

ASSIGNMENT: EE312 MACROECONOMIC THEORY

## **THE GREAT RECESSION OF 2008 (SUBPRIME CRISIS)**

This essay is starting with the background story of the 2008 global financial crisis which is caused by the sub-prime mortgage when all did not go according to plan. Next is the effect of the crisis on the Thai economy and how the government at that time, with the political issue, deals with those effects from the economics crash in USA.

Traditionally, if you have bad credits or do not have steady job, the opportunities that you will get the mortgage from the bank is low since the lender do not want to take the risk. It had changed in the 2000s when the investors in the US and abroad decided to invest in housing market because they think that it's low risk high return investment. The idea is that they will buy the mortgage since they can collect the interest from the borrowers, so it became the mortgage back-securities which promise the higher return and it seems like it is not risky at all. Many creditors company at that time gave the AAA rating a for this type of investment so people started to buy more and more securities. Moreover, the price of the house at that time is increasing and investor thought that even if the borrower defaults the mortgage, they could sell the house for more money, this is the reasons why they thought it was very safe to invest.

The issue started when lenders tried to create more mortgages by lowering the standard for rating the borrowers, as a result, they gave loans to the people with just enough income to pay off their debt. The idea is that they must pay for the house, otherwise, they will not have the roof over their head. This is called the "Sub-prime mortgages", or even worse, the "Predatory lending practice" which lends money to people without any verification so the investment became less safe but people still keep investing while lenders trying to create as much mortgages as they can. Moreover, the house is getting more and more expensive. But after that, the more and more borrowers are not able to pay off their debt or stop paying, leaving the tremendous amount of house for sale with no buyers. The result is that many sub-prime lenders lost the liquidity and getting stuck with bad loans, some of them had declared bankruptcy and financial institution stop buying sub-prime mortgages. As the result, the panic caused the crash in stock market and US economy suddenly collapse.

Thailand at that time, in 2008, was dealing with the political turmoil especially during when the People's Alliance for Democracy (PAD) seized the Government house and two major airports ( Suvarnabhumi and Don-Muang) causes great declined in tourism and other related industry since foreigners did not have confidence in safety, combining with the increase in crude oil price causes the exports to fell for the first time in 6 years.

The effect of the crisis is also affect the import and export of Thai economy, which took a big part (more than 70 percent) in Thai economy at that time and this sector has played significant role in the economic growth for several years. As the result, price and the quantity of total export and import drops tremendously by 3-8 percent in 2009. When combining both reasons made the unemployment rate skyrocketed and became a problem when consumer tend to buy less and less since they did not have job. As the result, the business need to cut back their production responding to less demand. Anyway, Export-oriented business would be affected the most since demand for goods in the export destination had declined significantly. The example of these industries are automobile and parts, electrical appliances and electronics.

Unlike many other countries, Thai had no serious bubbles in the real estate sectors. Moreover, Thai financial system after 1997 has been strengthen, this is another cushion against the global financial crisis at that time. The unemployed workers from the industrial sectors can be moved to agricultural sector since Thailand is one of the major agricultural countries.

For the monetary issued at that time is mostly deal with the interest rate, they increased the interest rate by 0.25 percent for many times and try to maintain it because they were afraid of the inflation. Moreover, Bank of Thailand also issued the regulations on foreign exchange, for example, limiting the amount of cash carrying in and out of the country, relaxation on exchange control regulations and purchase foreign currency that SMEs sold to financial institution. Finally, Central bank also have measures to prevent Thai baht speculation.

In conclusion, the sub-prime crisis started when the lenders gave loans without standards to the people that might be unable to pay off their debt since they thought that even if they default on the loan, they can sell the house. Everything went bad when most people stop paying their debt and financial institution and lenders went bankrupt. The effect on the Thai economy mostly affected on the export and import industries since the demand at the destination fell. Moreover, tourism and service sectors also be affected due to political unrest at that time. But the strong financial system and lessons from the 1997 financial crisis made the cushion against this crisis and soften the effect of the 2008 financial crisis.

Sources:

The sub-prime crisis

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