

Subprime Crisis

A Correspondent writes :

If the 2001 crisis was triggered by the bursting of the dotcom bubble, the present one takes a different form insofar as it was set off by subprime default. "It began in the US where the 'sub-prime' mortgage market—hefty housing loans to people with little or no regular income—began to flounder as the Federal Reserve raised interest rates and borrowers began to default on their repayment. Without this revenue coming in, the holders of this dodgy debt—the hedge funds, the banks—began to struggle to meet their other financial commitments".

This crisis isn't over yet. It demonstrates how this housing problem spread further afield : "Earlier this year ... US house prices started falling. Subprime lending had created a building boom, which in turn caused a property glut. Many of the low 'leaser' rates on subprime loans then began to expire. As borrowing costs spiralled, more and more Americans sank under their debts. Defaults rose and repossessed homes hit the market, driving prices even lower, so cash-strapped borrowers could no longer remortgage their way out of trouble. Little wonder a quarter of US subprime mortgages are now expected to end in tears". Debts at risk in America are thought to include not only some \$800bn of subprime debts (currently facing a default rate of 12.4%) but also some \$700 bn of 'All A' loans which have also become unmarketable even though the borrowers are "mid-tier" borrowers thought to be good credit risks, at least at the time the loans were made.

Bad debts of \$100 bn, enormous as they sound, are as nothing, however, compared to the vast sums likely to be lost as a result of the current crisis. The reason for this is that debt has become a commodity in the past few years to a far, far greater extent it ever was in the past.

"The sub-prime problem has caused panic beyond the US because, instead of holding loans on their balance sheets, lending banks have been offloading them to investors. In a global market for debt, financial institutions almost anywhere in the world could have taken on the risk of the loans in return for what seemed an attractive return."

As the Indian economic planners are increasingly following American style of business, the US subprime crisis is hitting Indian market too. The way Indian bankers, nationalised and private, are competing with each other in advancing loans, including housing loans, may trigger a crisis affecting the artificial market boom. Already the American sub-prime crisis has set in motion a chain reaction, particularly in third world economies in the area of export trade. □□□