

2010 School Seminar Series

Waikato Management School
Te Raupapa



Background of the 2007-2010 Financial and Economic Crisis

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Professor Roderick Macdonald
Universite du Quebec, Montreal

Abstract:

Although the financial crisis was first experienced by players in the financial sector as a liquidity and credit crunch in 2007, the essence of the crisis resided in a large number of institutions holding assets of dubious value: the so-called “toxic” assets. To understand the genesis of the financial crisis then, we need to understand why these assets are toxic and how various financial institutions came to acquire these assets.

The onset of the 2007-2010 financial crisis can be simplified into two complementary processes in the United States of America. The first is a boom in housing. The second process was the growth of securitization in general, and the securitization of mortgages in particular.

These two processes culminated in two effects. On the ground, a large number of persons saw their homes foreclosed as they failed to meet mortgage payments. In the financial world, a growing number of investors discovered that the “nearly risk-free” securities they held were in fact risky and thus of very uncertain value. This began in the fall of 2006. It is this latter issue that is at the heart of the financial crisis, rather than the former issue.

Of course, to fully understand the effects of the two processes that led to the bust of 2007, we must first understand the historical context of the crisis, and the mechanics underlying the sequence of events.

Presenter: Roderick Macdonald