

2008 Economic Depression

Fransaita Hazelwood

ECO 202

Professor Jantz

Southern New Hampshire University

2008 Economic Depression

Fransaita Hazelwood

ECO 202

Professor Jantz

Ten-Year Period of U.S. Economic History Overview

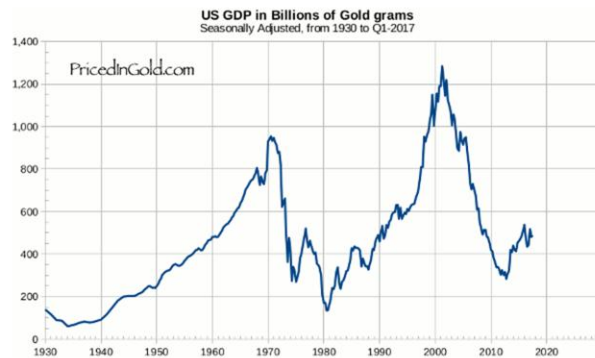
Year	Nominal GDP (trillions)	Real GDP (trillions)	GDP Growth Rate	Events Affecting GDP
2000	\$10.252	\$13.131	4.1%	Tech bubble burst.
2001	\$10.582	\$13.262	1.0%	9/11 attacks.
2002	\$10.936	\$13.493	1.7%	War on Terror.
2003	\$11.458	\$13.879	2.9%	Iraq War. JGTRRA.
2004	\$12.214	\$14.406	3.8%	
2005	\$13.037	\$14.913	3.5%	Katrina. Bankruptcy Act.
2006	\$13.815	\$15.338	2.9%	Fed raised rates.
2007	\$14.452	\$15.626	1.9%	Bank crisis.
2008	\$14.713	\$15.605	-0.1%	Financial crisis.
2009	\$14.449	\$15.209	-2.5%	Stimulus Act.
2010	\$14.992	\$15.599	2.6%	ACA. Dodd-Frank.
2011	\$15.543	\$15.841	1.6%	Japan earthquake.
2012	\$16.197	\$16.197	2.2%	Fiscal cliff.
2013	\$16.785	\$16.495	1.8%	Sequestration.
2014	\$17.522	\$16.900	2.5%	QE ends.
2015	\$18.219	\$17.387	2.9%	TPP. Iran deal.
2016	\$18.707	\$17.659	1.6%	Presidential race.
2017	\$19.485	\$18.051	2.2%	Trump Tax Act

ECO 202

Southern New Hampshire University

- During 1950, the GDP growth rate in the US was affected by the Korean war which affected the GDP growth rate for three consecutive years. In 1952, it dropped up to 4.1 percent from 8.7 percent. In 1953, the war ended there was a recession which ended in 1958 with a GDP growth rate of -0.7 percent.
- The federal government raised the taxes in 1959 and this resulted into a recession in 1960. In 1963, the recession ended.
- In 1964, the GDP growth rate was raised by the launching of LBJ's Medicaid and Medicare up to 6.5 percent.
- In 1966, there was a drop up to 2.7 percent caused by Vietnam War. It then rose a bit in 1968 during the moon landing.
- When Nixon took office in 1969, the GDP growth rate dropped to 3.1 percent and recession followed.
- During recession, there was events such as wage price controls and stagflation which ended the recession by 1975.
- The federal government lowered the rates which led to inflation. To curb this, the federal government then raised the interest rates to 20 percent in 1979
- Recession followed and there was a tax cut to end it. The recession ended in 1982. The taxes were then raised to reduce the people's spending rate where these to and fro events took place for years trying to bring the economy into stability.

GDP

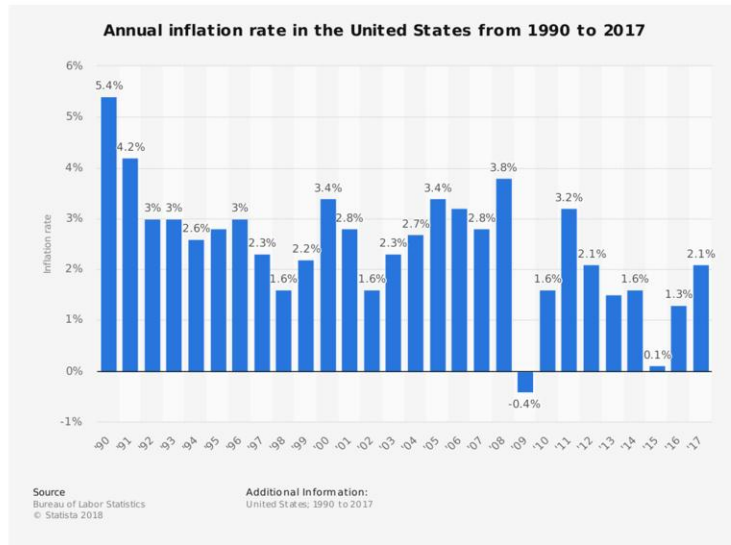


ECO 202

Southern New Hampshire University

- In 2001 the GDP had dropped up to 1.0 percent, war of terror followed, Iraq war also followed and Katrina's Bankruptcy act which pushed the GDP growth rate to 3.5 percent in 2005. The government raised the taxes again which decreased the GDP growth rate up to -2.5 percent in 2009.
- The GDP growth rate then raised in 2015 which was much attributed to the Iran deal, it then dropped in 2016 during the presidential race. However, it increased to 2.2 percent after the Trump tax act in 2017.

Inflation rate

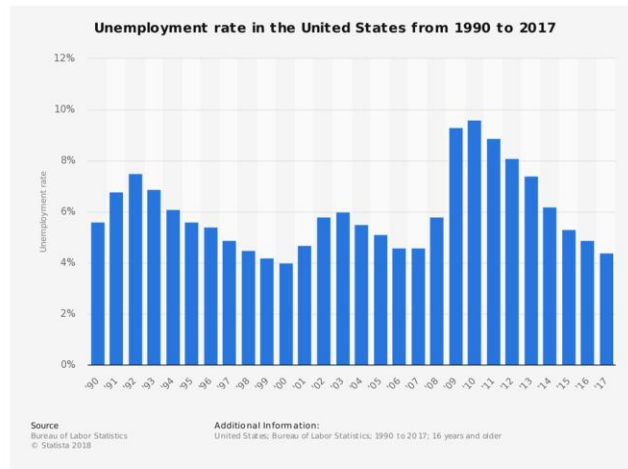


ECO 202

Southern New Hampshire University

- The inflation rate is measured using consumer price index and producer price index.
- Whenever the GDP growth rate is low, it is directed to the stock market. Few people will be willing to participate in the stock market

Unemployment rate



ECO 202

Southern New Hampshire University

- The economic growth does not change from adjustments of inflation.
- Unemployment is calculated by adding the employed people and the number of unemployment

Interest Rates

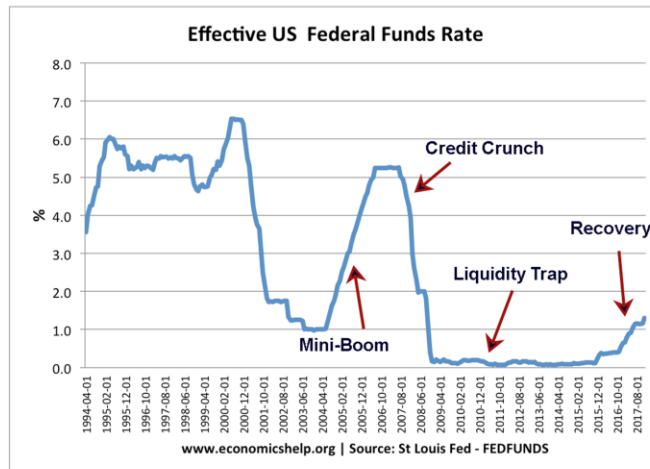
- With the increase of taxes by the federal government, the interest rates also increases
- The citizens are reduces their spending power and the possibility of being lend money for business
- With the decrease of taxes by the federal government, the interest rates also decreases.
- The citizens are increases their spending power and the possibility of being lend money for business by financial sectors.

ECO 202

Southern New Hampshire University

Include Speaker's notes.

Interest rates cont.



ECO 202

Southern New Hampshire University

- In around 2003 to 2004, there was a miniboom caused by decreased interest rates.
- When the interest rates are lowered, it means that the charges for borrowing a loan are very little
- Many people can therefore afford to borrow funds and increase their purchasing power.
- This leads to inflation. In the midst to correct inflation, the interest rates are increased to reduce the purchasing power of these citizens.
- This leads to unemployment since the business will decrease due to financial constraints.
- Low interest rates encourage investments and foreign trade which leads to inflation.
- During high rates of inflation or unemployment the GDP decreases.

Foreign Trade: Imports and Exports

- The Great Recession decreases most of the Western world trades. Therefore, the demand of imports decreases for it depends on people's income.
- Increase in demand for goods and services decrease, decreases the exports and increases the imports from all around the affected countries, the US included.
- In AD-AS model the demand curve shifts to the right.

ECO 202

Southern New Hampshire University

- Imports refers to the goods and services bought into the country from abroad.
- Exports refers to goods and services sold abroad.
- For a country to gain economically, it should focus on the goods it has a competitive advantage and export it for a goods it has a competitive disadvantage.

Foreign Trade: Models

- $GDP = C + I + G + NX$
- Whenever there was a recession, the federal government would raise the taxes. This would decrease the GDP growth rate since the taxes reduces the people's purchasing power.
- the federal government would also decrease the government spending which reduces the economic growth by transferring additional resources from the productive sector and keeps it tot itself.

ECO 202

Southern New Hampshire University

C= consumption

I= investments

G=government spending

NX= exports-imports

Fiscal Policy

- Enactment of Emergency Economic Stabilization Act of 2008 in October 2008.
- Enactment of the Economic Stimulus Act of 2008. For low and middle class families earning between \$300-\$1200 were offered tax rebates.
- The Economic Stimulus Act of 2008 enabled reduction of aggregated demand as the low income families used the rebates to pay their debts or increase their savings.
- The program was referred to as Troubled Asset Relief Program (TARP) and enabled the banks to get rid of the huge mortgage backed securities burden.

ECO 202

Southern New Hampshire University

The Enactment of the Emergency Economic Stabilization Act of 2008 on October, 2008 helped the Federal reserve to obtain \$700 billion that was to be used to purchase mortgage-backed securities from banks. Banks were unable to get rid of this mortgages. They were unable to recover the loans secured using mortgage-backed securities. Banks were also unable to secure most long-term credit facilities to investors and their customers (Roubini, 2008).

The Act enable the Troubled Asset Relief Program (TARP) created by Federal reserve to enable the banks to get rid of the huge mortgage-backed securities burden.

The impact of this policy change was increased liquidity to banks and revival of companies such as General Motors and Chrysler which were financially crippled.

In October, 2008, Enactment of Economic Stimulus Act of 2008 enabled the Federal reserve to create the Term Asset-Backed Securities Loan Facility (TALF) of \$ 200 billion further to encouraging lending and trading of mortgage backed securities.

Fiscal Policy Actions

- There two fiscal policy actions used in the economy; expansionary and contractionary fiscal policy.
- Expansionary fiscal policy is used to correct recession through increasing government spending and lowering taxes.
- Contractionary fiscal policy is used to correct an economic growth rate that has grown out of hand to stop it from causing inflation.
- During recession, the aggregate demand is lower than the aggregate supply curve.
- The fiscal policy influences government spending, interest rates and tax rates.
- Fiscal policy is the revenue that generates the government policy.

ECO 202

Southern New Hampshire University

- The government borrows money through selling of government securities to the public and uses the money to provide goods and services to the public.
- The main goal for fiscal policy to reduce employment, promote economic growth and maintain stable prices to reduce inflation.
- The government also uses monetary policy where money in the hands of people is regulated using monetary tools such as interest rates.

Fiscal Policy Impact

- The impact of this policy was increased liquidity to banks and revival of companies such as General Motors and Chrysler which were financially crippled.
- Households with adequate savings or credit facility calculate their consumption budget using their lifetime earnings but not those of the current year.
- Rebate associated spending encouraged the slight growth of GDP in the second quarter of 2007.
- These Acts helped the Federal reserve to obtain \$700 billion that was to be used to purchase mortgage-backed securities from banks.

ECO 202

Southern New Hampshire University

The impact of this policy was to increase liquidity to banks and revival of companies such as General Motors and Chrysler which were financially crippled.

Households with adequate savings or credit facility calculate their consumption budget using their lifetime earnings but not those of the current year.

Rebate associated spending encouraged the slight growth of GDP in the second quarter of 2007.

These Acts helped the Federal reserve to obtain \$700 billion that was to be used to purchase mortgage-backed securities from banks.

Monetary Policy

- Before the depression the Federal reserve had a policy in which a 5.25% interest rate on banks was required to access federal funds.
- Federal Home Loan Mortgage Corporation (Freddie Mac) could also buy mortgage – backed securities from financial institutions.
- The initial sign of the 2008 depression was the halt of purchasing securities backed by subprime mortgage.
- Banks and investment firms for the next year were adversely affected and the Federal Reserve made changes to revive the banking and mortgage firms.

ECO 202

Southern New Hampshire University

The first indicator of the 2008 recession was February 2007, after the Federal Home Loan Mortgage Corporation (Freddie Mac) notified the financial firms that it would not buy subprime mortgage-backed securities.

Financial firms in housing-related markets performance had deteriorated.

Banks failed to offer credit using mortgage-backed securities to fund long-term loans.

In the next six months there was no major collapse of banking institutions or weakened macroeconomics (Christiano et al, 2008).

Banks and urged the Federal reserve to reconsider the policy but the Federal Open-Market Committee (FOMC) declined on August, 2007

Monetary Policy Actions

- In October 2008, the Federal Reserve created the Term Asset Backed Securities Loan Facility (TALF) in the amount of \$200 billion to encourage lending and widen the market for mortgage backed securities'.
- The policy lowered the Federal Open Market Committee (FOMC) 5.25% interest rate charged on banks to 2.25%.
- The final change of the monetary policy during the 2008 recession was the reduction of the target federal funds rate to 0.25%.

ECO 202

Southern New Hampshire University

The first change in the policy by the Federal reserve was the creation of a special credit facility to banks. It was passed on March 11, 2008 and was referred to as Term Securities Lending Facility (TSLF).

This credit mechanism allowed the banks to access liquidity using high-grade mortgage-backed securities for a duration of one month.

The Federal reserve also lowered the target funds rate to 2.25%.

The impact of this policy was alleviating the closure of Mortgage investment firms which could not secure loans using mortgage-backed securities.

For example, Bear Stearns, an investment firm collapsed in March and Federal reserve provided a \$29 loan to JPMorgan Chase to bail Bear Stearns preventing it from shutting down.

Monetary Policy Impact

- The halt of purchasing securities backed by subprime mortgage denied banks liquidity.
- Banks were unable to dispose the securities which they had used to give credit before policy change.
- Banks could not advance credits using mortgage backed securities.
- The subsequent monetary measures by the Federal Reserves were aimed at helping banks dispose and use mortgage backed securities.
- Banks were unable to offer credit leading to failure of financing long-term projects which caused a collapse of industries.
- The Federal Reserve adoption of the Term Securities Lending Facility (TSLF) enabled banks to use securities backed by prime grade mortgage to access extra liquidity.

ECO 202

Southern New Hampshire University

The gradual lowering of Federal reserve target funds rate from 5.25% to 2.25% and the to zero increased the liquidity of banks.

Banks were able to have more cash to provide credit to businesses and individuals.

The Term Asset-Backed Securities Loan Facility (TALF) and Term Asset-Backed Securities Loan Facility (TALF) enable the banks to dispose the securities previously bought using mortgage-backed plans.

The numerous policies led to an overall effect of enabling the banks to start issuing asset-backed loans as banks could not initially be able to secure loans using mortgage-backed securities. The GDP growth improved by 2-3% in the first quarter of 2009 and up to 3% in the last quarter of 2009 signaling the end of the recession.

Conclusions

- The 2008 Depression in U.S. economic was a period where the great economic recession was experienced in US.
- It was a worldwide economic turndown which started from 2008 and went to 2010
- The even caused a great financial crisis.
- This led to scarcity of most valuable assets in the economy and collapse of the most popular financial sectors.
- During this time, millions of people lost jobs despite the increase of the population both newborn and immigrants in the country.

“Agree/Disagree”

- I agree with both fiscal and monetary policies since they do regulate the economy.
- Even though the policy encourages unemployment and inflation, through contractionary policy, the economy is controlled.
- It corrects the economy when it has grown out of hand and when there is a recession in the economy.

References

Christiano, L., Motto, R., & Rostagno, M. (2008). Shocks, structures or monetary policies? The Euro Area and US after 2001. *Journal of Economic Dynamics and control*, 32(8), 2476-2506.

Roubini, N. (2008). The current US recession and the risks of a systemic financial crisis. Written testimony for the House of Representatives' Financial Services Committee Hearing on, 26.

Steuerle, C. E. (2008). Contemporary US tax policy. The Urban Institute.