When will financial markets heal?

- Stock markets recovering and bond yields normalizing
  
  Since the depths of the recession, financial market stresses have been substantially reduced. Stock markets, though inherently volatile, have recovered markedly from their low point. The spread between interest rates on corporate bonds and on U.S. Treasury securities has returned to more normal levels. The easing of financial stress shows that financial markets are returning to normal, and that investors and lenders are getting over the fear that gripped them during the crisis. In addition, corporate profits have rebounded. These financial market developments have led to some recovery in the wealth that households lost in the downturn. And high-quality companies can borrow more affordably in the bond market to fund expansion, hiring, and other investments.

  References:
  The Economic Outlook and Macroeconomic Policy, speech by Ben S. Bernanke, Chairman, Federal Reserve Board of Governors, at the National Press Club, Washington, D.C., February 3, 2011.

- Credit still tight
  
  Stable financial markets and healthy financial institutions are important for households that need to borrow for a mortgage or to finance a college education and for businesses that need to hire workers. Following the devastation of the financial crisis, financial firms and their regulators began working to rebuild sturdier and more efficient financial markets. It will inevitably take time to develop appropriate new risk standards and implement the new financial reform legislation that was passed in 2010. After tightening lending standards dramatically during the crisis, banks have been loosening them only slowly, so the flow of credit remains tight in some areas of the economy.

  References:

- Risk remains from international increases in government debt
  
  Following the global financial crisis, government debt levels have risen rapidly in many countries. This reflects loss of tax revenue and temporary increases in spending to combat recession and support the banking system. International investors have worried whether some smaller countries will be able to fully repay their debts. These countries have had to pay higher interest rates to borrow. The danger that some countries might default has prompted worries about the financial institutions that hold the debt of countries that are struggling financially. In addition, borrowing costs have risen for households and businesses in the affected countries. To calm fears of default, some countries have raised taxes and cut government spending. These austerity measures may constrain economic growth in the near term.

  References:

http://www.frbsf.org/econanswers/ahead_q2more.htm