What have been the major economic costs of the financial crisis that started in 2007-8?

Comment on the scope of the proposed reforms to banks that have been made since.

Do they go far enough in addressing the problems?

Economic cycle is the key attribute of any economy, with the boom period turning to a slowdown period and finally leading to recession. The chief features of this cycle are the forces of demand and supply which operate in a particular market. Year 2008 witnessed one of the most severe economic crises, beginning from the most developed countries it spread through the underdeveloped nations, which even worsened the effect. The main source of this recession was identified to be from USA.

The crisis of 2007-08 was like an eye opener to the financial system of USA. As the financial reform of the country were very liberal. In comparison to US, there were many countries around the world whose financial system was very tight and that saved those countries from the adverse effect of the crisis. The country like New Zealand, India followed very tight financial policies. After the financial crisis of the year 2007-08 the banking reform system of USA also had undergone changes. There were number of reforms that were implemented in the form of control measures.

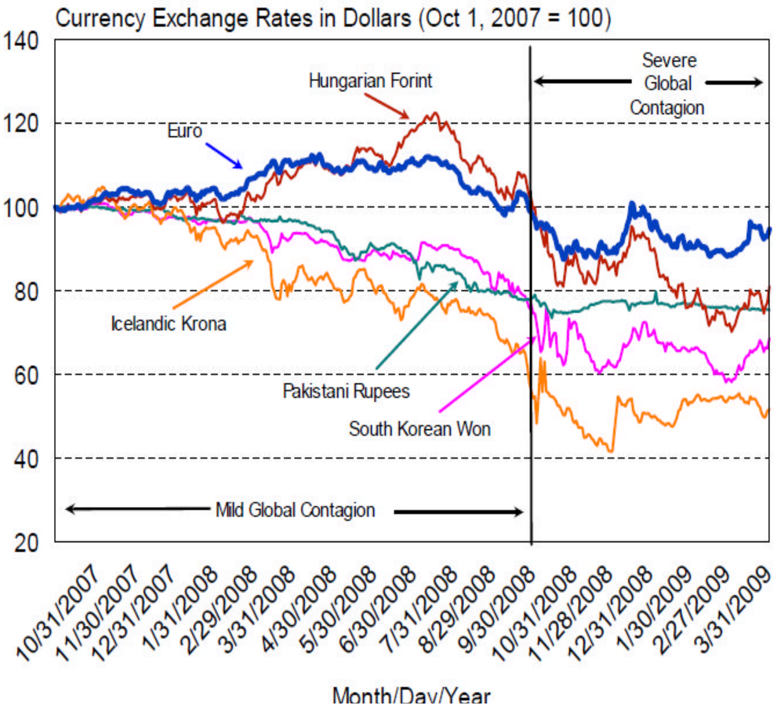
The financial crisis was also termed as "US sneezes and the world catches cold". Financial organizations became careless in providing loans and individuals with under average ranking also got loans with no trouble. This resulted in formation of demand in good quantity in the real estate division (especially Housing). This demand though formed failure to pay to the organization and therefore the starting of dropout. This be described the subprime lending apparently created a housing effervesce. (Grail Research, 2009) In excess of and on top of this, these loans were transformed into securities which were known as asset backed securities (ABS). A gigantic game of lending or credit and hence investing (in ABS) were also backed by insurance against loses. Each and every one of these stood on the similar base- the subprime lending. As the non-payment from the public happened, it led to losses in the whole financial and insurance sector. Furthermore, the real estate prices begin to decrease at very elevated rates. Marketplace subsequently chased descending drift with every fleeting date. (Robert, 2008)

A chief ***monetary crisis*** was observed throughout that time in roughly every nation of the earth. It clearly revealed that one nation which is considered as the most developed and superpower over the other nations, managed to extend the ill effects to other nations in a good way. And when it's a country like America which contributes a good percentage to the world GDP, the effects can be worsening. The housing and property sparkle had paved way to a more than normal supply and hence prices couldn't be persistent any longer (Grail Research, 2009).

Eminent spokesman around the globe had diverse opinions, but there were a number of consents to the cause for the deceleration which concluded towards the depression. It was supposed that owing to tempting marketplace circumstances, banks and financial institutions had initiated to take riskier verdicts, like providing loan to subprime customers and generating ABS supported on the respective.

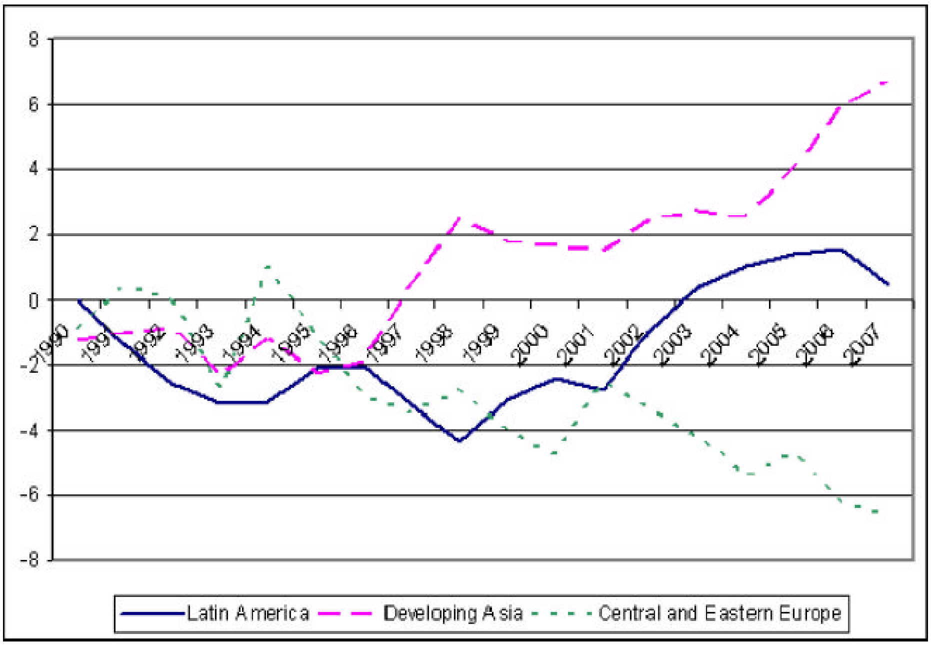
Drastic and consistent slow down happened in the economic system of the country, which can be seen in the following graph:

Figure 4. Exchange Rate Values for Selected Currencies Relative to the U.S. Dollar



The above graph shows that with the financial slow down in US, how the other markets also got impacted. This includes euro, Hungarian forint, South Korean won etc, all the markets fall significantly.

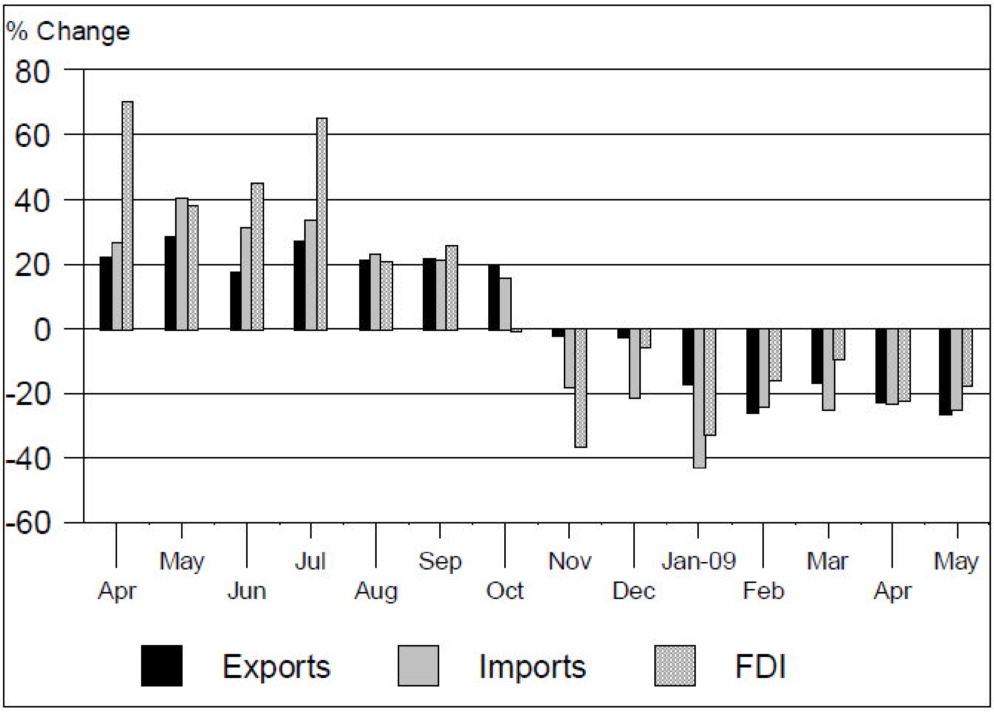
The effect of the crisis was mainly on the emerging markets such as Latin America, Brazil, Mexico, Russia etc. out of all the emerging markets that felt the heat of the crisis, Europe got affected the most. The average deficit of the country rises to 9 percent of the GDP in the 2008. The financial crisis on other countries and emerging markets can be understood with the help of this assignment.



Source: International Monetary Fund

The level of China's disclosure to the financial crisis, particularly from the U.S. sub-prime mortgage crisis, is blurred. One side, China seats plentiful boundaries on capital streams, mainly outflows, so that it can preserve its handled float currency policy. These limitations frontier the capacity of Chinese populace and a lot of organizations to spend their investments abroad, gripping them to put in those investments nationally. Though a number of Chinese try to budge funds overseas illegally manner. Therefore, the shock to Chinese private sector firms and persons and .Chinese investors to sub-prime U.S. mortgages is probable to be minute. Nevertheless, China's trade and FDI flows maintain to demonstrate spiky declines. A lot of analyst's challenge that China's large-scale bank lending and infrastructure expenditure projects have assisted to improve the home economy, but caution that these can not be grasped for an indefinite period.

year-on-year basis



Source: Global Insight and China's Customs Administration.

China being a highly export dependent country had to suffer in terms of reduced global demand for products manufactured in China. The export promotion policy of China was the major cause of its high dependency on exports. China's banking arrangement was comparatively out of harm's way while the Western banking arrangement was standing on the periphery. Consequently, the increase in liquidity in the inter-bank money market has been translated into an increase in bank credit and broad money. The banks came out with expansionary monetary and fiscal policies, which did helped in short run but its impact on the economy in the long run was of concern. China has been growing at a double rate since 2001 and this over capacity lead to serious threats at the time of crisis. Also China has seen good investments in infrastructure which make up the long term investments while the short term manufacturing investments lacked.

China's growth after the crisis largely depends on the capability of the government which can balance the export surplus by inducing domestic consumption.

The diagram depicts the key phases of the crisis

Nations started approaching incentive packages in own countries and nations with fine provisions of trade and commerce. Incentive packages were essential to instil finances in the nation and perk up the level of investment and expenditure in the nation. Other than incentive schemes, nations also came up with rescue packages to assist businesses protract the slaughter and hence avoid joblessness. The Federal bank has declared more than $700 bn aid for the financial sector; while Germany had announced greater than $200 bn and consequently Britain more than $ 500bn dollars to struggle the fiscal calamity. Banks came up with such reforms which could help the economy revive and hence globally the world around.

When the circumstances of the backbone of the stock markets, The Wall Street tremble, it becomes very much essential for government in rule, to undertake grim deeds. The ***rescue and incentive schemes*** augmented the cash pour in the nation. And hence, the nations also abridged the dimension of their personal budget shortfall as even though by boost in cash flow the worth of cash decreases, it is believed to be a helpful instrument to decrease budget shortfall. Nevertheless, the government can inject equivalent amount in the form of tax benefits and financial supports. Both of them mounts to the expenditure of the financial system and therefore boosts any shortfall in the budgetary deficit. Both optimistic as well as pessimistic possessions have been seen with regards to such packages. (Grail Research, 2009)

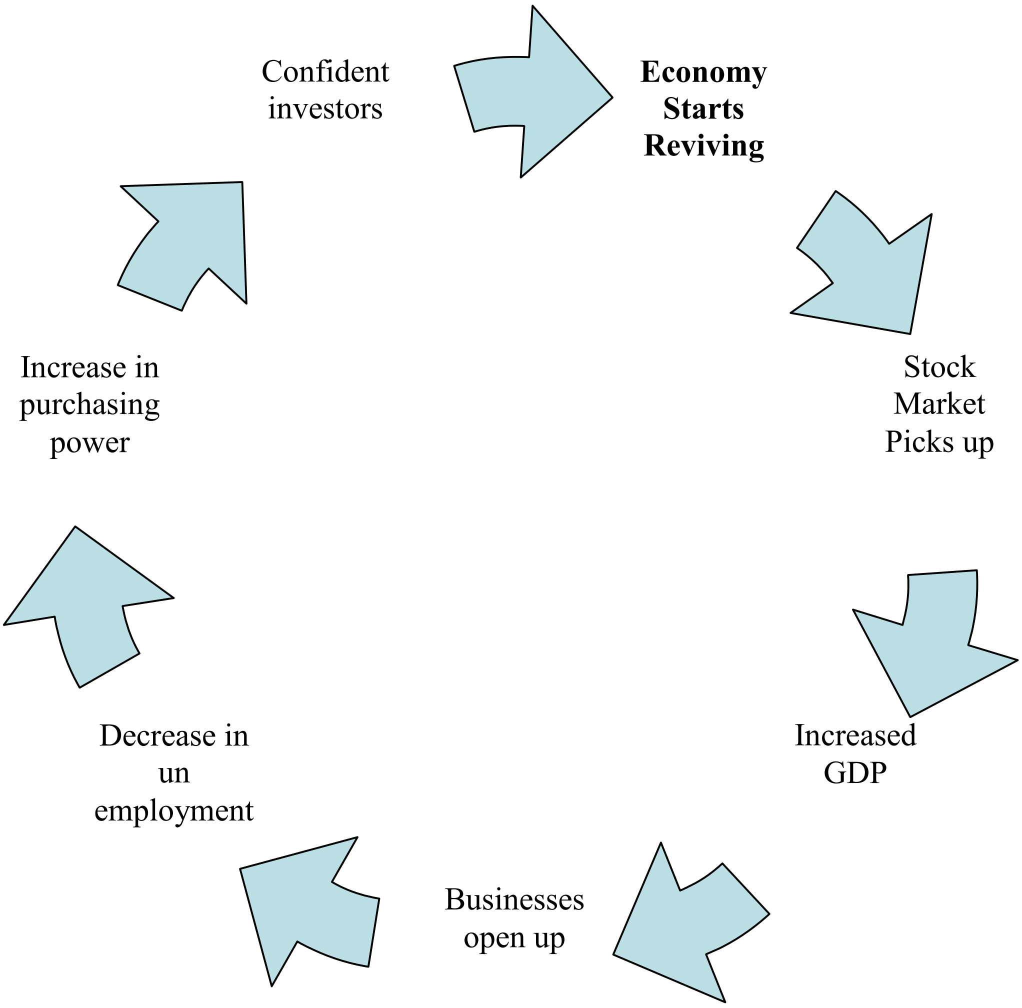
While making the financial policies the government faced a number of problems. The first objective was to make such a policy that will help in regaining the confidence of the public. The level of regulation was second decision, whether the decision needs to be made in state level, national or international level.

The role of IMF was also very crucial in this period of time as IMF was the lender in last resort for the country. Secondly, IMF was also responsible to provide guidance and advice to the country to make strategies to overcome this crisis. To solve this issues number of meetings took place such as Bretton woods 2, G20 etc.

It would be wise to comprehend the ***optimistic aspects*** and to know the positive effects of increased money supply. The fundamental hypothesis which leads to the depression was concluded to be as; increased supply and decreased demand and that too simultaneously. Through the introduction of such packages, money starts stirring in the financial system and therefore the demand begins to pick up. Tax enticements draw people to expend extra. And hence, one of the features of the disequilibrium begins to get influenced positively. Depression also observed unstable price altitude specified by inflation rates. The increase in demand leads to an increase in price level, consequently controlling the inflation.

Not only is the demand affected, but injection of funds in the financial system also improves the big businesses in the nation. Consequently, loses appear to decrease and even spin into returns. Therefore this fetches steadiness and growth from business viewpoint. Consequent to this, businesses initiate to cultivate and we once again see mounting demand. In general, the financial parameter begins to function normally. Unemployment rate starts dipping as the business commences stability. (King, Sarah Sanderson Cushman, Donald P., 1997)

During the period of slump, the action of the government is anticipated eagerly. After the government begins to take care of the losses through the incentive and rescue packages, investor turns out to be extra positive. This consequently attracts foreign investors and also assists improving relations with the foreign nations.



Each and every factor mentioned above switch on towards the revival of the economic condition of the nation. As the financial system revitalizes, the share market begins to move in an upward direction. And hence, the GDP figures are encouraging, and the assurance of the individuals in the nation and external begins to increase. Financers around the globe now seem to be much more interested in investing a nation which is encountering an upward trend. And this effect begins to multiply and a development is seen in each facet, earlier which was troubled by the financial calamity. An enhancement in the worth of assets is seen due to increased demand and betterment in the share markets. Eventually, demand begins to mount and individuals become more certain of investing. Employment creation is witnessed and the distribution of income boosts up in a more evenly pattern. With a rise in the general income level, expenditure also rises and finally all constraints of a fit, steady and emergent economy begin to function well in capacity. (Grail Research, 2009)

Out of the many elucidations to struggle the downturn, the deeds of the government and the central banking systems are largely accepted. These actions generally involve bailout and incentive packages. These actions come with certain ***disadvantages*** too and are much stronger in nature. (Richard C., 2008)

First of all, a reduction in the value of money is seen as now more money is poured into the system. This is because the value of money and the flow for money are negatively related to each other. As a result of it inflation rises, and hence hitting the general price level. The consequence of such packages and schemes should be related not only to the current scenario but also to the future scenario as well. Although stimulus packages are supposed to treat crisis in the nation, but the present ad future implications of the same should be taken care of.

We also observe the currency going down with regards to the forex market and hence foreign investors losing. Now, this affects the image of the concerned country as compared to other countries associated with it. The trust of financers dwindles and they hunt for better alternatives in other nations. Losing out on investors has a very long lasting effect on the financial system of the concerned country.

Always a particular sector is chosen for the rescue or incentive package. This partiality provides advantage to that particular sector and hence dwindling hopes of the other sectors. Now this might be a problem in nations which are strong in political aspect. The sector which is given due importance with regards to rescue and incentive packages, now falls under the limelight of investors and hence investors budge towards the lucrative banking and insurance sector in this case. This budge paves way for more supply and consequently producing an injury.

From the cited disadvantages, it is very certain that declaring an incentive package or a rescue package is extremely significant to the concerned country. Such a declaration strokes the globe at large. Also, wellbeing of the nation is poorly influenced on the onset of such crisis and each and every step of the nation towards correction of such crisis comes into the strike list for the worldwide market as well as financial followers. It takes many business cycles to unwrap the effects of these packages.

More than two years now, the disaster then is having a sturdy bang till date, which is noticeably quashing but not with much hustle. But the combined pains of the government in action and the big banks have now fetched us to a height which stands approximately twice of what it departed to in 2008. It wouldn't be possible to have such an improving worldwide economy without the help of such injections of money. Recession itself possess such gigantic harmful effects on the financial system that these packages becomes necessary no matter the number of drawbacks it bears along. Though, it doesn't denote that once a depression is observed, government opts for injection of funds by means of such schemes. The government in action ought to be extremely cautious while building such verdicts. (Allen, Roy E. 1999)

After the contraction in the growth of world economy, analyst has forecasted the growth of 9 percent. Hedge funds were regarded as the bad boys of the financial world as they were a loss of 12.8 percent loss in the year 2008. According to the share national credit program, 2009 the credit quality of USA has gone down. After this crisis Federal reverse Chairman Paul Volcker the government should make sure that there is a sticker difference between the banks that deposited money and investment banking system.

China is one of the most important contributors in the event of global recovery by being the first country in announcing the global stimulus packages. Chinese government also took strategic steps to recover the global crisis. Chinese government led the proposal of making a multinational sovereign wealth fund to support developing countries, and also announced to support developed countries that were impacted due to the crisis.

A proper business cycle consists the recession period also, so it is bound to happen. Recession 2008 tale, might have been partly evaded if the banking standards were tighter and well guarded. There were many strategies and reform made by the government to gain the financial stability. However, US need to tighten its regulatory system for sustainable growth and avoid such crisis in future.

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