

Chapter 1 : The Credit Crunch Lab: Iceland's Warning to the World - SPIEGEL ONLINE

The Icelandic financial crisis was a major economic and political event in Iceland that involved the default of all three of the country's major privately owned commercial banks in late 2008, following their difficulties in refinancing their short-term debt and a run on deposits in the Netherlands and the United Kingdom.

Despite rising fast financially in the past few years, Iceland is feeling the chilly effects of the global credit crunch – so much so the fiercely independent island nation is considering European Union membership to save its tanking currency. A special report, jointly developed by U.S. For more information on MoneyWeek, please click here. If you think the credit crunch is hitting the United States and United Kingdom hard, spare a thought for Iceland. Its big players – Landsbanki Islands HF and Kaupthing Bank – have been on an extraordinary borrowing spree, sucking in vast quantities of cash to fund lending and acquisitions across Europe and the United Kingdom. This tiny country – home to a mere 300,000 people – has somehow created a financial system nine times the size of its gross domestic product GDP. And a nasty hangover. Now, the cheap credit that fueled the binge has all but disappeared, and the banks – as well as the economy – are in trouble. House prices, which had doubled since 2000, are now falling. According to the Icelandic Central Bank, the economy will contract by 2.5% this year. Lucky then that the Alka Seltzer is on its way. Can they really go it alone in the global market place or should they begin to think the unthinkable and join the European Union? Just ask any fisherman up and down the west coast of Ireland what he thinks of the EU, and the opening of Irish waters to big Spanish tankers. But with the economy destabilizing and the currency all over the place, support for the idea is growing. EU membership would mean that the Icelandic central banks would lose the power to set interest rates. But that may well be a perfectly fair price to pay for a more stable currency. The majority of durable goods, for example cars and washing machines, are imported into Iceland. So given that the currency has been taking a beating, Icelanders are now paying much more for the goods they import. Inflation rose to an annualized rate of 10% in 2008. And over the past three months, consumer prices are up 6%. But then, given that interest rates in Iceland are running at 12%, the country is extremely energy efficient. Its population enjoys nearly free hydroelectric power by harnessing the flow of its natural and manmade waterfalls. The International Monetary Fund ranks the icy island the fourth most affluent country in the world, Vanity Fair reported in its May issue. But with its banks losing money fast, that status is in jeopardy. Public sentiment is leaning toward falling into the arms of the EU, should the need arise. Given how much is at stake, the issue will be treated cautiously.

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Chapter 2 : Iceland: financial crisis - Telegraph

The Credit Crunch Lab Iceland's Warning to the World. First came the financial crisis, then the uproar: Iceland is the first European country to suffer the full effects of the global financial crisis.

Iceland announces part of a plan to shore up its troubled banking sector. The Fed cuts its base lending rate to 1. The G7 nations issue a five-point plan of "decisive action" to unfreeze credit markets, after a meeting in Washington. Banking giant Citigroup had tried to block the move after it launched rival bid. President George W Bush says it will help to return stability to the US banking sector and ultimately help preserve free markets. The figures underscore fears that the wider US economy is now being hit by the financial crisis. The Dow Jones index falls points or 7. The economy shrank for the first time in 16 years between July and September, as economic growth fell by 0. The European Central Bank lowers eurozone rates to 3. Leaders of the G20 developed and emerging economies gather in Washington to discuss ways to contain the financial crisis and agree on longer-term reforms. Chancellor Alistair Darling also says government borrowing will rise to record levels, but defends the move as essential to save the UK from a deep and long-lasting recession. The scheme aims to stimulate spending and boost consumer confidence. The committee concludes that the US economy started to contract in December. It says the cuts will be spread across both businesses. The Dax in Frankfurt lost. The news prompts big falls in share prices in the US and Europe. The ECB has now reduced rates four times from 4. The Irish government says it is to nationalise the Anglo Irish Bank after deciding pumping money into the lender was not enough to secure its future. The emergency funding will help the troubled bank absorb the losses it incurred when it bought Merrill Lynch. It now projects the UK will see its economy shrink by 2. The International Labour Organization said that as many as 51 million jobs worldwide could be lost this year because of the global economic crisis. The plan is aimed at saving or creating 3. The main summit takes place in London in April. Chancellor Alistair Darling says the UK economy will shrink by 3. The majority of its assets are to be sold to Fiat. The effects of the banking crisis will be felt for generations, the MPs warned. It also says unemployment will rise to. The banks would have faced restrictions on executive pay. President Barack Obama describes it as the biggest shake-up of the US system of financial scrutiny since the s. Several - but not all - other US banks subsequently announce big profits. However, analysts warn that the US banking crisis is not yet over. The jobless rate increased to 7. The latest figures take the annual rate of decline to 5. In subsequent days, as other UK banks announce their results for the period, a mixed picture emerges.

Chapter 3 : Financial crisis of " - Wikipedia

Iceland's economy was destroyed during the credit crunch because it ultimately lacked a big enough central bank like the Bank of England or Federal Reserve. In fact, some individual Iceland's banks were far bigger than Iceland's economy itself and so could never have been rescued.

The country has gone from one of the highest rates of growth to bust. The government is being forced to intervene with guarantees, but as could be expected they are aimed at sustaining the rich not the ordinary working people. The Irish economy is officially in recession. The housing market reached a pick in the first months of and then started to fall, dragging with it other sectors of the economy. And last week the Irish credit system was about to collapse. Until last year, Ireland had the fastest growing EU economy. Now it is experiencing the worst fall. The Irish government has had to finally intervene and take emergency measures. Other EU countries could follow soon. The Credit Institutions Financial Support Bill will not guarantee, however, mortgages, personal loans, etc. Yet, Irish banks are busy lobbying the government in order to get a reduction to 0. That is, banks will be able to continue business as usual with the backup of the Irish State, or in other words, on the back of the Irish workforce, whose mortgages and loans are not guaranteed. The crisis of the Irish credit system had been going from bad to worse in the two weeks that preceded the Bill. The Anglo Irish Bank and Irish Nationwide were the most affected and were about to collapse, but it was the whole of the Irish financial system that was in crisis. The minister for finance put it like this to the Seanad Irish Times, 4 October, House completions doubled between and , from 47, to 90, a year. Prices also doubled, reaching a peak at the beginning of before starting to fall. The fall in prices has halved the construction of new homes in . Only around 40, are expected this year, and the same amount next year. The crisis in the housing market has triggered a sharp increase in the number of unemployed and a generalised fall in retail sales. The number of unemployed on the live register has increased by nearly , in only one year. The total on the live register now is around , There are hard times ahead The global dimension of the crisis This is not just a domestic phenomenon. The Irish economy is only a part of the world capitalist system. As days go by, we can see more and more clearly the international dimension of the crisis. Since the mild recession of , the slow growth of the economy in real terms led the channelling of funds into landed property, insurance, and stock exchange speculation in general. What has happened in Ireland is not peculiar to the Irish economy. What is remarkable about the last economic cycle on a world scale is the wide gap between real and fictitious capital, particularly in the housing market. First the housing bubble burst, then came the collapse of the credit system. Banks had made huge profits from lending on real estate. It all first started in the US. Two years ago, housing prices reached a historical peak and started to go down. US banks had more than half their assets in real state. The crisis later spread to the UK, Spain, and Ireland. The trend has been the same in nearly all OECD countries. The bubble of fictitious capital is in fact a product of very low rates of real growth since the crisis of the s. Since then, increasingly lower rates of profits have driven capitalists to introduce measures reminiscent of nineteenth century capitalism. Rather than investing in improving productivity, productivity is raised by changing work practices and increasing the intensity of work. Thus we have more exploitation, more productivity, but also more reduced incomes. This easily leads to overproduction because consumers workers when they are not in the workplace cannot buy all that they have produced. Speculation has therefore increasingly become the way to make easy profits and expand consumption and production. Capital always flows wherever profits are higher - Finance, Insurance and Real State in the last period. But capitalism has reached its limits. Only cyclical deep crises of the kind we are living now are in sight. Bailing outs or nationalisations? In the UK, Bradford and Bingley was recently nationalised. In Ireland, the government has also decided to go for a bailout of the credit system. Only the Labour Party has opposed it on the grounds that the government has not disclosed the terms and conditions of the Bill. The Labour Party has not gone beyond that point. Unfortunately, I must support it with gritted teeth because there are a lot of scum, and I state this deferentially in one sense, who do not deserve to be bailed out in this way Unfortunately, this is the only way we can protect our society. They confuse the interest of banks and big businesses with the interest of all. With

this proposal they simply reveal that they do not have any class-based perspective. The Bill has a clear class content: The right wing, on the other hand, reveal more "pragmatism" when it comes to defending their class interests. Last week the Irish government considered the possibility of allowing "one of our six financial institutions - or perhaps even two - to become insolvent and be nationalised. Yet, they feared that nationalisations could create distortions of competition between Irish and EU banks. In the end, they decided just to subsidise the big speculators and loan sharks. The housing crashes and credit crunches that have followed in Ireland and in the OECD are not accidental or merely domestic problems. They are connected because of the global tendency of the gap between real and fictitious capital to grow, and, ultimately, because of the anarchy of the market economy. A tight regulation of the Irish housing market, as the Labour Party argues for in Ireland, might had avoided the housing crash. Yet, if billions had not been invested in housing in Ireland they would have moved elsewhere. There was no way to avoid the recession within the parameters of the market economy. Now, even right-wing governments are declaring that the credit system must be tightly regulated, but it is not clear how the regulation of the credit system is going to come about. They do not say. But of course, there is an alternative to bailing out the credit system. That alternative is full nationalisation. The governments of the UK and the US have already nationalised some credit institutions. That is a partial nationalization of the credit system. They are doing it, however, in order to save the "scum" that have provoked the crisis in the first place. That means that the poor must subsidise the rich, and, when the rich recover, what has been nationalised will be privatised again. Only the full nationalization of the credit system would allow for a proper regulation of the credit system. That is the lesson to learn from this crisis. Only in that way other housing crashes and credit crunches can be avoided in the future. Only in that way is it possible to protect the interests of "ordinary people".

Chapter 4 : Iceland Ponders EU Membership as the Credit Crunch Sinks its Currency

It was also Iceland's oldest and second-largest bank, after Kaupthing Bank. But the credit crunch was to expose the failings in the expansionist Icelandic banking model.

It is late afternoon, dark and icy, as Vilhjalmur Bjarnason drives to his university office in Saemundargata to do some more work. Vilhjalmur, 56, a former banker, works as a university lecturer for macroeconomics, serves as the chairman of the Association of Small Investors and is a keen runner. Lately, he has been extremely irritated because he predicted everything that is now happening. He has always remained politically neutral because he believes that an economist should preserve his independence -- although it has also put the brakes on his career. Now he is under consideration to become the new head of the central bank or an adviser to the finance minister. Then, says Vilhjalmur, they learned to tap into their unique natural surroundings, damming waterfalls to generate energy and using the hot water from geysers as a source of heat. According to Vilhjalmur, things could have continued that way -- but Iceland was infected by greed. Kristin Gunnarsdottir and many of her comrades-in-arms see the decision to launch one of the largest hydropower projects ever as the main factor that triggered a veritable orgy of borrowing. She says that the beginning of construction on the Karahnjukar power plant, which was to further boost the production of aluminum, was cleverly marketed around the world. These loans were relatively cheap as long as the value of their own currency continued to rise. Capital flowed into the country because Iceland seemed incredibly safe. A few ambitious businesspeople would get together with bankers and young business graduates to pool their money and contacts. Then they went to one of the three large banks, which were formerly state-owned banks that had been privatized. Vilhjalmur says that this borrowing frenzy gripped people from all walks of Icelandic society. However it was the ordinary people who were left saddled with debt while the tycoons kept their new yachts. Who were these tycoons? They are the main culprits. I can prove it. We could rescue a lot of money. They have to be brought to trial. Kristin, the writer, sits in front of her fireplace.

Chapter 5 : Ireland: housing crash, credit crunch, poses need to nationalise banks

The IMF, the Credit Crunch and Iceland ISK billions over a month period from end 8 to end, the permissible amount of domestic credit creation for is limited to an.

While egg-flavoured politicians, in response to the crisis, began to flail wildly and point pointy fingers at one another, professional research has concluded that the entirety of the American financial crisis can be firmly blamed on one man, who is known only by the name Ron. Ron makes a living by selling home loans to Americans who are keen on acquire property. The problem was that the majority of these homebuyers had insufficient income to pay for the loans, instead assuming that the Debt Fairy would come and save them. While the general public was surprised that one man alone could cause the entire credit crunch, it turns out that Ron was just the start of a whole bunch of people like Ron. Their combined efforts resulted in one million billion trillion hell of a lot of dollars of home loans being written off by US banks. So blame them, and as well as those greedy Republicans and selfish Democrats. But no one cares. Apparently, this guy thought the credit crunch was a new trend. New Century Financial, which specialised in Optimus Prime mortgages, filed for Chapter 11 bankruptcy protection. Bear Stearns lost almost all its investments in a Hedge, causing Ben Bernanke pictured above to estimate the crisis will cost almost " million, billion, trillion dollars. In Japan, news breaks that the Origami bank has folded, the Sumo Bank has gone belly up, the Bonsai Bank planned to cut branches. Meanwhile in other parts of Japan shares in Kamikaze Bank nosedived and Karate Financial were preparing to chop jobs. When news broke that Kareoke Bank was up for sale and reputed to be going for a song, panic hit Tokyo. Some blame the mysterious Captain Crunch for the current financial crisis. In comparison, UK mortgage lender Northern Rock ran into financial difficulties it was thrown a lifeline from the Bank of England. This triggers a panic amongst customers with savings at the bank, causing a stampede not seen in England since the Primark sale. However, the Bank of DinoJesus then collapses, causing the largest investor, Mr. T to become very angry. The central banks continue to make more funding available. Billy Rabblemere of Ohio, donates 47 cents from his piggy bank to help his mother with household bills. Many blame the global credit crunch on the actions of banking "Fat Cats" and their unwise investment in the oil rich nation of Mordor , subsequently invaded by George W Bush in There are significant developments in two major credit crunch-related investigations in the US, which it is hoped will restore confidence in the credit markets. Separately, two former Bear Stearns workers face criminal charges related to the collapse of two hedges linked to Optimus Prime mortgages. Frantically looking for a buyer for their remaining assets mostly low quality crack cocaine , they approach the US Federal Reserve but are sent home, crying to momma. After days of searching frantically for a buyer, Lehman Bruvas file for Chapter 11 bankruptcy protection, becoming the first major rappers to collapse since the start of the credit crisis. Former Federal Reserve chief Alan Greenspan dubs failure as "probably a once in a century type of event" and warns that other major firms will also go bust. Gordon Brown leads the world in the brilliant?! The last hope of Western economy, the Arab sheikdoms, suffer their own crisis after the financial breakdown of Emirate Dubai. The recent "recession is over" headlines are obsolete by the new downturn. Most economists now agree that the USA and UK are now in recession and the consensus is that the recession will last for the next hundred years or so. This means that both countries are likely to be acquired by China or India. You might lose your house, car, and other valuables. You need to firmly establish, right now, your new place in life. You should become a prostitute. What other job has the flexible hours that a prostitute has? Work whenever you please! Learn the skills you need to know. It worked for Amy Winehouse , after all. Alternatively, you could just be smarter about your savings.

The IMF, the Credit Crunch and Iceland These are huge bills to have been presented all at once, and far out- stripped available financing resources of only US\$ billion.

If countries could export darkness, then Iceland would have nothing to worry about. She has a new, exhausting pastime -- demonstrating. For the past three months, Kristin Gunnarsdottir has spent many of her days in downtown Reykjavik. Armed with a pot and spoon, she and her fellow protesters have taken up position in front of the Icelandic parliament, the Althing, accompanied by a few hundred or -- as is usually the case -- a couple of thousand other demonstrators. Recently, she says, the wrath of the people was so great that the crowd was on the verge of storming the Althing, dragging out the government, and hanging them from the huge Christmas tree. The tree is no longer there. From the Magazine "Some of the demonstrators torched it," she says. Kristin Gunnarsdottir grabs a thermos full of coffee, switches on the TV and is just about to settle down by the fireplace when she is stopped short. She stands there, awestruck, and points to the screen. Kristin is in her mids, red-haired and cheerful. She used to be a TV journalist, but is now a writer who has produced three bestsellers. But since the beginning of the financial crisis, she has been one of the leaders of a revolt the likes of which Iceland has never seen before, a revolution from below that aims to sweep away everything that existed before. She is from the left-leaning Social Democratic Alliance, the smaller of the two coalition partners, and looks exhausted as she gazes into the camera and explains that she will only continue to support the government if a series of demands are met. Then come politicians who say that these demands cannot be fulfilled. The stronger of the two coalition partners, the conservative Independence Party, ruled the country for nearly 18 years. This party led a government that was responsible for some , Icelanders who are all related to each other in one way or another and are, for the most part, very blonde, very nice, educated, pleasant people. Now the financial crisis and the scandals that it has brought to light have cast Iceland into turmoil and chaos. On the surface, life continues, yet everyone is shaken to the core by an unfathomable feeling of uncertainty. In that sense, Iceland is like a crystal ball that reveals the future of the rest of Europe. Iceland has become a kind of laboratory for the credit crunch: The first waves of layoffs have started to roll across the country. Everyone knows someone who has already lost his job or will lose it soon, everyone knows someone who knows -- and hates -- an investment banker. The coolest bars in downtown Reykjavik are conspicuously empty, like "" and "b5", where financial high flyers were still enjoying wild parties during the midsummer nights of No one in Iceland is sure. This has sparked wild rumors throughout the country. According to one story, the richest Icelanders left the country months ago, their bags packed with cash as they boarded a private jet bound for Portugal. Supposedly they will return soon to cover up their tracks. The Icelandic krona has lost a third of its value against the euro within one year and remains volatile. Nobody in the shops knows the current exchange rate anymore. Nowhere else in the world, so it seems, is the crisis as visible as in Iceland, nowhere else is it so concrete. The small size of the country also means that every citizen can easily calculate how much debt has accumulated in his or her name. How can the current generation ever work off this debt? Economists anticipate double-digit inflation and predict that the economy will shrink by 10 percent.

The government of Iceland became the first in the world to be effectively brought down by the credit crunch. It came after several nights of rioting over the financial crisis. A poll would not.

Share via Email This article is over 10 years old Lie back and think of an economic upturn We had to go out and be with friends. Iceland is on the brink of collapse. Inflation and interest rates are raging upwards. People talk about whether a new emergency unity government is needed and if the EU would fast-track the country to membership. On Friday the queues at the banks were huge, as people moved savings into the most secure accounts. Yesterday people were buying up supplies of olive oil and pasta after a supermarket spokesman announced on Friday night that they had no means of paying the foreign currency advances needed to import more foodstuffs. But Iceland built its extraordinary wealth on the crest of the worldwide credit boom and now the crunch is sweeping it away, bankrupting a people for whom the past eight years have been, for most of them and by their own admission, one long party. In just five years, the average Icelandic family saw its wealth increase by 45 per cent. But, as a result of the international banking crisis, the billionaires who own everything from West Ham United football club to the Somerfield supermarket chain, Hamleys toy shops and the House of Fraser, are in trouble and the country is drowning in debt. Iceland is on its own. Iceland Airwaves takes place in a fortnight, when more than Icelandic bands and 50 foreign ones will play in venues around the city over four days. Most of the tickets have been sold in krona, but the international acts need to be paid in euros, which is going to cost the organisers dearly. And many people should have a bad conscience for what has happened. Someone should be prosecuted, they have sucked Iceland dry, taken the money and ran, and left us totally in the shit. People I know who have gone to the UK or the US to study have found their grants worthless, they are stranded. Well, we will have to go back to the basics now. Icelanders are risk-takers, but hard working, they will have to downsize. We will have to eat haddock and Icelandic lamb and forget these imports of goose livers and Japanese soy sauce. When everyone was extremely rich in Iceland - you know, last month, it was with money that they never have earned. Now those who were extremely rich are just normally rich, but they think they are poor. They were spoilt, spending billions. Now they will stay in Iceland, but they will still eat out. People need to eat. They are not expecting any customers today. We were selling , , a month. We have already seen two dealers go down. It took ten minutes, it was very easy. But 60 to 70 per cent of those loans were in foreign currency, Japanese yen or Swiss francs, and they have gone up 90 per cent as the krona burns. A car worth 5 million krona now has a 9 million loan on it; how are people going to make those payments? But the building has halted, nothing is being finished, nothing is selling. The interest rates are staggering. What people are doing now is swapping houses if they want to go bigger or smaller. Blame it on the Vikings. So they flew off in this mad ocean in a wooden boat which is pretty hardcore, North Atlantic in the year And they found this island full of snow We were poor fishermen or farmers, so it had an incredible effect on confidence when we saw these young men out buying up British and Danish companies. Everyone grabbed at the new opportunities like children. Really, it was no surprise that Hamleys toy shop was one of the first purchases. Tonight the young women are feeling no pain. It jointly owns Kaupthing Edge, an internet savings bank with , British savers.

Chapter 8 : Iceland: Britain's Credit Crunch Scapegoat - TIME

But Iceland built its extraordinary wealth on the crest of the worldwide credit boom and now the crunch is sweeping it away, bankrupting a people for whom the past eight years have been, for most.

The loan would be given across three or four years, with an interest rate of 30 to 50 basis points 0. So in a situation like that one has to look for new friends. Russian deputy finance minister Dmitri Pankin said that "The meeting took place in a friendly atmosphere We are working thoroughly on the issue to take a final decision". Dutch finance minister Wouter Bos stated that the Netherlands would oppose the loan unless agreement was reached over deposit insurance for Landsbanki customers in the Netherlands. Iceland is in red. In , banks were deregulated in Iceland. As with many banks around the world, the Icelandic banks found it increasingly difficult or impossible to roll over their loans in the interbank market , their creditors insisting on payment while no other banks were willing to make fresh loans. In such a situation, a bank would normally have to ask for a loan from the central bank as the lender of last resort. As such, it was completely dependent on the Central Bank of Iceland for emergency loans of liquidity , and could not turn to the Bank of England for help. The UK Financial Services Authority FSA was aware of the risk, and was considering imposing special liquidity requirements on Icelandic deposit-taking banks in the weeks before the crisis. The Guernsey authorities were also planning on bringing in restrictions on foreign banks operating as branches and on transfers of funds between Guernsey subsidiaries and parent banks "parental upstreaming". Bank restructuring[edit] Wholesale funding disappeared in September leading to the collapse of Glitnir, Kaupthing and Landsbanki. Due to the size of the combined balance sheet of those banks the government of Iceland did not have the means to save those banks. They were put into receivership instead with their boards replaced. Nevertheless, the failed banks were restructured by dividing them into a new and an old bank in order to avoid a credit crunch. The new banks will also have to reimburse their predecessors for the net value of the transferred assets, as determined by "recognised appraisers". As of 14 November , these net values were estimated as: The international businesses remained with the old banks for winding up. Please update this article to reflect recent events or newly available information. November The current[when? Similar job losses are[when? For example, the private Sterling Airlines declared bankruptcy on 29 October The national airline Icelandair has noticed a significant slump in domestic demand for flights. However, the airline states that year-on-year international demand is up from last year. The newspaper 24 stundir has ceased publication due to the crisis, resulting in the loss of 20 jobs. Although Iceland as a member of EFTA already had a free trade arrangement with the EU, it had always rejected full membership due to concerns that its independence could be compromised. On 12 March , Foreign Minister of Iceland Gunnar Bragi Sveinsson stated that he had sent a letter to the EU withdrawing the application for membership, without the approval of the Althing , though the European Union stated that Iceland had not formally withdrawn the application. Other UK organisations said to have invested heavily include police services and fire authorities, [] and even the Audit Commission. The cost of deposit insurance in the UK is not completely clear as of November The crisis also prompted the Ministry of Foreign Affairs to reduce its foreign aid to developing nations, from 0. Opponents of the bill argued that Icelanders, already reeling from the crisis, should not have to pay for mistakes made by private banks under the watch of other governments. However, the government argued that if the bill failed to pass, the UK and the Netherlands might retaliate by blocking a planned aid package for Iceland from the International Monetary Fund IMF. The commission released its report on 12 April

Chapter 9 : BBC NEWS | Business | Timeline: Credit crunch to downturn

Re: the credit CRUNCH! Oct 13, , PM Icelandic banks took risks far above what they could manage and in this way,they're like so many other banks in many www.nxgvision.com,the Icelandic people have to pay a big price for trusting the wrong people in their financial www.nxgvision.com/re contemplating Iceland or Norway next www.nxgvision.comme,I wish.

Subprime mortgage crisis The s were the decade of subprime borrowers; no longer was this a segment left to fringe lenders. The relaxing of credit lending standards by investment banks and commercial banks drove this about-face. Subprime did not become magically less risky; Wall Street just accepted this higher risk. However, as market power shifted from securitizers to originators and as intense competition from private securitizers undermined GSE power, mortgage standards declined and risky loans proliferated. US subprime lending expanded dramatically – As well as easy credit conditions, there is evidence that competitive pressures contributed to an increase in the amount of subprime lending during the years preceding the crisis. Major US investment banks and GSEs such as Fannie Mae played an important role in the expansion of lending, with GSEs eventually relaxing their standards to try to catch up with the private banks. Wallison [60] stated his belief that the roots of the financial crisis can be traced directly and primarily to affordable housing policies initiated by the US Department of Housing and Urban Development HUD in the s and to massive risky loan purchases by government-sponsored entities Fannie Mae and Freddie Mac. On September 10, , the House Financial Services Committee held a hearing at the urging of the administration to assess safety and soundness issues and to review a recent report by the Office of Federal Housing Enterprise Oversight OFHEO that had uncovered accounting discrepancies within the two entities. The majority of these were prime loans. To other analysts the delay between CRA rule changes in and the explosion of subprime lending is not surprising, and does not exonerate the CRA. They contend that there were two, connected causes to the crisis: Both causes had to be in place before the crisis could take place. In other words, bubbles in both markets developed even though only the residential market was affected by these potential causes. After researching the default of commercial loans during the financial crisis, Xudong An and Anthony B. Sanders reported in December Business journalist Kimberly Amadeo reported: Three years later, commercial real estate started feeling the effects. Gierach, a real estate attorney and CPA, wrote: In other words, the borrowers did not cause the loans to go bad, it was the economy. This ratio rose to 4. This pool of money had roughly doubled in size from to , yet the supply of relatively safe, income generating investments had not grown as fast. Investment banks on Wall Street answered this demand with products such as the mortgage-backed security and the collateralized debt obligation that were assigned safe ratings by the credit rating agencies. By approximately , the supply of mortgages originated at traditional lending standards had been exhausted, and continued strong demand began to drive down lending standards. This essentially places cash payments from multiple mortgages or other debt obligations into a single pool from which specific securities draw in a specific sequence of priority. Those securities first in line received investment-grade ratings from rating agencies. Securities with lower priority had lower credit ratings but theoretically a higher rate of return on the amount invested. During , lenders began foreclosure proceedings on nearly 1. From to , the Federal Reserve lowered the federal funds rate target from 6. Additional downward pressure on interest rates was created by the high and rising US current account deficit, which peaked along with the housing bubble in Federal Reserve chairman Ben Bernanke explained how trade deficits required the US to borrow money from abroad, in the process bidding up bond prices and lowering interest rates. Financing these deficits required the country to borrow large sums from abroad, much of it from countries running trade surpluses. These were mainly the emerging economies in Asia and oil-exporting nations. The balance of payments identity requires that a country such as the US running a current account deficit also have a capital account investment surplus of the same amount. Hence large and growing amounts of foreign funds capital flowed into the US to finance its imports. All of this created demand for various types of financial assets, raising the prices of those assets while lowering interest rates. Ben Bernanke has referred to this as a " saving glut ". Foreign governments supplied funds by purchasing Treasury

bonds and thus avoided much of the direct effect of the crisis. US households, on the other hand, used funds borrowed from foreigners to finance consumption or to bid up the prices of housing and financial assets. Financial institutions invested foreign funds in mortgage-backed securities. The Fed then raised the Fed funds rate significantly between July and July . By , many lenders dropped the required FICO score to , making it much easier to qualify for prime loans and making subprime lending a riskier business. Proof of income and assets were de-emphasized. Loans moved from full documentation to low documentation to no documentation. One subprime mortgage product that gained wide acceptance was the no income, no job, no asset verification required NINJA mortgage. Informally, these loans were aptly referred to as "liar loans" because they encouraged borrowers to be less than honest in the loan application process. Bowen III on events during his tenure as the Business Chief Underwriter for Correspondent Lending in the Consumer Lending Group for Citigroup where he was responsible for over professional underwriters suggests that by the final years of the US housing bubble , the collapse of mortgage underwriting standards was endemic. By contrast, private securitizers have been far less aggressive and less effective in recovering losses from originators on behalf of investors. Such loans were covered by very detailed contracts, and swapped for more expensive loan products on the day of closing. Countrywide, sued by California Attorney General Jerry Brown for "unfair business practices" and "false advertising", was making high cost mortgages "to homeowners with weak credit, adjustable rate mortgages ARMs that allowed homeowners to make interest-only payments". One Countrywide employee who would later plead guilty to two counts of wire fraud and spent 18 months in prison stated that, "If you had a pulse, we gave you a loan. Government policies and the subprime mortgage crisis A OECD study [] suggest that bank regulation based on the Basel accords encourage unconventional business practices and contributed to or even reinforced the financial crisis. In other cases, laws were changed or enforcement weakened in parts of the financial system. The repeal effectively removed the separation that previously existed between Wall Street investment banks and depository banks, providing a government stamp of approval for a universal risk-taking banking model. Investment banks such as Lehman would now be thrust into direct competition with commercial banks. Written by Congress with lobbying assistance from the financial industry, it banned the further regulation of the derivatives market. In , the US Securities and Exchange Commission relaxed the net capital rule , which enabled investment banks to substantially increase the level of debt they were taking on, fueling the growth in mortgage-backed securities supporting subprime mortgages. The SEC has conceded that self-regulation of investment banks contributed to the crisis. Regulators and accounting standard-setters allowed depository banks such as Citigroup to move significant amounts of assets and liabilities off-balance sheet into complex legal entities called structured investment vehicles , masking the weakness of the capital base of the firm or degree of leverage or risk taken. Derivatives such as credit default swaps CDS can be used to hedge or speculate against particular credit risks without necessarily owning the underlying debt instruments. Prior to the crisis, financial institutions became highly leveraged, increasing their appetite for risky investments and reducing their resilience in case of losses. Much of this leverage was achieved using complex financial instruments such as off-balance sheet securitization and derivatives, which made it difficult for creditors and regulators to monitor and try to reduce financial institution risk levels. US households and financial institutions became increasingly indebted or overleveraged during the years preceding the crisis. Changes in capital requirements, intended to keep US banks competitive with their European counterparts, allowed lower risk weightings for AAA securities. The shift from first-loss tranches to AAA tranches was seen by regulators as a risk reduction that compensated the higher leverage. Lehman Brothers went bankrupt and was liquidated , Bear Stearns and Merrill Lynch were sold at fire-sale prices, and Goldman Sachs and Morgan Stanley became commercial banks, subjecting themselves to more stringent regulation. With the exception of Lehman, these companies required or received government support. However, both Barclays and Bank of America ultimately declined to purchase the entire company.