

## **An Analysis of the Us Economic Crisis of 2007**

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**Abstract:** The economic crisis in the United States in 2007 has had a great impact on the world economy. With the influence of the overheated real estate market, the U.S. investment banks began to issue subprime loans, resulting in the occurrence of the subprime crisis, which eventually led to the collapse of the stock market. These have caused enormous economic damage to major developed countries and some developing countries. The damage stems from the massive investment in derivatives by financial institutions, the governments' indifference and indulgence towards financial institutions, and the overwhelming enthusiasm of consumption due to the subprime mortgage crisis. This article adopts the method of literature induction to investigate the relationship between the U.S. government and major financial institutions, as well as to analyze the causes of the financial crisis and relevant remedies.

### **1. Introduction**

Since the bursting of the dotcom bubble in 2000, the U.S. economy has been suffering, the Federal Reserve has cut interest rates to 1 percent for 27 consecutive times to boost unemployment, loose monetary policy and deficit fiscal stimulus have fueled excessive consumption by U.S. residents and helped fuel the housing market's rise. Faced with an overheated housing market, the Fed raised interest rates 17 times in a row from 2003 to 2006, raising its benchmark rate from 1 percent to 5.25 percent. The sharp rise in interest rates has increased the burden on homebuyers to repay their loans, and mortgage defaults have accelerated the bursting of the HOUSING bubble in the United States. From 2007 to 2008, the subprime mortgage crisis broke out and spread rapidly to the city of the international financial crisis, the severity of which is known as "once in a hundred years". In April 2007, New Century Financial Corporation, the second-largest subprime lender in the United States, filed for bankruptcy protection, and more than 30 subprime mortgage companies closed down. Next, Lehman Brothers, the world's leading investment bank, collapsed, Merrill Lynch was acquired and big European banks such as RBS, the commercial banking giant, were nationalized. Other financial institutions, such as insurance, funds and others, have also been significantly affected as participants in subprime loans. For the next nine years, U.S. industries were still affected by the financial crisis. Therefore, the study of the 2008 U.S. financial crisis is of great practical significance. In this paper, I will analyze the treatment of the crisis by the governments of the United States, Britain and Japan and summarize the impact of the more feasible treatment methods after the economic crisis. Secondly, I will analyze the role of the U.S. government and major financial institutions in the U.S. housing bubble and subprime mortgage crisis, investigating the relationship between the two, and aiming to find out the causes of the economic crisis.

### **2. Reasons for the U.s. Economic Crisis**

Excessive innovation in American finance and the generalization of financial leverage created the economic bubbles. Under the pressure of competition, the banks broke through the commercial principles to make loans in order to expand market share. There is no standard of the assessment risk of the lender's background and collateral. Second, financial institutions over-pursuit of interests, accordingly lead to a lack of legislative supervision. Some financial executives are simply concerned with their immediate interests, regardless of the professional ethics, hence, relaxing the control of

risk, using complex mathematical models, designing obscure financial derivatives, and constantly enlarging the leverage of financial, providing opaque trading information. These factors have caused the expansion of financial risks. Securitization of assets spreads credit risk concentrated in financial institutions from the United States to financial institutions around the world. Driven by the huge benefits of high leverage, investment banks have created a large number of financial derivatives around mortgage design, such as MBS, CDOs, CDSs and so on. Finally, these U.S. real estate bubbles spread around the world through these derivatives, contributing to the global subprime crisis.

From a legislative point of view, there is a lag in financial regulation in the United States. Due to the modernization of financial services in the United States, the resumption of mixed operations, financial supervision and division management system did not adjust in time, resulting in dislocation and lag. Financial regulation has not kept pace with financial innovation, leading to the lack of regulation. And the existing U.S. regulators are numerous and overly decentralized, which perform overlapping regulatory functions. On the surface, each business area has a full-time responsible regulator, but due to mixed operations and cross-cutting business among financial institutions, relevant innovations often focus on banks, credit securities and other business areas. Regulatory vacuums in a single area often lead to cross-cutting issues, particularly when it comes to systemic global issues, lack of effective regulation and coordination, which will lead to regulatory deficiencies and inefficiencies, for example, the Federal Reserve is only responsible for regulating commercial banks in the United States, and did not begin to regulate investment banks until 2004, leaving the major U.S. financial giants uncontrolled to engage in so-called financial innovation for considerable time. The proliferation of financial derivatives has led to a further increase in risk.

Financial market information is neither balanced nor integrated, and hence facing great challenges. as a new financial innovation tool, the United States subprime mortgage securitization has adopted many complex financial derivatives tools, so that subprime securitization has become confusing and brought investors cognitive difficulties, in the process of issuing subprime loans in the United States, this disclosure is inadequate. Under the U.S. Affordable Lending Act, the lending structure must clearly cover all the terms and costs of a loan transaction, and commercial fraud is punishable if the risk of a loan is intentionally provided or not fully explained to consumers, but due to fierce competition, U.S. subprime lenders are issuing loans despite potential risks, in order to increase business volume and make greater profits, Therefore, they begin to intentionally relax the investigation of lenders and lower lending standards. Lenders, by playing the role of securitization tools, will cause subprime risk, so the income investigation of lenders is no longer serious, some lenders and agents deliberately do not fully and truthfully disclose to lenders about the risk of subprime loans, and even provide false information, using various means to deceive the applicant's loans. Lenders who have applied for subprime loans are unaware of the potential dangers they face, and will be put at risk once the situation changes, i.e. house prices fall, these low-income people will not be able to repay their loans, their homes will be auctioned off, their lives will be in trouble.

### **3. The Pre-Mature Consumption Model in the United States**

Consumption, investment and export perform as the troika that drives national economic growth, the three are complementary, Over-consuming will lead to insufficient domestic savings, accordingly will affect the accumulation of national capital, Also, insufficient investment will affect the country's further development. The great consumption in the U.S. has crowded out investment, causing problems in the economy. For example, Americans tend to purchase products in installments, this will inevitably become problematic in the future.

Because the essence of the U.S. economic crisis in 2007 is caused by the subprime crisis, because the U.S. consumers ahead of the consumption and excessive innovation in the U.S. financial sector, triggering the expansion of U.S. credit, once the subprime applicants failed to repay the subprime mortgage on time, it will lead to the issuance of subprime loans and subprime mortgage as the main business financial institutions declared bankruptcy, leading to the collapse of the stock market, which triggered a series of chain reactions.

The subprime crisis was at the root of the U.S. economic crisis in 2007. The excessive consumption and uncontrolled reformation in the U.S. financial area have triggered the expansion of American credit. Once the subprime applicants fail to make payment on time, the financial institutions that specialized in subprime mortgages will inevitably go bankrupt, resulting in the collapse of the stock market, accordingly, leading to a series of chain reactions.

#### **4. Countermeasure**

After the financial crisis, in order to restore the domestic economy, the U.S. government adopted an expansionary fiscal policy and loose monetary policy. Fiscal policy consists mainly of the first act of 2008, the Government's Housing and Economic Recovery Act, which aims to help homeowners at risk of losing their homes and to help those who cannot afford to own. and the second emergency economic stability bill introduced in 2008. In 2009, the U.S. economic recovery and reinvestment bill was introduced. The Employment Incentives and Responses To Employment Act was introduced in 2010. This series of financial bills adjusts to bail out financial institutions and promote investment and employment.

1. After the economic crisis, the U.S. government adopted expansionary fiscal policy and loose monetary policy, in order to revive the domestic economy. The Fiscal policy mainly includes the following: (1) the First Act of 2008; (2) the Government's Housing and Economic Recovery Act, which aims to help homeowners who are at risk of losing homes and those who cannot afford homes; (3) the Second Emergency Economic Stability Bill introduced in 2008; (4) the U.S. Economic Recovery and Reinvestment Bill that introduced in 2009; and (5) the Employment Incentives and Responses to Employment Act introduced in 2010. This series of financial acts is tailored to bail out financial institutions, as well as to promote investments and employments.

2. Quantitative easing of monetary policy by increasing lending to financial institutions and liquidity to financial markets and encouraging large investments. From the end of 2007 to the end of 2012, the United States issued two sovereign bonds totalling \$16.4 trillion. These policies have contributed to the economic recovery and employment rate in the United States. The growth rate of U.S. GDP changed from negative growth in 2009 to positive growth in 2010 and remained positive for subsequent years. At the end of 2014, the Fed announced that it would stop buying bonds and withdraw from quantitative easing.

#### **5. Conclusion**

This article analyzes the causes of the 2007 economic crisis in the United States and relevant responses by the U.S. government, including possible proposals for the future recovery. It is clear to see that the economic crisis in the United States was caused by the subprime crisis and the overheated real estate market, as well as the proliferation of financial derivatives. For example, the lack of regulation and supervision by the government at that time. The 2007 economic crisis has immensely influenced the world economic system, such as the breakdown of the U.S. employment – among which – Lehman Brothers collapsed and made 28,000 staff dismissed. The U.S. economic growth rate has fallen to negative values for years. Therefore, this research is of great significance, so as to prevent similar economic crises in the future, and to provide suggestions to building the relationship between financial institutions and governments.

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