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Independent Study & Mentorship

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**Research Assessment #3**

**Subject**: Bank Lending During the Financial Crisis of 2008

**MLA Citation**:

Ivashina, Victoria, and David Scharfstein. "Bank lending during the financial crisis of 2008." Journal of Financial economics 97.3 (2010): 319-338.

**Assessment:**

The financial crisis of 2008 is a crisis that occurred mainly around September to November. New lending like capital expenditures declined as restructuring loans fell. The financial crisis of 2008 started with a 2007 credit boom, sub-prime mortages (mortgages given to buyers with low-credit ratings), and securitized products (tradeable assets that hold monetary value which are divided and sold to investors). The paper analyzes how financial crises affects the economy, specifically how credit is used. From my previous research, I have discovered that the financial crisis of 2008 has affected the global economy significantly. Therefore, I chose this paper to analyze for the purpose of understanding what causes global crises and future implications that the crises may have.

Ivashina and Scharfstein's analysis of the causes of financial markets are convincing, highlighting key limitations of lending. For example, Ivashina and Scharfstein concludes that a reduction in lending does not cause a decline in credit. More factors related to bank lending and a willingness to lend affects the financial markets as just as significantly. It is theorized that banks with a large amount of deposits lend more during crises, an idea that I believe is illogical. Although there is a large amount of projected profit that banks can make, they can also rack up long-term debt. When debtors can not repay their loans, banks can suffer. This idea follows the trend of the 21st century society. Investors would “pull their money from uninsured money market funds and the commercial paper market” and “redeploy” their money into “insured deposits” from banks. However, one confusing aspect of investors transferring money into deposits is that credit lines increase when deposits increase. So, when systematic shocks occur, where firms take money out of their emergency credit facilities, money is taken out, yet bank deposits increase. This occurrence happened in the Enron collapse, one of the biggest bankruptcies in the United States. For future studies, analyzing the Enron collapse will allow me to further understand crises and any trends that cause them.

In the economic context of the United States during September to November 2008, there are key details to understand. The crisis was inevitable due to the following. New lending was lower than expected before the financial crisis, with the dollar volume of lending being “49% lower than the peak of the credit boom.” Yet, new loans decreased rapidly during the crisis by “37% in dollar volume and 22% in the number of issues.” But, we come to the conclusion that real investment loans and restructuring loans have decreased, but revolving credit facilities is 39% larger than loans (26%). Common misconceptions include that investment loans are not affected by institutional investors and the decrease in investment-grade lending.

Thus, we can conclude that the economic climate of the United States has led new lending to decline, caused by a supply and demand effect. Banks that use deposits less and use more revolving line exposure makes lending money more difficult for borrowers, leading to the spiral of a financial crisis. However, the effects of financial crises are still should be questioned.

There are many variables that effect financial crises, and analyzing the effects in one paper can not truly cover all possibilities.

Ultimately, Ivanshina and Scharfstein’s paper informs me about an pivotal event in economic history. Bank lending in the context of the financial crisis of 2008 is a cause of misuse of monetary funds and confusion. In the direction of my understanding, financial crises affect the economy significantly, and different actions that states take to supply or prohibit loans determine their overall standing. For my future research, I would focus on governmental regulations and actions taken with negative implications, as that is the main issue of the financial crisis of 2008.