THE SUB PRIME CRISIS

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Part 1

1. **What does the lecturer mention is key in relation to the credit crunch?**
2. **What does the graph on house price fluctuations in the United Kingdom and the United States from the 1970's until today show about housing cycles?**
3. **What made so many people invest in the housing market?**

Part 2

4 **What is the purpose of a mortgage?**

5 **What does the lecturer say is the main cause of the credit crunch?**

6 **What does the lecturer say about the bank base interest rate and the mortgage interest rate?**

Part 3

7 **What does the lecturer mean by the reducing aggregate demand in the economy?**

8 **What is the name of the policy instrument the Bank of England uses to control wider interest rates in the economy?**

9 **How has the Bank of England tried to stimulate monetary demand in the economy?**

Part 4

10 **What circumstances does the lecturer say have caused the recession?**

11 **What is negative inflation?**

12 **Why would you normally expect to pay a higher interest rate of your mortgage if you have a poor credit rating?**

Part 5

13 When the sub-prime market started to expand in the United States why were there few problems despite the borrowers having poor credit ratings?

14 What was the purpose of the US Community Reinvestment Act?

15 Why did investors in the US prefer to buy into the sub prime market rather than investing in long-term government bonds?

Part 6

16 What does the lecturer say causes an economic 'bubble'?

17 What does the lecturer mean by 'fundamentals'?

18 What were 'teaser' interest rates that were offered to applicants for sub prime mortgages?

Part 7

19 What are American residential mortgage bank securities?

20 What caused the distrust between banks and financial institutions which led to the credit crunch?

21 Why could the banks not get funds through using the retail money markets?

Part 8

22 When did the U.K. banks start to get into the securitised mortgage market?

23 What was one of the things that Northern Rock did when it was nationalized?

24 What does the lecturer mean by the term 'moral hazard' in relation to the banks?

Part 9

25 What other big issue does the lecturer mention?

26 What responses to the banking crisis by the government does the lecturer mention?

27 **Why can the government not decide, in isolation, how to regulate the money market in the U.K?**

Key

Part 1

1. The housing market.

2. It shows that the housing cycle in the United Kingdom is more volatile than in the U.S.A.

3. They thought that house prices would continue to rise and would never fall.

Part 2

4 A mortgage is a large sum of money which is loaned to people to enable them to buy a property which they could not buy without this financial help.

5 It is the collapse in the availability of mortgages to prospective property buyers.

6 The base rate is set by the Bank of England every week, and it is now quite low. But the mortgage rates are still high – they have not fallen in relation to the base rate.

Part 3

7 He means that business and housing investment is falling as well as consumer spending; people do not have the money to spend on goods, especially houses.

8 It is called the transmission mechanism.

9 By reducing the interest rates that it sets.

Part 4

10 The lower interest rates have not stimulated enough demand. Lower demand is due to a perceived lack of credit. These circumstances together cause a recession.

11 Negative inflation is when low demand pushes prices down and continues to do so.

12 Because the mortgage lender would consider you at risk of not being able to repay the mortgage loan, so his risk in lending you money would be greater.

Part 5

13 If the borrowers could not continue the repayments they could move out of the property which would have made a capital gain during the time they had occupied it.

14 To extend home ownership to people who were on average or below average incomes and could not otherwise obtain a mortgage.

15 The yield on their investments was much higher in the sub prime market.

Part 6

16 A rise in expectations leading to ‘herd behaviour’ – banks and investors making large investments without regard for the underlying economic principles or the risk involved.

17 A strong increase in household incomes over time, low levels of interest rates and shortages of housing stock which forced house prices up. These are all influential factors in house prices

18 A short term very low interest rate, say for two years. Then the mortgage reverted to a standard interest rate plus a risk premium, so it became much more expensive.

Part 7

19 These are bundles of mortgage loans which are sold by the lending bank to intermediaries such as Freddy Mac and Fanny May who then trade these bundles on the international money markets.

20 They did not know how much bad debt, i.e. residential mortgage bank securities, were being held by other banks and financial institutions, so they would not risk loaning any money to each other.

21 The savings ratio for households had also collapsed, so there was a shortage of funds.

Part 8

22 In the early part of this century.

23 It started to run down its mortgages and made it more difficult for loan renewal for existing customers.

24 He means how is the government going to be able to control the banks to curb their speculation in money markets when it is acknowledged that world economies cannot function without banking facilities, and the banks know that they are indispensable.

Part 9

25 Several large banks and financial institutions have been merged or taken over which could lead to the possibility of monopolies being created.

26 The government purchased some underperforming bank assets such as the sub-prime mortgage bundles to improve liquidity and it nationalised some of the banks and supported takeovers and mergers of other financial institutions to create stability.

27 Because banking is a huge international business and for control measures to be effective they have to be agreed by all the major powers around the world.