**Federal Reserve and Government Intervention Program**

**The Housing Price Bubble, Collapse, Foreclosures, Bailout of Underwater Mortgages**

When the housing market collapsed, and stock prices plummeted in the United States, it sparked a financial crisis that lasted from 2007 to 2009. The primary cause of this catastrophe was that banks issued an excessive number of home mortgages without first assessing the borrowers' creditworthiness. Consequently, bad debts have skyrocketed, causing the housing bubble to burst (Hasbini, & Satterfield, 2018). As a result of a rise in the amount of money people could borrow to buy homes, the price of homes skyrocketed. When the housing bubble burst, borrowers' loans went wrong, causing the market to collapse.

Subprime mortgage crises of 2007–10 resulted from an earlier increase of mortgage lending, notably to borrowers who previously had difficulties securing mortgages, which both drove to and was helped by quickly increasing property values. Historically, homeowners with poor credit histories, minimal down payments, or exorbitant loan installments could not get mortgages. Lenders often turned down these mortgage requests unless they were covered by government insurance. Although the Federal Housing Administration (FHA) provided small-sized mortgages to specific high-risk households, others had no choice except to rent. A high degree of homeownership in that century, low mortgage foreclosure rates, and changes in mortgage rates and income drove home building and house values.

During the beginning and mid-2000s, lenders began offering investors high-risk mortgages by repackaging mortgages and selling them in pools. Private-label mortgage-backed securities (PMBS) provided most of the financing for subprime mortgages via new financial instruments. Insuring them with financial innovations or relying on other securities to handle any liabilities on the underlying mortgages made the less sensitive assets seem low-risk (Hasbini, & Satterfield, 2018). As a result, an increase in the number of first-time homebuyers was possible.

House prices rose due to the increased demand, mostly in areas where housing was in short supply. Expectations of even higher price increases fueled a rise in demand and prices for hous. Rising housing prices shielded PMBS buyers from initial losses, which was a win-win situation for everyone involved. Borrowers at great danger of defaulting on their mortgages had two options: sell the house for a profit and pay off the debt, or borrow more against rising market values. Because of the relative rarity of such times of increasing property values and greater mortgage availability, as well as the lack of long-term testing of new mortgage products, the riskiness of PMBS may have been underestimated. The risk was "off the radar" at the time because most of the measures of mortgage loan quality were centered on prime instead of new mortgage products.

As a result of the rise in housing values, mortgage refinancing and the sale of property became less appealing alternatives for paying off debt. As a result, the exposure of lenders and investors to the risk of mortgage failure grew. In April of 2007, the subprime mortgage lender New Century Financial Corporation submitted a petition to the bankruptcy court. As soon as PMBS and PMBS-backed assets were evaluated, it became clear that they carried a significant level of risk; thus, a large number of subprime lenders went out of business (Hasbini, & Satterfield, 2018). Because of the failure of bond financing for subprime mortgages, lenders ceased making riskier loans of any kind, including subprime and nonprime loans. As a consequence of this, there was a decline in the demand for housing, which resulted in a decrease in home values, which fuelled anxieties of potential future losses and led to an even greater decrease in the demand for dwellings. Despite having made sizeable down payments on their homes, homeowners in financial distress were unable to sell their residences at a price that would allow them to pay off their mortgages.

As a direct consequence of this, in the summer of 2008, the federal government took control of two corporations that were supported by the government: Fannie Mae and Freddie Mac. Prior to the onset of the financial crisis, Fannie Mae and Freddie Mac had both extended loans in order to finance the purchase of subprime mortgage-backed securities, which ultimately lost their value. The two government businesses also suffered losses on failing prime mortgages that had been acquired, insured, and packaged into securities backed by mortgage loans. These faulty prime mortgages had been bundled into securities.

**One Corrective Action Taken by the Fed: Quantitative Easing.**

Quantitative easing is just adding more money to the economy's money supply, indicating that the money supply is expanding. It is a reflection of the monetary policy of expansion (Holcombe, 2028). The Federal Reserve used open market purchases of government assets to raise the money supply. Commercial banks are paid for the government securities they purchase under this arrangement. Commercial banks utilize the money they acquire to lend to the general public, allowing them to buy more products and services with the additional funds they now possess.

In addition, this open market acquisition will lower interest rates in financial markets. The price of bonds will rise as more people buy them on the open market, reflecting an increase in their consumption. Since the interest rate is inversely proportional to the price of a bond, the interest rate will reduce over time. Businesses will be more interested in borrowing money if interest rates drop. In this way, the financial sector can assist in the recovery of the overall economy. To avoid another economic catastrophe, the Federal Reserve has strengthened financial system transparency by exerting more supervision over U.S. commercial banks.

**Government Intervention**

There has been much discussion in the economics community over the appropriate level of government involvement in the economy. Because of this, according to free-market thinkers, government participation should be maintained to a minimum. However, there are many who feel that government intervention is important in a number of areas, including externalities and monopolistic power. Economic growth is poorer during recessions because of the substantial decrease in private sector spending and investment (Kehoe & Pastorino, 2018). Economic growth and confidence take a major dip as a consequence of the government's decision to decrease costs. A severe recession may need borrowing money from the private industry to recruit jobless resources. In the event of a financial crisis, the Central Bank or the Government may be forced to create money. To avoid a credit and economic boom, the government may have no choice but to act.

Fiscal policy, according to Keynesian economists, may have a favorable impact on the economy. Monetarists think that monetary policy may assist in stabilizing the economy, although an independent Central Bank may not be deemed government involvement. On the other hand, opponents of government action claim that it makes things worse. Government assistance to industry, as one example, may foster the survival of less productive businesses. Moral hazard may be created if governments bail out banks, which may lead to banks having less motivation to avoid bankruptcy in the future Theoreticians of actual economic cycles, on the other hand, contend that although government involvement might shorten the duration of the downturn, it can also exacerbate existing issues, such as the growth of public debt (Kehoe & Pastorino, 2018). There isn't a real-world example of how a society can function without the state's involvement. The form must protect property rights and defense expenditures even among hardline libertarian economists. It is a discussion over how far the government should get involved. To this end, every facet of government action must include this principle. The following is an example of government intervention.

**Counter-cyclical fiscal policies (countering economic disruptions such as the housing bubble and the Great Recession)**

During the worse periods of financial crisis and recession, governments worldwide began taking steps to boost economic growth. Many countries, including the United States, have implemented fiscal stimulus plans that employ a variety of government expenditure reduction combinations. The American Recovery and Reinvestment Act of 2009 and the Economic Stimulus Act of 2008 were part of these efforts. The Federal Reserve used many unconventional approaches as it dealt with the crisis. It began by lowering the federal funds rate from five percent in September 2007 to 0-0.26 percent in December 2008, with the bulk of the decline coming from January to March 2008 and from September to December 2008, respectively. Over those times, there was a considerable decline in the economy's outlook and heightened risks to both production and inflation.

In December 2008, when the federal funds rate was at its actual lower limit, the FOMC began using its policy statement to give future direction for the federal funds rate. This was done when the federal funds rate was at its lowest possible level. In the wording that was utilized by the Board of Governors, phrases such as "for some time" and "for a lengthy period of time" were stated (Lowery, 2021). The purpose of this guideline was to boost the economy by lowering interest rates, increasing inflation expectations (or decreasing deflationary expectations), and lowering accurate interest rates.

In light of the slow and uncertain recovery from the Great Recession, "Low Rates of Resource Utilization, Restrained Inflation Trends, and Stable Inflation Expectations" were added as explicit requirements to the forward guidance. This was done in order to ensure that inflation expectations remain stable according to the Board of Governors 2009b (Lowery, 2021). The explicit schedule guidance of "deficient levels for the federal funds rate at least through mid-2013" was followed in August 2011 by institutional guidelines for uplifting the reserve ratio from its zero lower bound, with the threshold values based on the unemployment rate and inflationary conditions. These guidelines were implemented in response to the fact that the explicit calendar guidance had been implemented (Board of Governors 2012). An extension of this forward direction may be understood to be the traditional technique that the Federal Reserve uses to influence the current and future direction of the federal funds rate.

In 2013, the unemployment rate was 7.3% and real GDP barely increased by 4.5%. Federal Reserve's monetary policy strategy developed during the period when the federal funds rate was at zero. Following the Great Recession, the Fed initiated LSAP initiatives, including a $600 billion acquisition program in 2010-11 (commonly referred to as QE2) and an outcome-based purchase program in September 2012 (Lowery, 2021). As a result of the Great Recession, there has been an increased focus on regulatory reform and financial stability as well as the economic repercussions of the European sovereign debt crisis, and the limited expectations for the global economy in 2013.

**References**

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