US Subprime Mortgage Crisis: Causes And Impact

Introduction

It is an indisputable fact that ten years ago the outbreak of a financial crisis in America quickly brought the global economy into a full recession. The impact of this crisis far exceeds the period of the Great Depression. It is most governments, businesses, and individuals who have not predicted the coming of this crisis causing the entire U.S. financial system. Even if many countries jointly address the crisis that invests in the central bank, the collapse instantly is inevitable. Among them, the core of the problem is the government's lack of consideration of the consequences and impacts of the plan. Then it initiated the 2008 financial crisis. In this report, I intend to explore the sources of this problem along with how Hong Kong can get through this situation.

Background of The Subprime Mortgage Crisis

Crisis in America occurred in 2007. Chief among the causes of this problem is which stemmed from an earlier expansion of mortgage credit. The overbuilding during the boom period, the inability of homeowners to make their mortgage payments, and global current account imbalances were the typical causes of the crisis.

The Fed started to increase the interest rate by 2006 and that reached 5.25 percent (MANOJ, 2019). Meanwhile, in various regions of the United States where the home prices are decreased that influenced America Home construction. With the sharp increase in contract default, the growth of house prices did not follow the expectation when it caused the hardness in refinancing. Therefore, many subprime lenders were filing for bankruptcy or close down because subprime borrowers could not bear with a higher interest rate.

After the financial crisis in America, many investors lost the confidence of the subprime mortgage that arousing a liquidity crisis. Lots of America housing markets worsened when the financial industry continued to reduce financial leverage. This led to the price of relative financial assets decreased. The large financial institutions in America conducted bankruptcy and close down at the end. Although numbers of developed countries jointly invested enormous amounts of capital into the financial market; however, it could not prevent the chain reaction of the financial crisis. Until 2008, the financial crisis was out of control and spread influences on other countries. Although the America subprime loan market accounts for a small proportion of the overall America mortgage market, the profits are higher than initiate the 2008 financial crisis, thus the chain reaction destroyed the entire U.S. economic system.

Impact of The Subprime Mortgage Crisis

Based on the U.S. financial institutions previously issued too many irresponsible home mortgage loans to insolvent families, thus bringing about a series of far-reaching effects on society. This financial crisis still seriously affects the development of the real economy until now.

Affected by the financial crisis, U.S. higher education directly fell one fifth on university endowment funds. Also, the difficult capital turnover between universities and banks directly affects employees' wages, thus triggering signs of a recession. Between different U.S. states, non-energy states are more affected by the financial crisis than energy-rich states based on the former focuses on taxes and the latter focuses on energy. (WANG, 2009, P5). Besides under the payment imbalance as the tuition fees of universities rise, the pressure on the low-income family has also mounted up a lot, thus these people are beginning to reduce the cost of expenses to respond to low incomes. Facing such an unfavorable economic environment that many giant companies are in danger of going bankrupt including all walks of life. Along the bankruptcy of Lehman Brothers has caused three of the top five U.S. investment banks to go bankrupt. Subsequently came a gone down in stocks and a rapid increase in the number of unemployed. (WANG, 2009, P7). Not only that, because the U.S. and Hong Kong economies are directly linked to each other thus this has negatively affected Hong Kong's export trade from both trade channels and financial channels. This sign has also led to a sharp rise rapidly in Hong Kong's unemployment rate in the short term.

Causes of The Subprime Mortgage Crisis

To commence with, people were compelled to make a vital down payment while they were borrowing for purchasing a house until the 1970s. Making regular monthly credit payments for an extended period was a necessity for them. (Dickerson, 2009) The consecutive growth inside the housing markets was trending up through the loose monetary policy of the Federal Reserve Bank in late 2001. The developer built, and consumers purchased more and more houses as they could during the low-interest period. The escalating house price was an unprecedented home price appreciation of the U.S. government. Meanwhile, it encouraged excessive consumption, including credit more, and saving less. (Mah-Hui, 2008, as cited in Papadimitriou, Chilcote, & Zezza 2006) Ostensibly, housing was more affordable than before. Nevertheless, it aggravated the meteoric house price appreciation. Overbuilding during this period had contradictory influences and started causing the crisis.

Besides, skyrocketing housing prices benefited and generated enormous sums of property for some homeowners. These were not gains, but it is an inaffordability obstacle for renters to purchase houses. For instance, some borrowers might ravenously acquire the house that they could not afford. So, they may be a fraud by expanding their incomes to trickster credits or paid to buy users with high-grade credit histories. For the others, especially first-time homeowners, they would be shocked when discovering they were not able to trade their homes once the housing market hindered. Among the declining housing prices in 2006, the homeowners would not receive refinances from the banks when the mortgage was higher than the value of the house. With the information asymmetry and no ownership in their homes, the homeowners have endured the costly mortgages. (Dickerson, 2009) Also, the mortgage was not the bare risk, while all varieties of debt were repackaged and resold as collateralized debt obligations (CDOs), which banks purchased the most. Loaning with insufficient money when trading the CDOs in the default was not permitted. Thus, no investment from the owners of capital. As a result, those borrowers were incompetent to return their payments for the loans.

Last but not least, most Asian countries have tremendous current account surpluses and international exchange reserves today. The U.S. public debt stood at $5 trillion and foreigners held $2.2 trillion of them in 2006. Japan was holding the most, followed by China. In 2007, the

poorer nations like China and Saudi Arabia were financing the consumption of the U.S. government and households when its current account deficiency of $790 billion. Since 2004, with the diminishing in the government agency bonds, they have used most of the inflow assets as proceeding asset-backed securities. Furthermore, the United States, the most extensive debtor country in the world, absorbs stocks from overseas fundamentally because the U.S. dollar is still the foremost international currency. The U.S. experiences both advantages because of its economic, political, and influence of the army. It commands the global imbalance with an unpredictable end. However, economists analyzed exceeding saving by the emerging nations was the stem root of the predicament. (Mah-Hui, 2008) Apparently, global current account imbalances created part of the crisis.

In a nutshell, numerous elements were initiating the U.S. Subprime Mortgage Crisis like over-demanding in house markets, the inability of holders to handle for the debts, and inequalities between country accounts. The government should step in the markets and help with it so that it can prevent the adverse impacts brought from the crisis.

Hong Kong's Economic Background in 2019

Hong Kong, as an Asia-Pacific international financial center, faces numerous challenges and competitions from international and mainland Chinese financial centers Hong Kong’s economic conditions in 2019, before september the development of the real gross domestic product (GDP) has slightly increased. According to the statistics conducted by the Census and Statistics Department, there was a rising trend of Hong Kong’s real GDP that increased 1.02% from February to July. However, after the social activities in Hong Kong such as the demonstrations of anti-Fugitive Offenders Ordinance, based on police brutality, it caused social unrest and decreased the tourists’ confidence in Hong Kong. Meanwhile, the catering industry is unable to resist the huge renting and decline in passenger traffic and has closed down one by one, but this condition will not be restored in a short time. In other words, each industry has been stricken to varying degrees, especially the tourist industry which is one of the pillar industries and has been destroyed. Hence, there was a drawing trend of Hong Kong’s real GDP that decreased 2.9% from August to October. According to the quarter-on-quarter figures that made public by the Census and Statistics Department(2019), it indicated that Hong Kong has experienced two consecutive quarters of negative growth, and the economy has entered a ‘ technical recession’. Therefore, the Chief Executive of the Hong Kong SAR, Carrie Lam (2019) advocated that,Hong Kong is facing a downturn that is more severe than the periods such as the SARS outbreak in 2003 or the financial crisis.” Hong Kong’s economy will be worse than before in the long term with a reasonable guess.

What Lessons Can Hong Kong Learn From the U.S. Crisis

U.S. subprime crisis was caused by many factors like monetary policy, cold shoulder of the government. But most people agreed that the main reason was the liquidity crisis (Thakor, 2015). In the subprime segment of the market, more and more house owners defaulted on their mortgage, 25% of delinquency rates were found in this segment (Hellwig, 2008). The investment bank took back and sold the houses. Because the supply of housing was more than the demand, the value of houses was falling. Hence, the value of the mortgage also decreased. At the same time, the investment bank could not return the money of all investors as the bank had loaned most of the money to invest in the mortgage. For example, Lehman Brothers

Holdings, the investment bank, went bankrupt.

Avoiding the same crisis happens again, the Hong Kong government should maintain the capital adequacy ratio of the bank at a reasonable level. The review of Thakor (2014) shows that the impact of bank capital on systemic risk is the most important factor of any such assessment. It proves that if there is more capital in banking, it will reduce both insolvency and liquidity risks. Also, a suitable capital adequacy ratio can reduce the probability of a systemic crisis by 25% (Gauthier, Lehar & Souissi, 2012). On the other hand, the government can predict future economy by comparing previous housing prices, asset reserve, and GDP to avoid history repeats.

Conclusion

In conclusion, we believe that this is clearly a problem of such complexity that no solution is likely in the short term. However, we can take it as a mirror to prevent the financial crisis in the future. We believe that the outlined effect in America above would avoid Hong Kong to have the same situation if the government noticed.