

# Content Review



# Lecture Review: Global Financial Crisis

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- ▶ Problems in the financial sector; bank failures.
- ▶ Recession (biggest since the GD); increase in unemployment.
- ▶ International transmission through interconnected financial markets.



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  - ▶ You did not need to own a MBS to buy a CDS on it!
  - ▶ When too many mortgages failed, the insurance companies could not pay out the CDS.



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  - ▶ This led to a moral hazard problem where originators' revenue did not depend on the quality but rather the amount of loans.
  - ▶ Led to many loans made out to subprime borrowers who were at a greater risk of default.



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  - ▶ Reliance on credit rating agencies to gauge risks (who were paid by the banks to rate the MBS that banks were issuing).
  - ▶ Historically, very low default rates on mortgages.
  - ▶ Since mortgages were collateralised, some debt value could be recouped hence considered safer.





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Policy response to the GFC

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- ▶ Discount window lending for banks.
- ▶ Troubled Asset Relief Program (TARP) passed to purchase troubled companies' assets and stock.