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Prohlašuji, že jsem bakalářskou práci na téma

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podpis autorky

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II. Introduction

The word crisis is heard every day, in the newspaper, on TV, radio, in people's everyday conversation, we are constantly being reminded of what kind of "crisis" we are in. All of us are directly or indirectly affected by the consequences that financial crisis had caused. It is important, as individuals know the absolute most about it in order to prepare for the future or minimize the damage. This well-known crisis, also known as the global financial crisis, started prominently at the end of summer 2007, when the powerful bank Bear Stearns went bankrupt, and for the rest of the year the economic markets went down despite all efforts the government made to stop it. It resulted in the threat of total collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world¹. Today, it is generally considered to be the biggest crash since the Great Depression in the thirties of the last century. Since 2007 the crisis has spread into every corner of the world and influenced each sector of government politics, etc. People are touched by the consequences caused by this crisis every day and as of today, all markets are in the position of great stagnation. Some of the leading experts predict the markets can go even lower, which makes the situation even more frightening.

At first, I wanted to write about the financial crisis in the context of the EU, but with time I thought it would be much more interesting to compare two continents. The continent where it started, and with the Europe. While writing the thesis I decided to focus particularly on the United States compared to the Czech Republic.

¹ Online encyclopedia Wikipedia [Cit. 2013-04-20 at 10:55 am] last updated in October 2012 available at http://en.wikipedia.org/wiki/Financial_crisis_%282007%E2%80%93present%29

My bachelor thesis is divided into five main sections. The reasons of the crisis, followed by the consequences in general, are described in the first part of my work. The most important terms, which occur throughout the text, are found at the very beginning as well.

The explanation of the unknown terms before the very beginning, help the ordinary reader can get a rough understanding. After I analyzed the reasons of the crisis followed with the background and short summary.

The second part talks about the world's recession and its influence on the world economy.

The third part orients on the current situation and impacts on the Czech Republic and the United States. The changes that both governments made to improve their economical situation. Where do they make efforts to support the business and where they save it. This crisis is most likely not the deepest crisis in the history, but it definitely brought the biggest changes in the mind of society.

The fourth part is fully practical. It shows results of my own research casting light on the impacts for an ordinary people in reality. Basically I did a research, made up questions and consequently analyze them. The conclusion is found at the last page. Financial crisis of 2007

II.1. Important terms

To fully understand the content of my bachelor thesis, it is essential to understand all specific economical term which occur throughout the text.

Financial crisis

A situation in which widespread assets suddenly lose their value. Financial crises often result in recessions. Recently, financial crisis around the globe have started to appear more frequently in the past decades, for example: Asian financial crisis (1997), financial crisis in Mexico (1994) or the Icelandic financial crisis (2008), all critical situation

demanding a solution. The implements for rescuing the economy can be reelecting the government, changing the market, outbreak of war and many others.

Liquidity

Liquidity is the ability of a company or a debtor to meet obligations immediately. "Liquidity degree of individual assets is given by their ability to be converted into disposable funds". Cash is the most liquid form of payment, real estate and goods on stock are regarded to be the least liquid.

Mortgage

A right of lien for real estate loans, a form of credit securing. In case a debtor does not pay the debt in time, a bank owns the right to confiscate the house and afterwards sell it, as it is stated in the contract. The contract expires when the debt is settled.²

Rating

Rating is a marking system of debt securities (bonds, debentures, notes) by bond rating agencies on the basis of the issuer's financial stability, earnings record, creditworthiness, etc. It is designed to inform interested parties who would need to know a history of an individual's credit history. The ratings are given to large-scale borrowers (companies or governments) and are an indication to the buyers how likely they are to be paid back. "It can also affect the amount that companies or government are charged to borrow money. If a country is deemed to have suffered a downturn in fortunes and its rating is lowered, investors may demand

² FIALOVÁ, Helena a Jan FIALA. *Ekonomický výkladový slovník: [kompletní přehledná příručka pro studium a manažerskou praxi]*. 9. aktualiz. vyd. Praha: A plus, 2011. 194 s. ISBN 978-809-0380-455.

higher returns to lend to it, as it is judged a riskier bet.”³ Rating agencies must be independent and credible. The most famous rating agency is Standard & Poor s. It is an American company, but earned a reputation of being highly reliable all around the world. With regard to the assessment grading, the rating agencies give appropriate marks to each company (e.g. AAA as the top mark and CCC being the worst one).⁴

Insolvency

“A debtor's inability to pay. Inability to meet one's obligations being due. It can reflect debtor's overindebtedness or time discrepancy between incomes and expenses. An insolvent company or person can be brought to bankruptcy by a relevant legal procedure.”⁵

Banking system

System of banking institutions dealing with bank operations. There is usually a two-stage bank system, which represents the central bank together with the commercial banks. A central bank is appointed by the government.⁶

Subprime mortgage

“Subprime mortgages” is a definition for loans, which are given to people who may not be able to pay the loan back (also called non-liquidity customers). Typically, subprime loans are for people with blemished or

³ The British Broadcasting Corporation webpage [online] [Cit. 2013-04-20 at 10:55 am] last updated on 25. February 2013 available at www.bbc.co.uk

⁴ The British Broadcasting Corporation webpage [online] [Cit. 2013-04-20 at 10:55 am] last updated on 25. February 2013 available at www.bbc.co.uk

⁵ DOWNES, John. *Dictionary of finance and investment terms*. 7th ed. Hauppauge: Barron's, c2006. viii, 832 s. ISBN 978-0-7641-3416-6

⁶ FIALOVÁ, Helena a Jan FIALA. *Ekonomický výkladový slovník* 9. aktualiz. vyd. Praha: A plus, 2011. 194 s. ISBN 978-809-0380-455.

limited credit histories. These loans contain a higher rate of interest with less favourable conditions than prime loans, which compensates for increased risk.

Prime loan

By contrast the prime loan stands for a loan to a borrower who is regarded as being highly creditworthy, has no obvious financial difficulties and a good payment record, and is therefore very likely to repay the loan. Generally bank best costumers consist of large corporations.⁷

Federal Reserve System (FED)

Federal Reserve System, better known as the FED, is the central banking system of the United States. It was founded in 1913 by Congress, which intended to eliminate the severe financial crisis that had hit the American economy. The FED has both private and public components, and was designed to serve the interests of both the general public and private bankers. The structure is based on 12 regional reserve banks supervised by the Federal Reserve Board. It conducts supervision of the nation's banking system and ensuring the health of the banking system. It also performs to maintain the American economy stable and control the inflation.⁸ „For the federal government, the Reserve Banks act as fiscal agents, paying Treasury checks; processing electronic payments; and issuing, transferring, and redeeming government securities.“ Until 2012 the FED used to be strongly criticized for its non-transparency.

⁷ DOWNES, John. *Dictionary of finance and investment terms*. 7th ed. Hauppauge: Barron's, c2006. viii, 832 s. ISBN 978-0-7641-3416-6

⁸ Federal Reserve Systém [online] [Cit. 2013-04-16 at 12:02 am] last updated on 3. March 2013 available at www.federalreserve.gov

Investment bank

It is a financial institution that assists individuals, corporations, and government in raising capital by underwriting and acting as the client's agent in the issuance of securities.”⁹

Gross domestic product (GDP)

The gross domestic product is one of the macroeconomic indicators measuring the overall production performance of the economy. It is the total market value of all final goods and services produced within a country during some period, usually one year, expressed in monetary units. ¹⁰The GDP is measure by national government statistical agency and mirrors the country's standard of living.

II.2. The subprime mortgage crisis

Every action has its own reasons and impacts, but providing mortgages to people with no liquidity brought the whole world in trouble. It all started with so called “subprime mortgages”, as I already mentioned.

One of the reasons of the crisis breakout is undoubtedly the Community Reinvestment Act (CRA), enforced by Parlaiment in 1977. The Act requires that deposit-taking financial institutions offer equal access to lending, investments and services. Before the CRA, many bankers excluded low-income neighborhoods and people of color from their lending products, investment, and financial services – a practice known as “redlining”. This term was coined by the community activists, when they discovered the failure of banks to offer loans in low-income neighborhoods. This denial of loans was so geographically distinct, that it

⁹ Online encyclopedia Wikipedia [online] [Cit. 2013-04-20 at 11:23 am] available at www.en.wikipedia.org/wiki/Investment_banking

¹⁰ FIALOVÁ, Helena a Jan FIALA. *Ekonomický výkladový slovník* 9. aktualiz. vyd. Praha: A plus, 2011. 194 s. ISBN 978-809-0380-455.

was easy to draw red lines on maps to mark the “bad” areas. The CRA encouraged the stop of all the discrimination towards immigrants in the United States. Banks were indirectly pushed into providing money to customers without a steady income or title deeds. Households began to purchase solely on debt, and the financial institutions were allowing it to happen. One sector where consumers spent their money was on consumer goods, such as cars, electronic devices, etc. The other sector was the real estate market. The low mortgage rates sank to the absolute bottom. The mentioned subprime mortgages were provided to anyone, but what were the advantages? The low rates were steady only for first few years, but after, the bank has the right to increase their rates. These loans were actually not as favorable as they were supposed to be. Hispanics, Asians and Afro-Americans who migrated to the USA often did not know the language properly or were less educated. The majority of them did not read the “fine print,” but these notes are usually the most important and the banks took advantage of their lack of language acknowledgment. If those people read the under-line notes, they would learn banks can increase their rates anytime they want. Housing costs lots of money in the U.S., according to the *National Association of Realtors* in 2011 only 33 percent of all home buyers in the U.S. population can afford purchasing a new house by paying in cash.¹¹ Among this 33 percent, are investors, wealthy individuals, and also many of the purchasers had possession of such a large amount of capital due to the fact they had recently sold their former home, so 33 percent seen higher than it should have been. The rest of population lacking this kind of capital did not have other option than applying for a loan.¹² So people were blinded by the well

¹¹ National association of realtors [online] [Cit. 2013-04-11 at 2:10 pm] available at www.realtor.org

¹² U.S. Department of Housing and Urban Development [online] [Cit. 2013-04-11 at 2:13 pm] available at _____ at

known “american dream” of having a big house and rushed frivolously into its purchase. While the prices for commodities kept climbing upward, more and more risky mortgages began to emerge. Editor of *Left Business Observer* Dough Henwood wrote on weekly magazine *The Nation*:

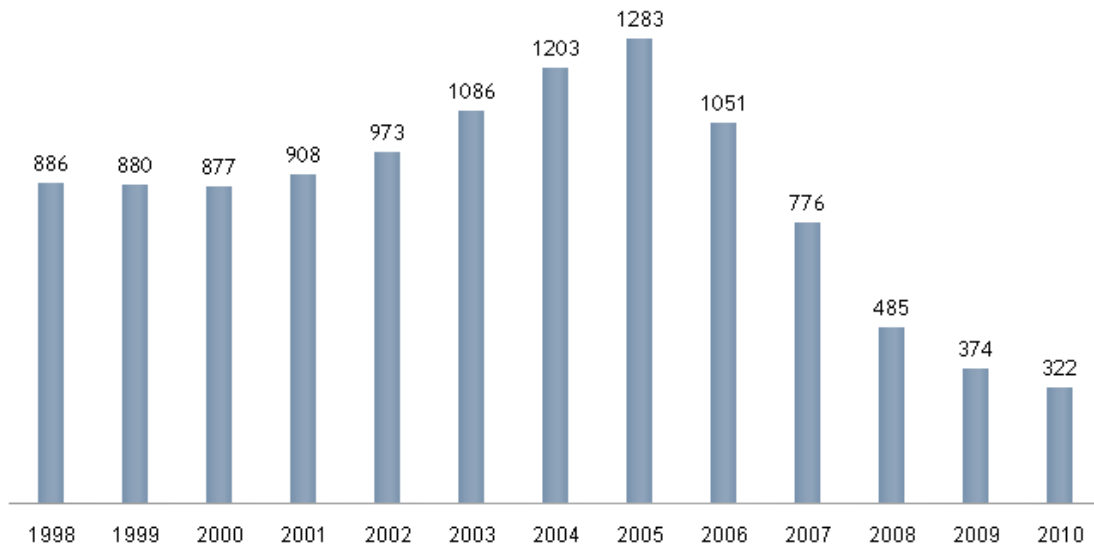
“There used to be times, when a person applying for a mortgage had to put down a substantial deposit at first, but this is the past. In the year 2005 an average applier for purchasing a house was required to make a down payment of 2 percent of the total sum of the house and 43 percent appliers didn’t even make down any money.”¹³ (translated from Czech into English by author of this thesis)

As we can see from the graph below, until 2000 the market stayed stable. The amount of mortgages corresponded with the amount of the growth of American population. There was just a slight difference between each year. After 2000 the number of purchasing houses rapidly grew. From 2000-2005 the amount of sold houses jumped up, which was mainly caused due to the easy accessibility of getting a mortgage. The year 2005 symbolizes the peak of purchased homes. Between years 2001-2005 the number of sold houses inflated to 9 percent, while the population grew only 1 percent .The rapid downward started after 2005. One of the reasons of this was the overestimated price for houses.

www.portal.hud.gov./hudportal/HUS?src=/program_office/fair_housing_equal_opp/lending/subprime

¹³ FOSTER, John Bellamy a Fred MAGDOFF. *Velká finanční krize: příčiny a následky*. 1. české vyd. Všeň: Grimmus, c2009. 156 s. Ekonomie (Grimmus). ISBN 978-80-902831-1-4.

Graph number 1: The number of purchasing new houses in USA



Source: Euroekonom (online) available at <http://www.euroekonom.cz/grafy-svet-data.php?type=usa-prodanedomy-rok>

Another reason for the decreasing number of provided mortgages was the fact, that in 2004 the Federal Reserve System (so called FED), increased the basic interest rate from one to three percent, and the next year the rise went up to a record four percent. This step strongly influenced the demand for mortgages, and in 2006 the market monitored the decline in closed contract of sale.

By increasing the basic interest rates, the poorest of customer started immediately having difficulties to pay off their monthly installment. The debtors were left with two options.

They could either move out, let the bank to confiscate their house and try to sell it, or continue with paying their monthly payments even though many of them took another loan at another financial institution. The so called "second mortgage" covers the prime mortgage, also called the first mortgage, in the case of default. They guarantee that the prime mortgage will get pay off.¹⁴ Unfortunately soon or later after not paying a few

¹⁴ FOSTER, John Bellamy a Fred MAGDOFF. *Velká finanční krize: příčiny a následky*. 1. české vyd. Všeň: Grimmus, c2009. 156 s. Ekonomie (Grimmus). ISBN 978-80-902831-1-4.

monthly repayments, the banks were allowed to confiscate the houses and try to sell them. The real estate market became overinflated with new houses for sale. In this situation, when the debtor is not able to pay their debt, the bank forecloses on the mortgaged property and covers their costs by selling the house. This principle works at a balanced market, but with a surplus of commodities banks started having difficulties selling the houses and cover their losses. They could no longer produce a profit.

Graph number 2: Time for selling a house (months)

Source Euroekonom (online) available at <http://www.euroekonom.cz/grafy-svet-data.php?type=usa-dobaprodejedomu-rok> Graph number two provides the figures of the average time it takes to sell a home, starting with the late 90's. From 2004 to 2008, the average time it took rose from four to over eleven months.

The third reason behind the crisis outbreak were the real estate brokers. It has been revealed throughout the years they did not bear any responsibility for their closed contracts. American real estate brokers are paid according to the number of contracts they close every month, so it is obvious they tried to close as many contracts as possible, no matter what it could cause in the future. Many of them certainly had to anticipate, some of their clients may not be able to meet liabilities to the bank. Brokers with the vision of higher bonuses kept striking a deal no matter what, and the crisis continued to expand.

II.3. Fannie Mae and Freddie Mac

These two abbreviations stand for Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac). Both names bear the word "national", which shows the establishment is a part of the American government. Fannie Mae and

Freddie Mac are loan agencies. They aimed to encourage the housing market by providing affordable housing. Fannie Mae was founded in 1938 during the Great Depression as part of the New Deal.¹⁵ This corporation borrowed money from domestic and foreign investors and subsequently rendered to banks. The profit was gained from the difference between the interest the bank provided money for and the interest the bank borrowed money.

In 1968 the government created Freddie Mac as the competitor to Fannie Mac in order to prevent monopoly over the mortgage market. These corporations had already expected difficulties in the 80', when the United States broke out in a banking crisis. These government-sponsored corporations represent an irreplaceable role to the real estate market because of the large number acting for approximately 40 percent issued mortgage contracts. Their objective is to provide enough liquidity in the nation's mortgage finance system. The giants purchased loans from private banks, who then transform these loans into mortgage-backed securities, and guarantee the timely payment to outside investors. This puts all responsibility on the bank's shoulders, and since a bank does not have to worry about holding these credits on „their balance sheets, they have more capital available to give out loans to other creditworthy borrowers.“¹⁶ What made the mortgages a particularly attractive investment was the fact, Fannie Mac and Freddie Mac overtook the responsibility in the event of default. The investors did not have to worry about credit risk and since both corporations provided these loans they became vulnerable. Both of them were deeply rooted in the risk of

¹⁵ *Financial and economic crisis: causes, consequences and the future.* Ed. 1st. Bučovice: Martin Stříž, 2011. 277 s. ISBN 978-80-87106-45-7.

¹⁶Center for American Progress [online] [Cit. 2013-04-11 at 2:13 pm] available at <http://www.americanprogress.org/issues/housing/report/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/> by Kristina Costa last updated on April 18, 2010,

subprime mortgages moreover making bad business decisions after the housing crisis in 2007. The companies began to show insufficient capital. Also, unlike most private investment firms, Fannie and Freddie had only one line of business (residential mortgage finance). This means the companies did not have other forms of an income source to for their loses when home prices began to fall. The size and the interconnection with the market made the U.S. government come rushing to help.

Experts agree, if the government did not create Fannie Mae and Freddie Mac, the housing collapse would go even further. The move is positively perceived by the economists but not by the taxpayers. After all it was them, who have yet to pay the bailout in total of a 137 billion dollars (this figure might go up to 200 billion dollar by the end of 2015) without being given much to say.¹⁷ There is a good message for them, in 2012 the government-sponsored enterprises had net incomes of 17,2 (Fannie Mae)¹⁸ and 16.8 (Freddie Mac)¹⁹ billion dollars. Hopefully this is the sign of a stable recovery.

II.4. Bear Stearns and Lehman Brothers

These two names represent investment banks, whose decline cause severe damage and caused confusion in the world market in 2008. Both became victims of the financial crisis, but there are also reports of

¹⁷ The New York Times [online] [Cit. 2013-04-11 at 2:13 pm] available at http://www.nytimes.com/2013/03/24/business/fannie-mae-freddie-mac-and-the-same-old-song.html?pagewanted=all&_r=0

¹⁸ Centre for American Progress [online] [Cit. 2013-04-11 at 2:13 pm] available at <http://www.americanprogress.org/issues/housing/report/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/>

¹⁹ Centre for American Progress [online] [Cit. 2013-04-11 at 2:42 pm] <http://www.americanprogress.org/issues/housing/report/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/>

mismanagement within the company and bad economic decisions. The firms were headquartered in New York City, but well known globally.

“With the collapse of the housing market, Bear began facing very dramatic financial travails in June 2007: the firm announced that two of its hedge funds were significantly invested in subprime mortgages were in trouble”. “In March 2008, Bear Stearns, the nation’s fifth largest investment banking firm, was battered by what its officials described as sudden liquidity squeeze related to its large exposure to devaluated mortgage-backed securities.”²⁰ The cost of debt surpassed the profit from investments and the bank simply lacked the cash and could not meet its commitments. The bank became on the edge of bankruptcy.

The high possibility of Bear Stearns going bankrupt caused a great panic and concerns around the global market. At this point the FED appeared at the scene. The government of the United States decided to support this company and gave it a helping hand.

In March 2008, the Federal Reserve System provided an emergency loan to try to avert a sudden collapse of Bear Stearns. Unfortunately the company could not have been saved. The FED made a decision of selling Bears shares to JP Morgan Chase, one of the major commercial banks. JP Morgan Chase agreed on buying the shares for the price of 2 dollars per share, even though its pre-crisis value was around 55 dollars per share, and it saved the company.

Another bank which got into financial difficulties, was Lehman Brother. This bank was known as one of the most successful American investment banks ever, therefore its bankruptcy created widespread panic all over the world. Lehman declared its insolvency on 15. September 2008. (This was actually the second potential fall in the history of the bank. The first crisis

²⁰ The New York Times [online] [Cit. 2013-04-11 at 2:51 pm] available at www.nytimes.com/2008/06/30/what-really-killed-bear-stearns

hit the bank in 1984, but was saved by American Express group). At that point of time the bank disposed of 30 billion dollars, but its assets were estimated for incredible 600 billion dollars. The company invested a giant sum in the subprime mortgage market, but Lehman was also rumored to get into financial difficulties due to its mismanagement. The top management (former head chief officer Richard Fuls, vice-president Ian Lowitt and chief executive officer Christopher O'mearra) are blamed for manipulating the audit and annual reports about the bank's situation. Basically, they were lying about the amounts that were coming in and out of the company.

The American government was expected to save Lehman Brothers as they saved Bear Stearns. In this case the Federal Reserve System made the decision that Lehman Brothers importance does not reach the importance of Bear Stearns, and its fall will not threaten the American economy. Another reason for letting the bank go bankrupt was the unwillingness to pump more taxpayer's money in banks-rescue. This decision had very negative consequences. After letting Lehman Brother fall, American public began to believe in the total collapse of the banking system. The American government did not seem to have this troublesome situation under control.

II.5. Globalization

Globalization is also known as one of the reasons of the crisis breakout. As the banks all over the world began to be linked and interconnected with each other, the mistrust in the global market caused banks to stop trusting each other. Banks did not know, which of them is involved in the subprime mortgages or what bank afflicted the financial difficulties. There were cooperation between banks on a daily basis, but banks tried to avoid this afterwards. The market suddenly appeared to lack liquidity. The necessary reaction of central banks (FED, Bank of England,..) were so

called “emergency loans”. Banks would obtain these loans after applying and proving its short-term lack of liquidity. The emergency loans solved the problem of lack of liquidity. But on the other hand, a bank applying for such a loan was perceived as a bank with serious financial difficulties. Other banks stopped to cooperate with it and even big European banks got into bad ways. Famous bank Northern Rock could be used as an example. Even though this bank belonged to the “healthy” banks, it got in troubles. The problem was that apart from other mortgage banks, Northern Rock did not derived money from the client's deposits, but used the form of short-term shares. Almost 73 percent of the bank's financial needs were financed through this way. When this market “ran dry” Northern Rock ended up at the edge of existence. At the end of September 2007, crowds gathered in front of the bank demanding their money. ²¹This phenomenon is called “bank run”. It happens when a large number of customers suddenly withdraw their deposits because they believe that the financial institution is, or might become, insolvent.²²

September of 2007 could be considered as the real beginning of the financial crisis, because the crisis spread from America into Europe. The mortgage crisis itself would never make such damage if there was no globalization.

II.6. Summary

The content of the previous section was to briefly described on the following page. There were many reasons causing the financial crisis. None of them could harm the global economy itself, but the mixture of all of them together helped create the major crisis we are in today.

²¹ KOHOUT, Pavel. *Finance po krizi: důsledky hospodářské recese a co bude dál*. 2., rozš. vyd. Praha: Grada, 2010. 266 s. Finanční trhy a instituce. ISBN 978-80-247-3583-2.

²² Online encyclopedia Wikipedia [Cit. 2013-04-20 at 8:45 am] http://en.wikipedia.org/wiki/Bank_run

The biggest responsibility probably points to the Federal Reserve System, which should have foreseen the coming threat. Not only did they the basic rates too low for too long, but also not saving Lehman Brothers (the fourth biggest investment bank), caused an alarming panic within the market.

Another culprit is the banking system. How was it possible to get a loan without proper verification from the applier's financial situation? How was it possible, that brokers were paid according to the number of contracts they closed? Is it not obvious they would try to sell as many homes as possible in order to see personal profit? Over 95 percent of submitted applications were based on false figures about his/her income.

Globalization also played an important role. As mentioned, globalization does not only bring positives but it has also its negatives. If the bank did not cooperate with each other globally, the market would not be this vulnerable. Most likely, the crisis would remain in the United States and with time would have been suppressed.

We can point fingers at who is to blame, but it all leads back to the most natural yet overlooked reason, human mentality. People's greedy personalities simply wanted more and more, with no regards to the consequences. They purchased on debts houses, cars, holidays or kitchen appliances. This raises the question, how would the economic situation be if society was aware of correctly managing their finances? No surprise governments nowadays are talking about implementing financial education at schools.

2. The threat of recession

Where is the border between crisis and recession? What are their differences? These questions will be answered in the following section.

In 2007, there already appeared to be questions and concerns about a possible recession. These thoughts became justifiable. The difference between crisis and recession is that a financial crisis is not such serious phenomenon. A financial crisis comprises of “market crashes, bursting housing bubbles, currency crisis or sovereign defaults.”²³ The financial crisis causes panic in the market, but does not result in big changes in the real economy, although it could trigger the recession. At this point people fear the possibility of a recession or worse, a depression. Economic recession is a part of a business cycle (there are four stages in the cycle: boom, recession, depression and expansion), when the economy monitors slowdown. The macroeconomics indicators such as gross domestic product (GDP), employment (in 2008 lost 16 000 employees their jobs), business orders decline, capacity utilization, household income, business profits, and inflation fall, while bankruptcies and the unemployment rate rise“.

²³ FOSTER, John Bellamy a Fred MAGDOFF. *Velká finanční krize: příčiny a následky*. 1. české vyd. Všeň: Grimmus, c2009. 156 s. Ekonomie (Grimmus). ISBN 978-80-902831-1-4.

FOSTER, John Bellamy a Fred MAGDOFF. *Velká finanční krize: příčiny a následky*. 1. české vyd. Všeň: Grimmus, c2009. 156 s. Ekonomie (Grimmus). ISBN 978-80-902831-1-4.

In the year 2009 President Obama and his team of economic experts prepared a plan appropriating 775 billion dollars into the American economy. At the time, these economists thought this would help cure the problem, but this “injunction” did not bring any recovery. In an article of America's daily report webpage *Economy in Crisis* was stated:

“As the Treasury and Federal Reserve began pouring hundreds of billions of dollars into the financial market in the final quarter of 2008, there were many who worried these actions would result in inflation.”²⁴

Time will tell whether this measurement taken will ultimately be the right move. Anyway, in order for the government to be able to finance its costs (such as educational system, infrastructure, health service, army,.), they have to borrow money due to lack the lack money they already released into circulation. In the current situation companies and individuals suffer from the difficulties to get a loan, which is one of the main reasons of recession. But if governments all over the world keep borrowing more and more, the classical effect of displacing the private debts with national debt.²⁵ Even though the efforts initially intended to be helpful at the beginning, after some time society viewed it as worsening the situation. If we look at it from the point of responsibility, the national debt is worse than private debt. It is sad that the people managing their finances responsibly bear the burden (charge) together with the frivolous society. The only good thing about recession is that it cures inflation. The politicians, who control the state budget, fear getting deeper in the recession. They usually try to stimulate the economy through lowering taxes, spending on social programs and ignoring the national deficit.

²⁴ www.economyincrisis.org/the-new-depression

²⁵ available at <http://useconomy.about.com/od/grossdomesticproduct/f/Recession.htm> by Kimberly Amadeo last updated June 30, 2011

When a central bank has the option to choose between preventing the banking crisis and abiding the goals of lowering or stimulating inflation, naturally bank chooses the crisis prevention. This is the story, how the U.S. debt breached a record 16 trillion dollar in 2012²⁶

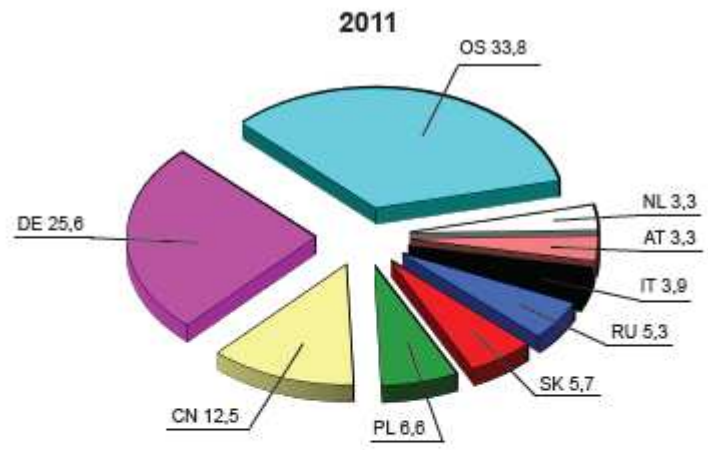
III. 3. Impacts on the Czech and U.S. economy

III.1. 3.1 Situation in the Czech Republic

The crisis in the Czech Republic did not strike the banking system as bad as other EU countries, but seriously harmed the states with the voluminous import of Czech goods and services. The Czech economy is a small, open economy strongly dependent on exporting. The domestic demand has never been strong, so it would be useless trying to stimulate the Czech economy by distributing money into the circulation. Any form of distributing money into economy while 80 percent of all expenses end up abroad would be wasting money. Germany, our biggest trader, was strongly afflicted by the financial crisis the market demand slashed, thus the Czech economy started falling into ruin. The graph portrays the states the Czech Republic deals the most with.

Exports by selected countries (share in %)

²⁶ <http://money.cnn.com/2012/12/31/news/economy/debt-ceiling/index.html> By Richard Barbieri and Jeanne Sahady January 2, 2013: 11:05 AM



AT	Rakousko	Austria
CN	Čína	China
DE	Německo	Germany
FR	Francie	France
IT	Itálie	Italy
PL	Polsko	Poland
RU	Rusko	Russian Federation
SK	Slovensko	Slovakia
OS	Ostatní země	Other countries

Source: Ministry of Industry and Trade of the Czech Republic

III.2. 3.1.1 European Union and Euro

In 2007 the European Union proved to remain rigid and resistant to the first-round effects of the banking crisis in the US. The Euro achieved to be rather stable versus the dollar. Unfortunately, the second-wave effects conflicted damage. The EU challenges the excessive deficit in the state budget. As a consequence of escalating deficit, the Euro was also set at stake. The forecast in 2013 says, while the US economy began to recover, the EU economy will still be in a deep hole.

Euro currency rate versus Czech crone since 2005

2005	2006	2007	2008	2009	2010	2011	2012
29,78	28,34	27,76	24,94	26,45	25,29	24,59	25,14

Figures: The European Central Bank, chart made by the author

As we look at the chart, the biggest reduction set is in 2008. This weakening of the Euro influenced the financial crisis in US. After 2009 Euro recuperated from the shock of the previous year, but fell again the next year.

The EU goal for next few years is lowering the budget deficit. The chart below represents the annual deficit of all EU member states in 2012. It portrays the governments who have worked hard on trying to limit their countries deficit, as well as the countries who have not successfully been able to minimize their deficit problem.

Government debt by Member State (million)

Belgium	euro	375 389
Bulgaria	BGN	14 390
Czech Republic	CZK	1 758 872
Denmark	DKK	832 455
Germany	euro	2 166 278
Estonia	euro	1 724
Ireland	euro	192 461
Greece	euro	303 918
Spain	euro	883 873
France	euro	1 833 810
Italy	euro	1 988 658
Cyprus	euro	15 350
Latvia	LVL	6 309
Lithuania	LTL	46 037
Luxembourg	euro	9 232
Hungary	HUF	22 380 937
Malta	euro	4 871
Netherlands	euro	427 515
Austria	euro	227 431
Poland	PLN	886 779
Portugal	euro	204 485
Romania	RON	222 212
Slovenia	euro	19 189
Slovakia	euro	37 245
Finland	euro	103 131
Sweden	SEK	1 357 939
United Kingdom	GBP	1 387 436

Source: Eurostat

It is still unknown why some of the EU members experienced such a sharp decline in their budget deficit. The struggling indebted countries are Portugal, Ireland, Italy, Greece and Spain, briefly called the PIIGS. The PIIGS need to revise their state budgets and draw up a budget concentrating on reducing their current expenditures. Otherwise, they will not be able to compete with other EU states and their economic growth will not progress. The oppressive position would bring many other unfavorable conditions such as a rise in unemployment, emigration, criminality, protests or even war.

III.3. 3.1.2 Inflation in the Czech Republic

In the event of recession, as mentioned before, governments resort to releasing more money into the circulation in order to ensure liquidity. The surfeit of money has an impact on price jump, and briefly for the same amount of money the customer gets less goods or service. Inflation belongs to macroeconomic indicators indicating an imbalance in the economy and is measurable by price index numbers such as the consumer price index or the gross domestic product. Inflation can have positive or negative impacts according to the type. Moderate inflation is sometimes good for economic growth. When consumers expect prices to rise, they are much more likely to buy at that point rather than waiting. This will increase demand. We distinguished several types of inflation according to different viewpoints such as “the rate of growth of the price level, the cause or the openness of inflation.”²⁷

In the Czech Republic, the rate of inflation is measured by the Czech Statistical Office. The degree of inflation for the first quarter of 2013 lies at 3,3 percent. In comparison with March 2012 the rate grew to 1,7 percent.²⁸

²⁷ FIALOVÁ, Helena a Jan FIALA. *Ekonomický výkladový slovník: [kompletní přehledná příručka pro studium a manažerskou praxi]*. 9. aktualiz. vyd. Praha: A plus, 2011. 194 s. ISBN 978-809-0380-455.

²⁸ <http://www.cnb.cz/en/statistics/inflation/>

III.4. 3.1.3 Unemployment in the Czech Republic

The unemployment rate is one of the indicators the Czech government must battle. According to the Ministry of labor and social affairs, the unemployment rate has climbed up to almost 600 thousand jobless people, while the job offices register only 38,863 vacancies. By March 2013 the Ministry of labor and social affairs registered altogether 587,768 job seekers (276, 167 female, 311, 601 male), 43,899 newcomers, which was more than in March of the preceding year, 35 438 school leavers.²⁹ With the unemployment rate at 8 percent, the Czech Republic must challenge the formation of new job opportunities in a way of attracting foreign investors and companies.

III.5. 3.1.4 Czech economizing

The Czech anti-crisis measures assemble measurements to support the Czech economy in long term. Here are some of them:

1. Lowering the income tax for legal entities

Decreasing the income tax to 19 percent leaves 6 billion Czech crowns in the enterprises. Companies could use these savings for investments, formation of new jobs, increase the wages or creation of “cushion” against the impact of economic downturn.

2. Support of export

With regard of the orientation of Czech export, the government paid special attention to the measurements to encourage the Czech export. The Czech export bank focuses on territories, where the Czech export formed a small percentage. These countries (Russia, China, Vietnam) are supposed to be more resistant than EU members.

²⁹ www.mpsv.cz

3. Support of the agriculture business

The budget will strengthen by 2.3 billion in order to increase the credit accessibility for small and middle size entrepreneurs.

4. Support of the unemployed

People who lost their job will obtain higher unemployment benefits. The duration of received unemployment benefits extends from 5 to 6 months. At the same time an applier for the benefit has to prove that he or she has worked 24 months in the last three years. The biggest change became evident in the first two months. In contrast with years before the crisis, the first two months the unemployed got 80 percent of their former average wage (the ceiling is 13 307 Crones). Older jobless people in the range 50-55 can draw the unemployment benefits for 9 months, and in the range up 55 even for one year. This reflects the impossibility getting a job after fifty.³⁰

5. Support of the program PANEL

With the cooperation of the Ministry of regional development the government subsidizes the reconstruction and reparation of concrete high-rise blocs for the purpose of prolongation their lifetime period, significant decreasing their power-production and improving their housing quality.

6. Raise in civil servants wages

The government also makes efforts to higher the wages in the public sector.

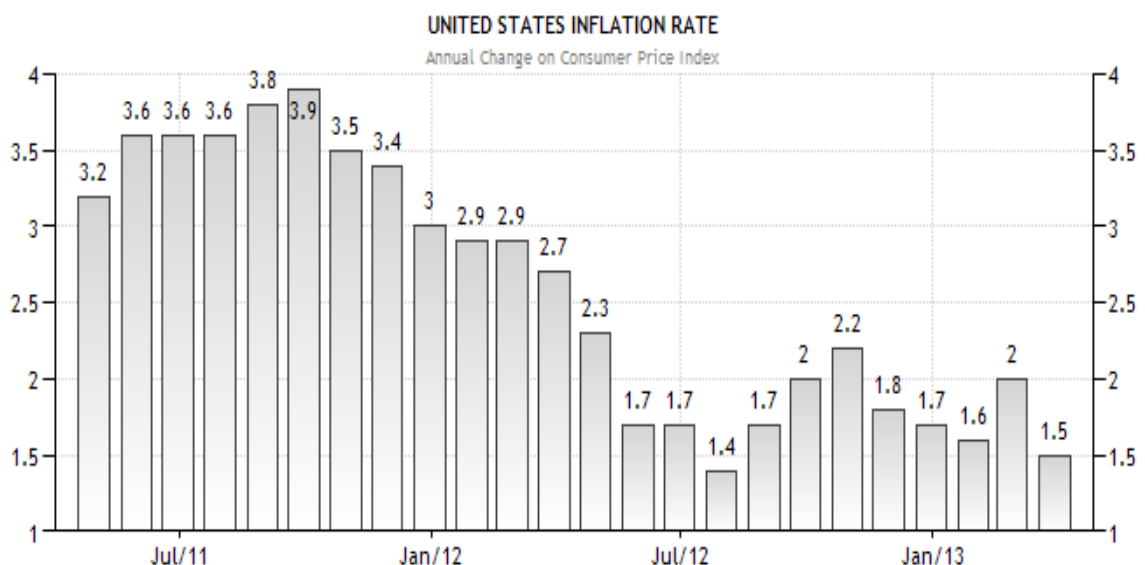
³⁰ www.vlada.cz

III.6. 3.2 Situation in the United States

The US has the world's strongest economy. The USA has single currency and relatively closed economy. While the Czech Republic focused on supporting the most vulnerable public sectors, the United States put the money into rescuing the collapsing financial market. However, the bailout of 16 trillion US dollar to save the banking system lead into enormous debts. The Federal government plans to take in 3.034 trillion dollar for 2014. The budget deficit is estimated to be 744 trillion dollar. Almost one third of the federal budget covers the interest of the deficit.

III.6.2. 3.2.1 Inflation in the United States

The current annual inflation is 1.9 percent. Its rate is measured by the Bureau of Labor Statistics. This chart records the lowest inflation in March 2013(1.5) since July 2012 (1.4.). It raises hopes of recovering the US economy.



SOURCE: WWW.TRADINGECONOMICS.COM | BUREAU OF LABOR STATISTICS

III.6.3. 3.2.1. Unemployment in the United States

Out of the 315 million of the US population, the labor force represents only 155.5 million employees. The increase in the unemployment rate hit the US similarly to the rest of the world. According to the Bureau of labor statistics there are 11.7 million unemployed individuals in March 2013. The unemployment rate dropped down to 7.6 percent. "Employment grew in professional and business services and in health care but declined in retail trade."³¹ However this figure is not trustworthy, because it is influenced by the fact more people stopped seeking a job and were not counted as unemployed. The difficulty in finding a job discourages some of the population to not even try. The US government should find a way to create more jobs in form of attracting the foreign investors or encouraging the demand for domestic products and services.

III.6.4. 3.2.2 US economizing

The US stimulus package of 787 billion dollars was approved in 2009 and intended to put America back to work. "The package was designed to quickly jumpstart economic growth and save between 900,000-2.3 million jobs"³² (28 billion in tax cuts, 224 billion in extended unemployment benefits, education and health care and 275 billion for job creation using federal contracts, grants and loans). Because people and companies had stopped spending their money, the US economy needed a stimulate. Professor Laura Tyson who advises President Barack Obama claimed : "When private sector demand is collapsing, investors are not investing and consumers have lost their jobs and the value of their house so they

³¹ <http://www.bls.gov/news.release/empsit.nr0.htm>

are not consuming. So basically the government comes in and puts some demand into the system - that is what stimulus is - that is the logic." ³³

The package was supposed to be spent over ten years. It includes:

- cut in the taxes

Obama was willing to provide \$8 billion in tax credits for companies hiring workers who have been unemployed for six months or more and 5 billion dollars in a form of tax incentives for companies to invest in equipment and plants. ³⁴

- extending the unemployment benefits

Nearly 43% of the unemployed have been so for more than six months -- a drag on the economy that Obama wants to soften by extending unemployment benefits once again.

The president wants a new tax credit of up to \$4,000 for businesses that hire workers who have been out of a job for over six months.

- energy investments

„\$4.5 billion for repair of federal buildings to increase energy efficiency using green technology.

\$11 billion for smart-grid activities, including work to modernize the nation's electric grid.

\$6.3 billion for Energy Efficiency and Conservation Grants to help state and local governments make investments that make them more energy efficient and reduce carbon emissions.

\$5 billion for the Weatherization Assistance Program to help low-income families reduce their energy costs by weatherizing their homes and make our country more energy efficient.

³³ http://money.cnn.com/2011/09/08/news/economy/obama_stimulus_plan/index.htm

³⁴ http://money.cnn.com/2011/09/08/news/economy/obama_stimulus_plan/index.htm

\$2.5 billion for energy efficiency and renewable energy research.“

- infrastructure investments

\$4.2 billion to invest in energy efficiency projects and to improve the repair and modernization of Department of Defense facilities, including Defense Health facilities.

\$1 billion for the Bureau of Reclamation to provide clean, reliable drinking water to rural areas and to ensure adequate water supply to Western communities affected by drought.

- environmental clean-up and clean water investments

„\$6 billion to clean up former weapon production and energy research sites.

\$6 billion for local clean water and drinking water infrastructure improvements.

\$1.2 billion for EPA’s nationwide environmental cleanup programs, including Superfund.

\$1.38 billion to support \$3.8 billion in loans and grants for water and waste disposal facilities in rural areas.“

- scientific research

„\$3 billion for the National Science Foundation, including \$2 billion for expanding employment opportunities in fundamental science and engineering to meet environmental challenges and to improve global economic competitiveness.

\$2 billion to the Department of Energy for basic research into the physical sciences including high-energy physics, nuclear physics, and fusion energy sciences and improvements to DOE laboratories and scientific facilities. \$400 million is for the Advanced Research

Project Agency–Energy to support high-risk, high-payoff research into energy sources and energy efficiency.

\$1 billion for NASA, including \$400 million to put more scientists to work doing climate change research, including Earth science research recommended by the National Academies.

\$600 million to the National Oceanic and Atmospheric Administration (NOAA) for construction and repair of facilities, ships and equipment to improve weather forecasting, support satellite development and address critical gaps in climate modeling.“

- modernization schools

IV. 4. Public opinion survey

The last part focuses on the public opinion and views on the financial crisis and how it affected them personally. Half of the respondents come from the Czech Republic and half from the United States, as there was the opportunity to make research in both countries. The exact representation is 25 respondents from the Czech Republic and 25 from United States. At the end of the survey is described a picture of an average respondent.

IV.1. 4.1 Questions

1. *What is your current occupation?*

student	13/50
maternity leave	3/50
unemployed	1/50
employed	25/50
retired senior citizen	8/50

According to the research the majority of the respondents are employed, followed by students. This figure could be influenced by the surveyer's environment. Positive indicators of this was how there were only one unemployed participant. On maternity leave were 3 women, and they all said they want to return to work in a few years.

2. *Do you fully know the background of the financial crisis?*

yes	7/50
no	15/50
somewhat	28/50

It is sad that 15 people did not know much about the financial crisis, even though it has been a well discussed topic in the last years. These correspondents might be either students not interested in the economic situation or seniors. The interested parties most likely make up the working population.

3. *How are you doing today financially, compared to how you were before the crisis?*

better	3/50
the same	15/50
worse	32/50

Almost one third is about the same compared to the pre-crisis time, but 32 people saying they are now doing worse than before the crisis shows that the crisis really affected society. It is worth to mention the three respondents doing better, this fact could be influenced by getting a better job, paying off the mortgage or selling some unnecessary property.

4. *Do you know anyone who was affected by the financial crisis severely?*

yes	39/50
no	11/50

For this question is important to mention the nationality of the respondent. Only ten out of “yes” answers were monitored in the Czech Republic and the rest 29 in the States. So we could deduce that the American society feels the consequences that this crisis has brought stronger than the Czech society. This reality shows, that the real crisis has not yet spread into the Czech Republic.

5. *For the people who were severely affected what did they lose?*

job	12/39
house	7/39
savings	9/39
nothing	11/39

As we can extract from the chart above people usually experience the consequences in form of losing their job. The lost of job sometimes leads in the lost of a house or a car, if the debtor is not able to meet his or her obligations. All seven respondents who chose the answer losing a house

come from the United States. They exemplify what happened in the US in 2007 when the mortgage crisis broke out. On the other hand nine of twelve “losing a job” answers stand for participates from the Czech Republic. Here can we see the strong dependence of Czech export. The downturn in demand for Czech goods and services resulted into higher unemployment rate than in the US.

6. What is your highest level of education?

did not finish high school	1/50
GED/high school	23/50
bachelor	21/50
above bachelor	5/50

The two options that were chosen the most were finishing their bachelors or finishing high school, which in the States is receiving your GED. There is almost no representation of the population with an unfinished education. The most bachelor degrees were answered in the States, and in the Czech Republic the most usual level of degree is the completion of high school.

7. Do you think we will start coming out of this recession within the next decade?

yes	21/50
no	18/50

I do not know	11/50
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The results to this question were pretty spread out. There was almost the same amount of people to say it will as it will not, and quite a few respondents that were not sure. It reflects how each person may have a completely different outlook on the future. You would think there would be more 'yes' and less 'no's, but it shows how many people are still skeptical about the future.

By summarizing the research **an average respondent** is a person who:

- is employed
- knows something about the background of the crisis
- is doing financial worse than at the pre-crisis time
- knows somebody severely affected by the crisis
- finished high school or bachelor degree
- is positive about the end of recession

V. 5. Conclusion

The forecast for 2013 does look friendly for the American economy. As we could learn from this thesis the European economy is far from soon recovery. The objective of this work is to provide a comprehensive overview of the global financial economy. It also focuses on the meaning of recession in the context of consequences of the financial crisis. The sources of the thesis were mostly found on the internet. According to my opinion the financial crisis is a contemporary topic changing every day, so using printed older sources would not bring the current overview.

The United States and the Czech Republic are facing big challenges in order to improve their markets, maintain their living standards or keep the ability to compete with other foreign countries. As we could read the governments chose different ways to battle for their economic improvement. Unlike United States, Czech Republic was pretty resistant to the impacts of crisis. Unfortunately, being almost absolutely dependent on exporting abroad negatively influenced the Czech economy. On the other hand, the United States faces a collapse in the banking system and it is hard to say, whose position is more agreeable. Since 2009 the world officially has been trying to defeat the crisis but so far without any success. This brings me back to the idea of implementation school subjects that would focus on correct managing finances and individual's possibilities. It is on our next generations to handle the impacts that our greedy population caused.

Abstrakt

MLEZIVOVÁ, N. Finanční krize a úspory. Bakalářská práce. Plzeň: Fakulta filozofická ZČU v Plzni, 42 s., 2013

Klíčová slova: Subprime mortgage, recession, inflation, unemployment

Předložená práce je zaměřena na problematiku současné finanční krize. V první části je popsána hypoteční krize v USA a její dopady na světovou ekonomiku. Zároveň uvádí významy některých ekonomických termínů objevujících se během práce. Dále je zaměřena na úspory a opatření vlád, které byly zavedeny proti dalšímu postupu krize. Také je poukázáno na problematiku státního dluhu.

Závěrem se práce snaží přiblížit reálnou situaci obyvatelstva pomocí průzkumu. Cílem je podání uceleného obrazu o finanční krizi.

Abstrakt

MLEZIVOVÁ, N. Financial crisis and economizing. Bachelor thesis. Pilsen: University of West Bohemia, 42 p., 2013

Key words: Subprime mortgage, recession, inflation, unemployment

The presented work focuses on the issue of the current financial crisis. The first part describes the mortgage crisis in the United States and its impacts on the global economy. It also explains few economic terms, which occur throughout the text. After, the work orientates on the impacts of crisis, measurements that the governments made to stop the crisis progress and points out the issue of public debts

Finally, this work tries to describe the real situation of population through a survey. The main objective is to provide a comprehensive depiction of the financial crisis.

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