

2008 ECONOMIC DEPRESSION.

Your Name:

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Policies at the Beginning.

- The initial sign of the 2008 depression was the halt of purchasing securities backed by subprime mortgage.
- This policy did not have a major negative impact on macroeconomics in February 2007 and the following six months.
- The Federal Open-Market Committee (FOMC) had a 5.25% interest rate on banks to access federal funds.
- This denied banks liquidity and made the banks to deny their customers credit using mortgage-backed securities.

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.

Impacts.

1. Financial firms in housing-related markets performance deteriorated.
2. Banks failed to offer credit using mortgage-backed securities to fund long-term loans.

In the next six months there were 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.

Actions During the Period.

- Enactment of Economic Stimulus Act of 2008. Low and middle income families earning between \$300-\$1200 were offered tax rebates.
- ESA 2008 enabled reduction of aggregate demand as the low income families used the rebates to pay their debts or increase their savings.
- 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.

In February 2008, President Bush signed the Economic Stimulus Act of 2008. Consequently, low and middle income families earning between \$300-\$1200 were offered tax rebates as a result of the act. Low and middle income families earning between \$300-\$1200 were offered tax rebates as a result of the act. This was based on the suggestion from economic theory that households with adequate savings or credit facility calculate their consumption budget using their lifetime earnings but not those of the current year (Steuerle, 2008).

The desired impact of the bill was to reduce the aggregate demand of credit the households needed from banks. As required the Act, enabled reduction of aggregate demand as the low income families used the rebates to pay their debts or increase their savings. This measure helped postpone the huge economic decline to the second half of the 2008. Rebate associated spending encouraged the slight growth of GDP in the second quarter of that year.

Actions During the Period

- The Federal Reserve adopted Term Securities Lending Facility (TSLF) on March 11, 2008.
- This policy enabled banks to use securities backed by prime grade mortgage for to access extra liquidity for a single month.
- The same policy helped non-bank financial businesses to access liquid bills from treasury through Primary Dealer Credit Facility
- The policy also lowered the Federal Open-Market Committee (FOMC) 5.25% interest rate charged on banks to 2.25%.

The next 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.

Actions During the Period

- Enactment of Emergency Economic Stabilization Act of 2008 on October, 2008.
- This act helped the Federal reserve to obtain \$700 billion that was to be used to purchase mortgage-backed securities from banks.
- The program was referred to as Troubled Asset Relief Program (TARP) and enabled the banks to get rid off the huge mortgage-backed securities burden.
- The impact of this policy was increased liquidity to banks and revival of companies such as General Motors and Chrysler which were financially crippled.
- In October, 2008, the Federal reserve created the Term Asset-Backed Securities Loan Facility (TALF) of \$ 200 billion to encourage lending and widen market for mortgage-backed securities.

The Enactment of 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).

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Actions During the Period

- In October, 2008, the Federal reserve created the Term Asset-Backed Securities Loan Facility (TALF) of \$ 200 billion to encourage lending and broaden market for mortgage backed securities.
- The final change of policy during the 2008 recession was the reduction of the target federal-funds rate to 0-0.25%.
- This was effected on December, 2008 with an aim of stimulating the economic growth.
- Banks were able to have more cash to provide credit to businesses and individuals.
- This policy also helped banks to start issuing asset-backed loans as banks could not initially be able to secure loans using mortgage-backed securities.

The final policy change by Federal reserve was on December 16, 2008. During the recession, there were gradual reductions of target federal-funds rate but this final change set the rate to 0-0.25% range. The aim of this policy was to stimulate economic growth. This measure supplemented the numerous special lending programs offered to banks. Further, American Recover and Reinvestment Act allowed the Federal reserve to offer \$800 billion tax cuts. Consequently, Banks were able to have more cash to provide credit to businesses and individuals. 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.

References

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