and the number of unemployed climbed to 14.7 million over the course of the recession, peaking at 10 percent of the nation's labor force in October 2009. In July 2013, four years after the recession is deemed to have ended, labor under utilization remains intractably high: 11.5 million people are unemployed and an additional 10.6 million are underemployed or frustrated.

The crisis resulted in a significant loss of trust in government institutions and the U.S. capitalist economic systems