ASSIGNMENT 03

Introduction to Macroeconomics

Course Code: ECO 102

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Sub-Prime Mortgage Crisis in US & the Effect

The subprime mortgage financial crisis, which has yet to be resolved, is the sharp rise in foreclosures in the subprime mortgage market that began in the United States in 2006 and became a global financial crisis in July 2007 and later extended to 2008. Rising interest rates increased the monthly payments on newly-popular adjustable rate mortgages and property values suffered declines from the demise of the United States housing bubble, leaving home owners unable to meet financial commitments and lenders without a means to recoup their losses. Many observers believe this has resulted in a severe credit crunch, threatening the solvency of a number of marginal private banks and other financial institutions.

The sharp rise in foreclosures after the housing bubble caused several major subprime mortgage lenders, such as New Century Financial Corporation, to shut down or file for bankruptcy, with some accused of actively encouraging fraudulent income inflation on loan applications, leading to the collapse of stock prices for many in the subprime mortgage industry, and drops in stock prices of some large lenders like Countrywide Financial.

This has been associated with declines in stock markets worldwide, several hedge funds becoming worthless, coordinated national bank interventions, contractions of retail profits, and bankruptcy of several mortgage lenders.

Reason for Ineffectiveness of Monetary Policy in a country like Bangladesh

Monetary policy is mostly effective in developed country where financial institution s like: banks, insurance, leasing firm, stock market etc. has influencing power in public life; people are well educated; financial infrastructure and rules are strong & protective; people have the access to information, communication technology, computing, internet and news. The degree of enlisting of public shares, rates of shares decide economic situation there. Effect of the policy is quicker because of fast knowledge spread, automation etc. As most of those factors like: strong and protective financial structure, automation, accessibility to information, computing, automated communication, news, education and internet etc. are absent Monetary policy is comparatively less effective in a country like Bangladesh.

Reason for Effectiveness of Fiscal Policy in a country like Bangladesh

Very shortly the reason of Fiscal Policy's effectiveness in a country like Bangladesh is: Monetary policy is ineffective here. Monetary policy could be more effective: if the financial infrastructures would strong enough; if banks, insurance and other financial organizations do have more capability to influence public life or if the communication technology like IT and computing have more public accessibility. As if none of them are strongly present here, comparatively fiscal policy is more effective here. Fiscal policy take long time to come to an effect because, before the fruit of fiscal policy reach to public's door, Fiscal Policy itself need to face lots of government's office; like: different ministries, TAX authority etc. offices. Another demerit is: it's politically unpopular. In fiscal policy if government decreases taxation it's hard to get fund from foreign donors or other external and internal sources or government need to go for loan to carry on government projects and business. On the other hand, if government raises taxation then government has the risk of losing popularity.