

Exploring the Causes of the U.S. Subprime Mortgage Crisis and Its Impact on China's Economy

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Abstract: The U.S. subprime mortgage crisis was a global financial turmoil triggered by excessive financial innovation, regulatory deficiencies, and lowered lending standards. This crisis inflicted severe damage on the U.S. economy and had profound implications for the global economy. As a significant trade partner of the U.S., China's economy experienced substantial impacts during this crisis. The outbreak of the U.S. subprime crisis directly slowed down the U.S. economy and decreased purchasing power. As the primary destination for Chinese exports, the shrinking demand in the U.S. market severely impacted China's export business. Numerous export-dependent enterprises faced difficulties, economic growth was curtailed, unemployment rates rose, and China's economic stability faced immense challenges. In response to the crisis, the Chinese government implemented a series of effective measures, gradually stabilizing market expectations and enhancing the economy's resistance to risks. Moving forward, China will continue to deepen reforms and promote high-quality economic development, contributing even more to global economic growth.

Keywords: U.S. Subprime Mortgage Crisis; Global Economy; Deepening Reforms.

1. Causes of the U.S. Subprime Mortgage Crisis

1.1. Absence of Financial Regulatory Systems

The U.S. subprime mortgage crisis was not solely due to the absence of financial regulatory systems. This crisis was the culmination of neoliberal economic policies persistently pursued and deepened in the U.S. over the past three decades. Neoliberalism, as an economic ideology, emphasizes reducing government intervention in the market economy and advocates laissez-faire market principles. Under this guidance, financial institutions and intermediaries pursued their own maximization of profits, often overlooking the robust responsibility towards the entire economic system. Many institutions excessively innovated in the subprime mortgage sector, neglecting risk controls and even engaging in fraudulent activities. They continually lowered lending standards and requirements to pursue higher profits, allowing more individuals with low credit scores or unstable incomes to obtain loans. Initially, these loans seemed beneficial for both borrowers and financial institutions[1]. However, as housing prices fell and interest rates rose, default risks gradually surfaced, leading to a chain reaction and the collapse of the financial market. Therefore, the eruption of the U.S. subprime crisis was not just a result of regulatory deficiencies but also a manifestation of market failure under neoliberal economic policies. Financial regulatory bodies in the U.S. and globally should profoundly reflect on the limitations and drawbacks of neoliberal economic policies, strengthen financial supervision and risk control, and ensure the robust development of financial markets.

1.2. Decline in Housing Prices and Rise in Interest Rates

As housing prices in the U.S. fell, the default rate on subprime loans soared. The decline in housing prices led to a devaluation of many mortgaged properties, and numerous borrowers found the value of their properties to be lower than

their outstanding loan amounts, diminishing their motivation to repay. Meanwhile, to combat inflation, the Federal Reserve continually raised federal interest rates, escalating the burden on borrowers[2]. For subprime loan borrowers, who were already individuals with lower credit scores, the dual impact of rising interest rates and falling housing prices made it increasingly difficult to bear the loan burden. Eventually, many borrowers opted to stop loan payments, resulting in a substantial amount of bad debt. Many financial institutions held significant assets in the subprime mortgage sector. With rising default rates and declining housing prices, these assets drastically devalued, leading to enormous losses for these institutions. The fall in housing prices and the rise in interest rates were key factors triggering the subprime crisis. These factors interacted, continuously escalating the default rate on subprime loans and leading to a significant amount of bad debt, causing the financial market collapse. Therefore, financial institutions and regulatory bodies should remain highly vigilant towards these factors, enhance risk control and regulatory intensity to prevent similar crises from recurring.

2. Impact of the U.S. Subprime Mortgage Crisis on China's Economy

2.1. Economic Growth Slowdown

The slowdown of the U.S. economy directly affected China's exports and economic growth. As an essential trade partner and export market for China, the fluctuations in the U.S. economy directly related to China's foreign trade and economic growth. If the U.S. economy continues to stagnate, it will further undermine global investor confidence, leading to a slowdown in international capital flows and consequently affecting China's economic growth. The slowdown of the U.S. economy resulted in a decline in its consumption demand. As the world's largest consumer market, the reduction in U.S. consumption demand directly impacted China's exports. Especially under the backdrop of the U.S. economic slowdown, the weakened purchasing power of U.S.

consumers significantly affected China's exports to the U.S. Simultaneously, the U.S. economic slowdown also intensified global economic uncertainty[3]. As the world's largest economy, the economic situation in the U.S. directly influences global market confidence. If the U.S. economy continues to stagnate, it will further undermine global investor confidence, leading to a slowdown in international capital flows and consequently affecting China's economic growth. To address this, stimulating domestic market demand could be achieved by expanding internal demand and optimizing industrial structure, thereby enhancing the sustainability of economic development.

2.2. Volatility in Capital Flows

In recent years, China has attracted a significant amount of international capital inflow, providing crucial support for the country's economic growth. However, with the aggravation of the U.S. subprime crisis, international capital flow became unstable. The U.S. subprime crisis led to turbulence in the global financial market and increased uncertainty. Investors began reassessing risks and adjusting their investment portfolios. Under these circumstances, some international capital might withdraw from China, seeking safer investment havens. Additionally, due to the economic slowdown in the U.S. and the global demand reduction, China's exports might be affected, further influencing China's economic growth and capital inflow. The volatility of capital flows could pose challenges to China's economy, necessitating measures to stabilize capital flows and strengthen financial market regulation. Simultaneously, China needs to enhance the transparency and fairness of its financial market, boosting investor confidence and attracting more international capital inflow. By stabilizing capital flows and reinforcing financial market infrastructure, China can maintain stable economic growth and contribute more significantly to the global economic recovery and development.

3. Measures to Address the U.S. Subprime Mortgage Crisis

3.1. Strengthening Financial Regulation

The U.S. subprime mortgage crisis, induced by various complex factors, had a relatively intricate genesis, with various elements interacting to trigger the crisis's outbreak. This crisis not only caused a massive shock to the U.S. economy but also had far-reaching effects on the global economy. For China's economy, the impact of the U.S. subprime crisis mainly manifested in reduced exports, capital outflows, and heightened financial risks. To address these effects, China implemented a series of measures, including strengthening financial regulation, as shown in Table 1. Enhancing financial regulation can regulate the behavior of financial institutions, reduce financial risks, and maintain the stability of the financial market. Specifically, supervision over financial institutions should be intensified, especially those involved in subprime mortgage businesses. Regulatory bodies should conduct regular audits and inspections of financial institutions to ensure compliance and prevent issues such as excessive leverage and risk concentration. Moreover, the development of financial derivatives markets should be regulated, and innovation in finance should be supervised and risk-assessed to avoid situations akin to the subprime crisis. Additionally, a more comprehensive financial risk prevention mechanism should be established[4]. Through risk assessment and early warning systems for financial institutions, potential risks can be promptly identified and mitigated, preventing the accumulation and spread of risks. Furthermore, enhancing the capital adequacy and liquidity levels of financial institutions can strengthen their ability to withstand risks. By maintaining financial market stability through various measures, the continuous and healthy development of the economy can be promoted.

Table 1. Measures for Strengthening Financial Regulation

| No. | Measures to strengthen financial regulation | Description |
|-----|---|---|
| 1 | Supervision of financial institutions | Enhance the supervision of financial institutions, including regular audits, inspections, and risk assessments, to ensure their compliant operations and prevent excessive leverage and concentration of risks. |
| 2 | Financial derivatives market norms | Standardize the development of the financial derivatives market, strengthen the supervision and risk assessment of financial innovations to avoid situations similar to the subprime mortgage crisis. |
| 3 | A financial risk prevention mechanism was established | Establish a more comprehensive financial risk prevention mechanism, including risk assessment, early warning systems, and risk mitigation mechanisms, to timely identify and resolve potential risk points. |
| 4 | We will improve capital adequacy and liquidity | Increase the capital adequacy ratio and liquidity levels of financial institutions to enhance their ability to withstand risks. |

3.2. Promoting Domestic Demand Growth

The complex genesis of the U.S. subprime crisis led to the collapse of the financial market and global economic turmoil. As China's economy has long relied on exports, the U.S. subprime crisis, which caused a slowdown in the U.S. economy and a decrease in purchasing power, directly impacted China's exports. This situation placed many export-oriented enterprises in difficulty, increasing unemployment rates and slowing down economic growth. To address this, the

Chinese government implemented numerous measures, with actively expanding domestic demand being a crucial initiative. China possesses a vast domestic market, and expanding internal demand can stimulate economic growth and reduce reliance on exports. The government stimulated domestic demand by increasing public spending, encouraging consumption and investment, and driving the continuous development of the economy. Additionally, China accelerated the pace of economic structural adjustment. The traditional economic growth model is no longer sustainable, and

structural adjustment is imperative. The Chinese government supported innovation, fostered emerging industries, and optimized the industrial structure, steering the economy towards high-quality, efficient development. By expanding domestic demand and accelerating economic structural adjustment, the economy gradually emerged from the shadow of the U.S. subprime crisis. The potential of the domestic market was fully unleashed, continuously strengthening the intrinsic drivers of economic growth. Simultaneously, this also provided crucial support and momentum for the global economy[5]. The U.S. subprime crisis posed significant challenges to China's economy, but it also accelerated the pace of economic transformation and structural adjustment in the country. Expanding domestic demand and accelerating economic structural adjustment are essential measures for China to address the U.S. subprime crisis and are inevitable choices to promote the continuous and healthy development of the economy.

3.3. Strengthening Capital Flow Management

The outbreak of the U.S. subprime mortgage crisis revealed the drawbacks of excessive liberalization and lack of regulation in financial markets. This crisis not only caused severe damage to the U.S. economy but also had a profound impact on the global economy. For our country's economy, the impact of the U.S. subprime mortgage crisis was mainly reflected in the reduction of exports, capital outflow, and

increased financial risks. To cope with the impact of the U.S. subprime mortgage crisis, our government strengthened the management of capital flows. The related measures are shown in Table 2. Firstly, the government strengthened the regulation of cross-border capital flows. By establishing a more stringent regulatory system, enhancing the monitoring and early warning of cross-border capital flows, timely identifying and resolving potential risk points, the government aims to prevent massive capital outflows from adversely affecting our country's economy. Secondly, the government improved the foreign exchange management system. By strengthening the regulation and management of the foreign exchange market, optimizing the structure of foreign exchange reserves, and enhancing the transparency and fairness of the foreign exchange market, the government stabilizes market expectations, boosts investor confidence, and reduces the risk of capital outflow. Thirdly, the government also encouraged the inflow of long-term capital and optimized the capital structure. Through providing policy support and preferential measures, the government attracts domestic and foreign long-term investors to participate in our country's economic development, increases capital supply, reduces financing costs, and promotes the sustainable and healthy development of the economy. Strengthening capital flow management not only helps to stabilize our country's economy but also provides more reliable support and momentum for the global economy.

Table 2. Measures to Strengthen Capital Flow Management

| No. | Strengthening measures for capital flow management | Description |
|-----|---|---|
| 1 | Regulation of cross-border capital flows | Establish a stricter regulatory system to enhance monitoring and early warning of cross-border capital flows, and timely identify and resolve potential risk points. |
| 2 | Improvement of the foreign exchange management system | Strengthen the standardization and management of the foreign exchange market, optimize the structure of foreign exchange reserves, and increase the transparency and fairness of the foreign exchange market. |
| 3 | Encouragement of long-term capital inflow | Provide policy support and preferential measures to attract domestic and foreign long-term investors to participate in our country's economic development. |
| 4 | Optimization of capital structure. | Optimize the capital structure to reduce financing costs and promote the sustainable and healthy development of the economy. |

4. Conclusion

In summary, the U.S. subprime mortgage crisis, as a global financial crisis, not only had a profound impact on the U.S. economy but also caused a significant shock to the global economy, including China. However, this crisis also prompted countries to re-examine their economic structures and financial systems, driving the transformation and reform of the global economy. In responding to the challenges of the U.S. subprime mortgage crisis, the Chinese government demonstrated strong decision-making ability and response strategies. Through strengthening financial regulation, promoting domestic demand growth, and strengthening capital flow management, China successfully stabilized the economic situation and provided important support for the recovery of the global economy. Looking back at the impact of the U.S. subprime mortgage crisis, we can see the remarkable achievements of the Chinese economy in

responding to the crisis. In the future, China will continue to deepen reforms and make greater contributions to the recovery and development of the global economy. At the same time, it will also continue to actively participate in global economic governance, jointly cope with global challenges with other countries, and promote the prosperity and stability of the world economy.

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