

Extra Feature Story

Financial Worries, Credit Crisis Are Felt Around the Globe

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As the financial crisis continued to have a ripple effect around the globe this week, U.S. stocks plummeted to five-year lows, affecting half of all Americans who have some sort of savings invested in stocks.

The bad market performance was caused by ongoing problems with banks and new predictions that the American car industry could collapse next year.

The domino effect of U.S. economic troubles has already reached overseas markets: Iceland is on the edge of bankruptcy, Japan's main stock index had its worst week in history and the International Monetary Fund predicted most countries will not have any economic growth at least until the middle of 2009.

The credit crunch

The cause of the current market crisis is lack of credit, meaning that banks and other lenders are not lending money because of fears that it will not be repaid.

Credit feeds the economy by enabling people and companies to borrow money or make up the difference until more cash flows in. Governments also borrow money, and banks borrow money from each other.

When banks are unable or unwilling to lend money, the normal flow of business slows down.

How the mess began

The root of the problem is the U.S. housing market. There are a massive number of bad home mortgages (loans), which has led to a complete loss of confidence in this market.

The housing market had a period of steady growth starting in 2000, during which housing prices were always going up and homes looked like great investments. More and more people took out housing loans, called mortgages, in order to purchase them.

Many banks and mortgage brokers gave loans to people for homes far out of their budget range. These types of loans are called "sub-prime" loans, and there were few regulations on lenders granting these loans.

Lenders add an interest charge -- usually an annual percentage of the value of the loan -- to the cost of a mortgage. Borrowers pay back the original loan plus interest.

Many sub-prime lenders took advantage of eager borrowers by issuing mortgages with interest rates that jumped to a higher percentage rate after a few years.

As long as home values continued to increase, people who had trouble paying their monthly mortgage bill could at least sell their homes at a profit and then pay off the loan.

But when the housing market cooled off and more homes were for sale than there were buyers, home values started going down. Mortgage holders who couldn't pay back their loans now couldn't sell their homes at their loan value.

When people can't make their monthly payment, they "default" on their loan and the lender takes ownership, or "forecloses" on, their house. Banks and lenders lost the interest revenue that would have come from those loans and now are stuck with a devalued home.

The investment banking collapse

The situation was made worse because many of these sub-prime loans were bundled together and then sold further up the chain to investment banks, drawing in more players.

Some of these investment banks borrowed lots of money to make these purchases and were then unable to pay that money back, causing some, like the investment bank Lehman Brothers, to collapse.

Because of so many failing banks and unpaid loans, money is "not flowing very much at all between banks and from banks to businesses" around the world, said National Public Radio's economics correspondent Adam Davidson.

Trying to help

Governments around the world have made efforts to relieve this credit crunch and get capital flowing again.

Congress passed a \$700 billion rescue package at the beginning of the month that gives the Treasury Department the power to buy up those bad mortgages and other bad assets held by troubled financial institutions.

The International Monetary Fund announced plans to launch an emergency-loan program for emerging markets in less developed nations.

On Wednesday, central banks around the world acted together to lower interest rates, hoping to encourage banks to lend, but the markets did not respond as positively as was hoped.

The Group of 7 will meet Friday, bringing together the top financial officers from the United States, Britain, France, Germany, Italy, Canada and Japan.

The pressure is on for these countries to find a global strategy to alleviate the current crisis and prevent more damage to the markets.

-- Compiled by Talea Miller for NewsHour Extra

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