THE GLOBAL FINANCIAL CRISIS: CAUSES. BAIL-OUT. FUTURE.

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Causes of the Collapse

- The Minsky Moment
- Minsky’s Stages
  - Money Manager Capitalism
- Financialization, Layering, Liquidity
- Fraud and the Real Estate Bubble
- Shredding of New Deal Reforms
- Bubbles, Goldilocks and Budgets

Minsky Moment

- Financial Instability Hypothesis
- Investment Theory of the Cycle and Financial Theory of Investment
- Hedge → Speculative → Ponzi
- Big Bank and Big Government Rescue
- Stability is Destabilizing

Boom and Bust

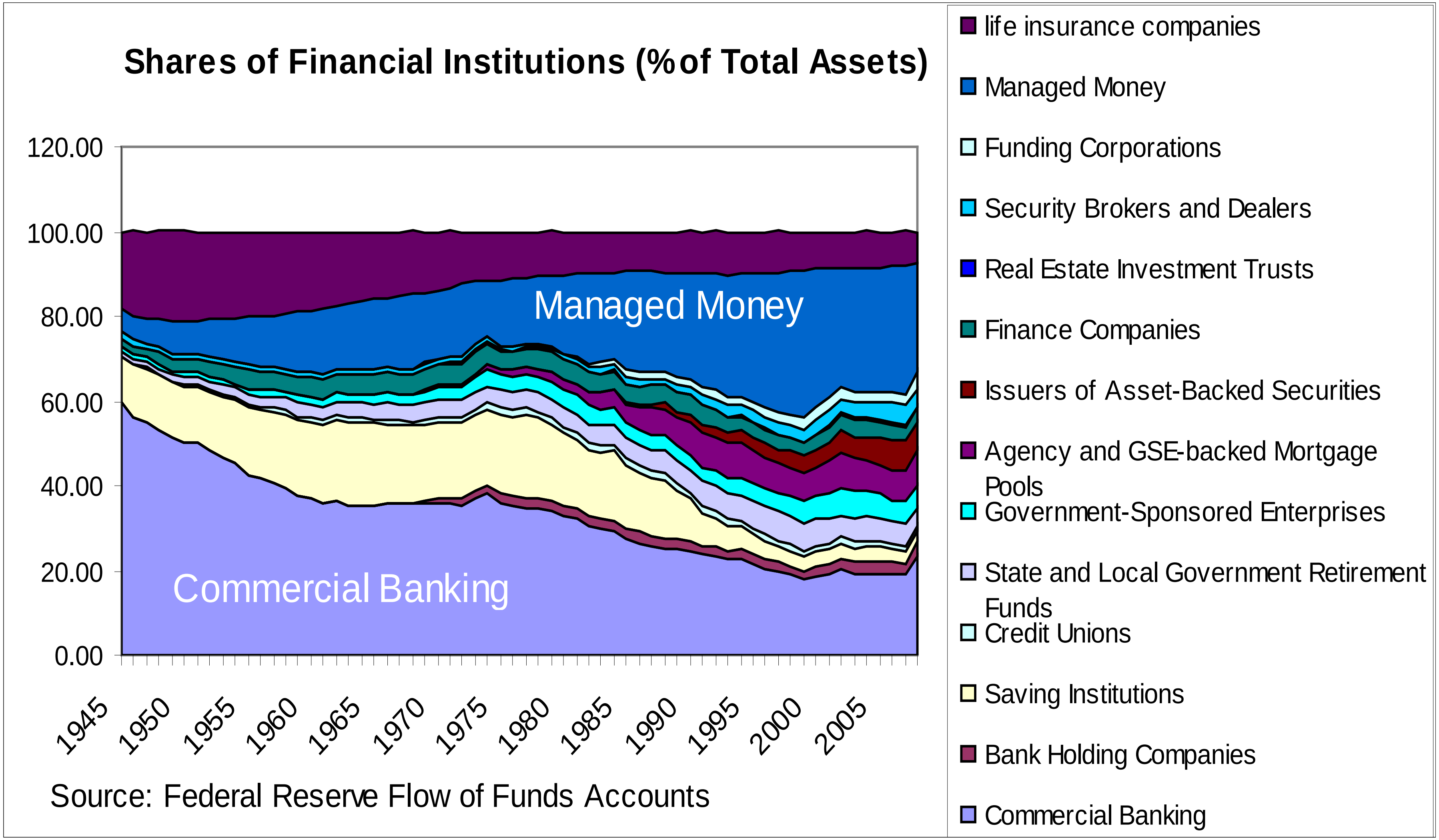
- 1980s Thrift & Bank Crises
  - Thrifts and Commercial real estate
  - Banks and LDC debt
- 1980s Leverage Buy-outs
  - Michael Milken and Junk Bonds
- 1990s New Economy and Nasdaq
  - "Irrational Exuberance"
- 2000s Residential Real Estate
  - Subprimes; foreclosures
- 2000s Commodity Markets
  - Quadrupled oil prices; food riots; starvation

Each follows the pattern and each crisis is worse than the previous

A Minsky Half-Century?

- Stages Approach: 57 Varieties
  - Commercial capitalism
  - Finance capitalism
  - Paternalistic (Managerial-Welfare State) capitalism
  - Money Manager capitalism (predator state, financialization, ownership society, neoliberalism, neoconservativism, shadow banking)
    - Stability bred instability
    - Accumulation of financial assets/liabilities
    - Globalization
    - Securitization
    - Self-supervision

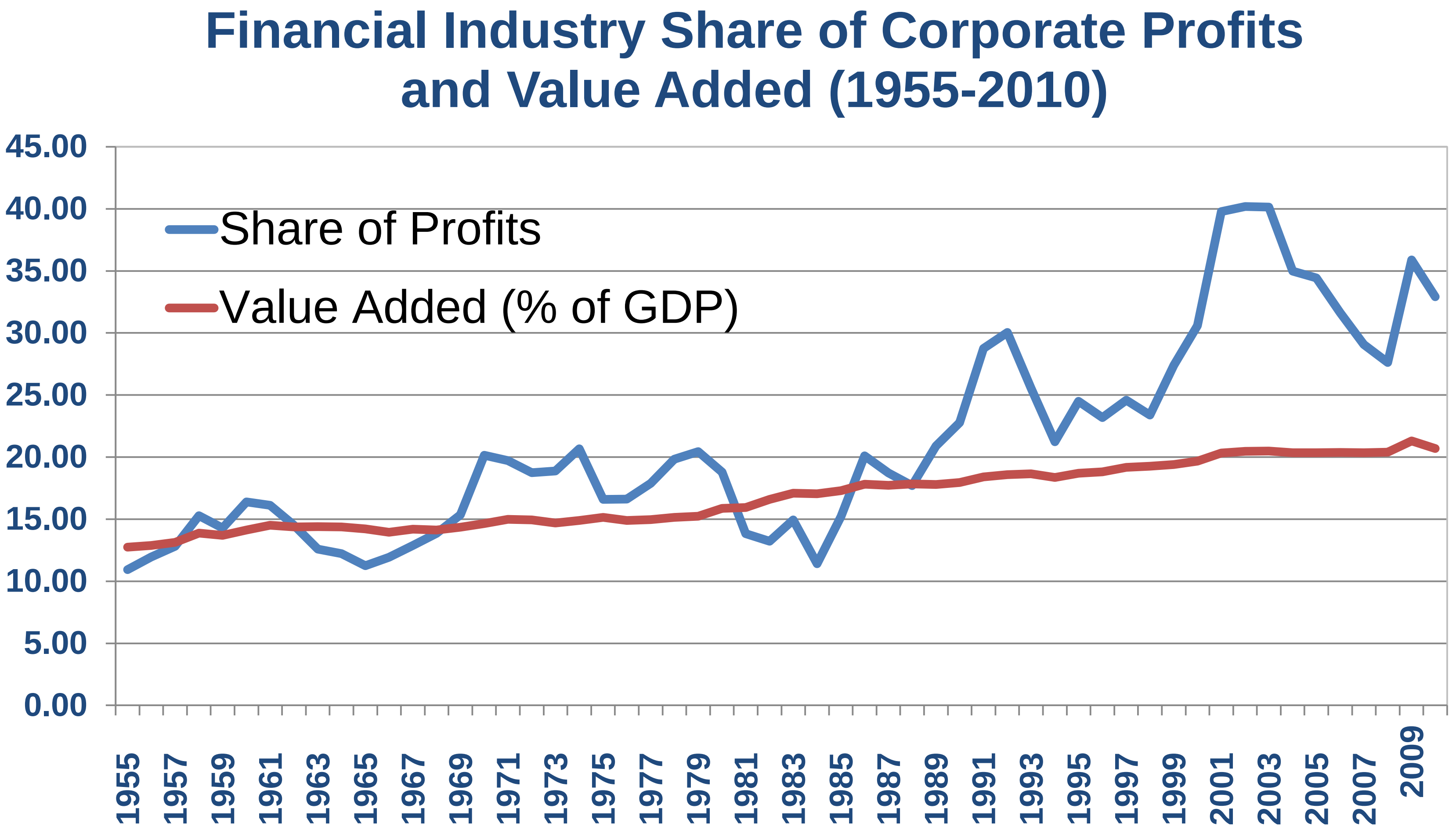
Decreasing Weight of the Banking Sector



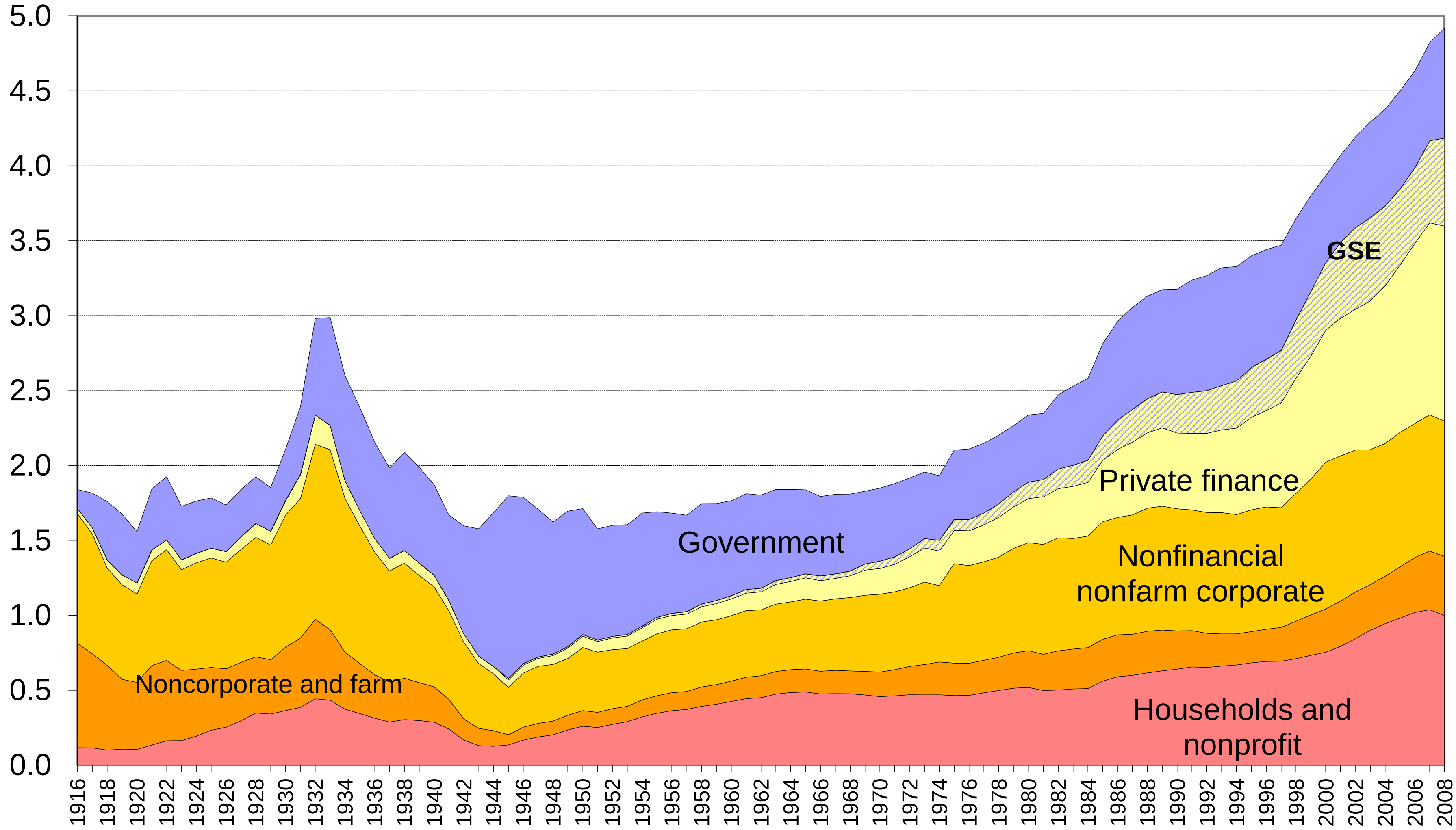
Financialization, Layering, Liquidity

- Rising share of profits and value added going to financial sector.
- Layering debt on debt on debt.
  - Positions in assets financed through very short term (overnight) borrowing.
  - Asset mkts and institutions tightly linked in complex ways
    - Liquidity and hedges were a mirage
- Casino-like speculation dominates.

Financialization of the U.S. Economy



Total Financial Liabilities Relative to GDP

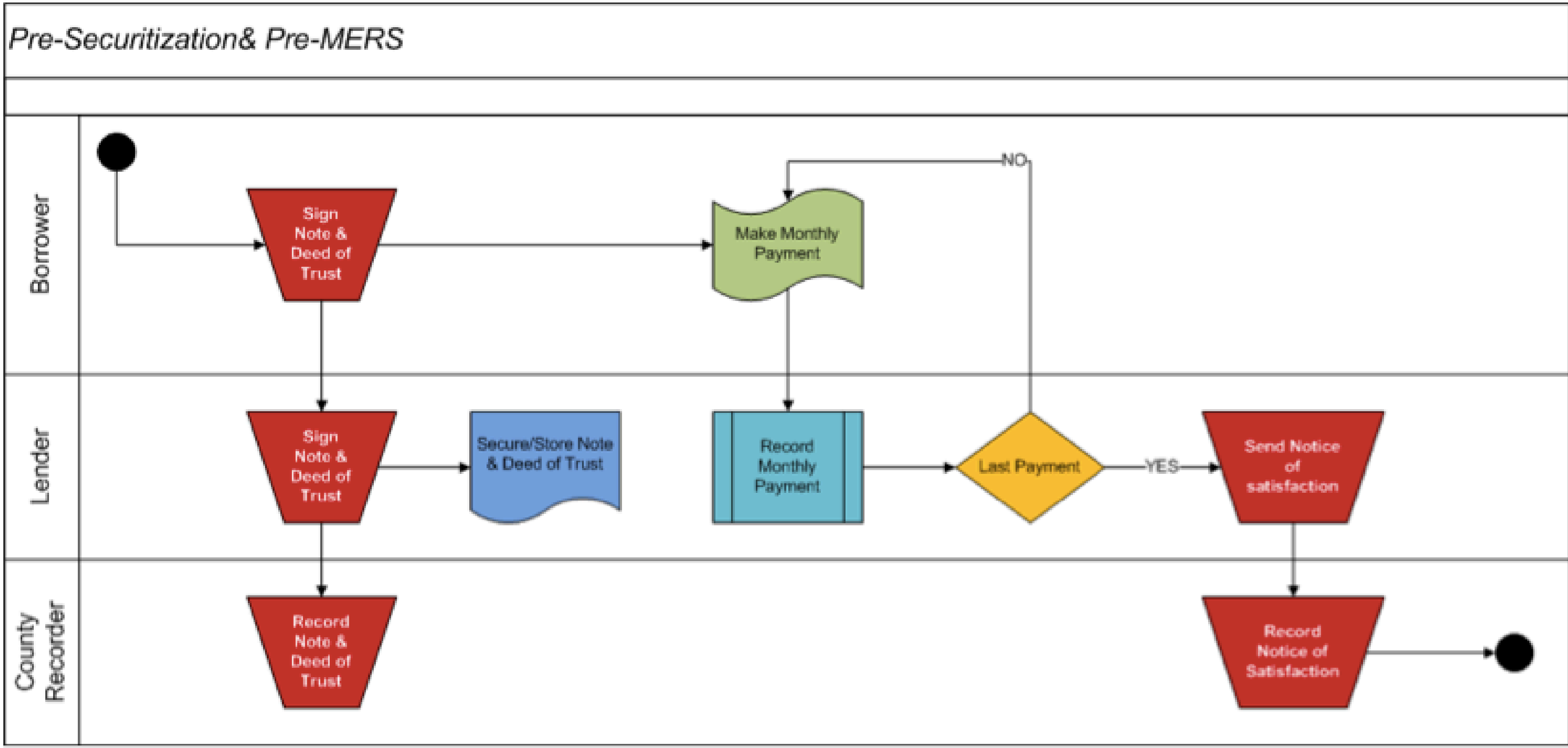


Sources: *Historical Statistics of the United States: Millennium Edition* (Tables Cj870-889, Ca9-19, Ce42-68, Cj787-796, Cj748-750, Cj389-397, Cj437-447, and Cj362-374), *Historical Statistics of the United States: Colonial Times to 1970* (Series X 689-697), NIPA, Flow of Funds (from 1945).

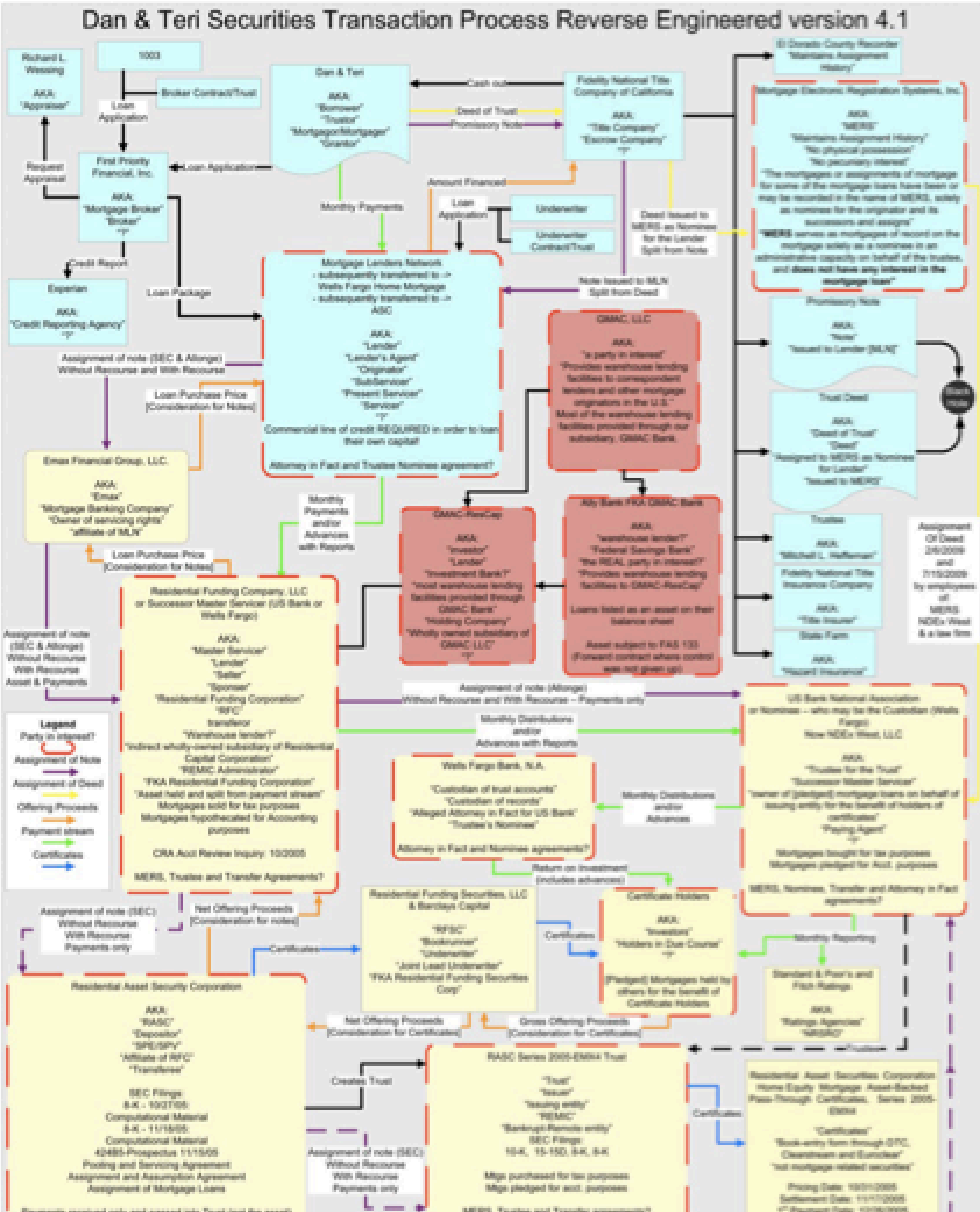
New Home Finance Model

- Jimmy Stewart's Thrift: loan officer, bank teller, home appraiser; public recorder.
  - Loans held to maturity
- New more "efficient" Wall Street model:
  - Involves broker, appraiser, lender, servicer, MERS, securitizer, credit rater, rocket scientists and proprietary models, MBS trustee, CDOs squared and cubed, CDSs and monolines, investors, traders, accountants, lawyers, lender processing services; robo-signers and document "recovery" services (forgery).
  - Model: originate to distribute, pump and dump, foreclose and resell.
  - Capitalizing unrealizable home values.

Mortgage Transaction without Securitization or MERS



** Sub process involving lender transfer of note and deed not shown.*



Mortgage Transaction w/ Securitization and MERS

- 40 Pts of Level One Failure
- Repeated data entry of loa loan values etc.= Chances f Error
- No identified standards of operation
- No unifying change contro authority
- Multiple Systems with var control, data entry procedu requirements

Real Estate Bubble and Fraud

- Like Shrek's onion: Every link in the Home Finance Food Chain was fraudulent:
  - Appraisers, brokers, lenders, MERS recording, investment bank securitizers, trusts, CDOs squared and cubed, CDS bets on failure, accounting firms, ratings agencies, and servicers.
- Most fraud was on part of lenders, and now servicers.
- Fed recognized growing fraud as early as 2000; FBI warned in 2004 "epidemic of fraud".

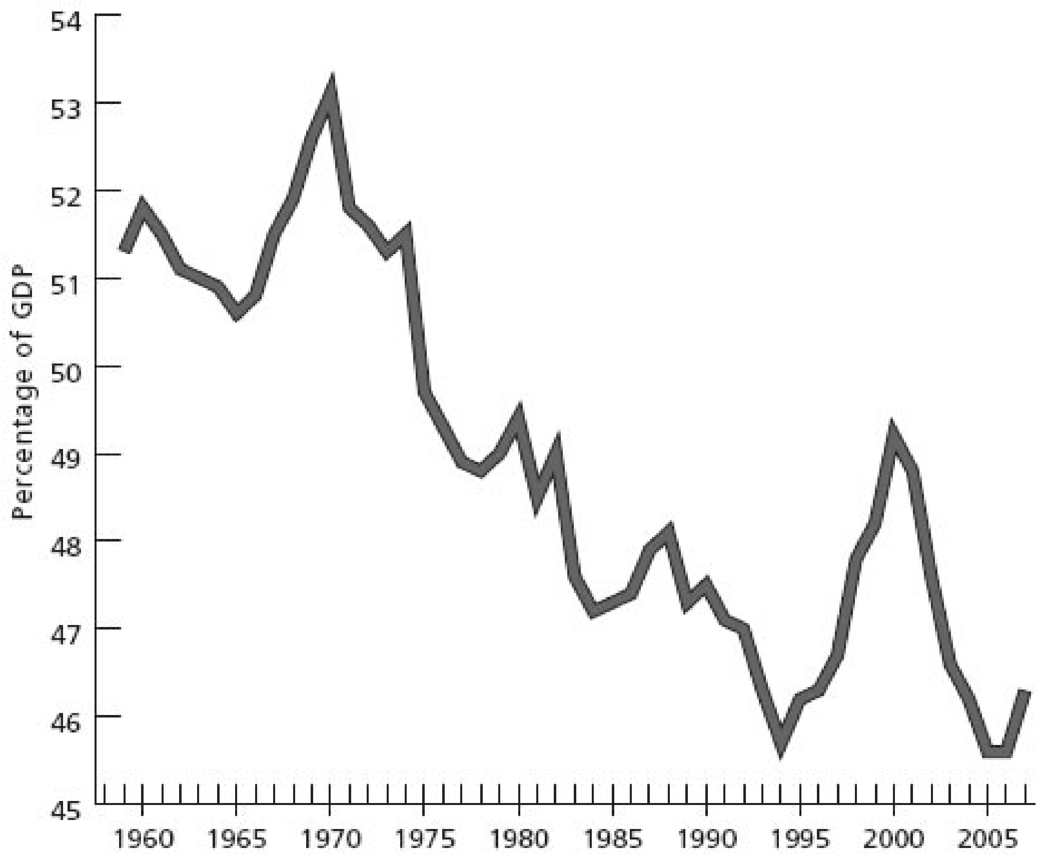
WHY?????????????

- Why the complexity and fraud at every layer?
- Model was flawed from beginning: could not have been profitable; interest payments could not cover costs,
  - Needed mortgages @ 120% of value to book fees,
- Complexity essential to hide accounting fraud.
- The beauty of a Casino: the house always wins.
  - $10T of homes → tens of trillions of dollars of bets.
- Foreclosure was inevitable, desired, outcome: bet on failure then reboot thru foreclosure and to hide the fraud.
- Galbraith: The Great Crash. Like 1929 investment trusts.

Shredding of New Deal Reform

- Deregulation, de-supervision, self-supervision
- Rising inequality
- Falling wage share
- Rising consumer debt
- Fiscal constraint

Wages and Salaries, % of GDP



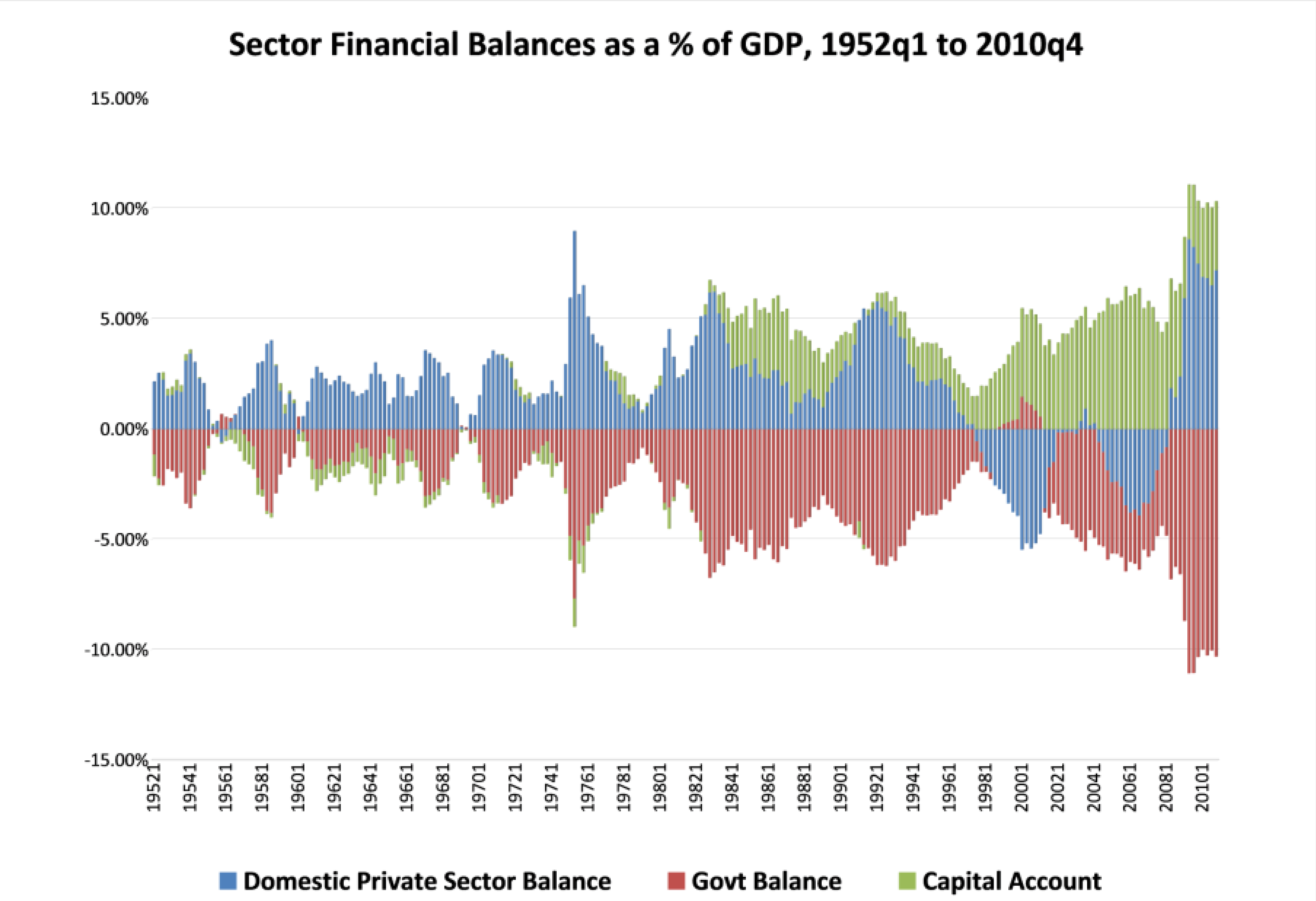
Financial Bubbles, Goldilocks and Budgets

- Greenspan “Put”; Bernanke “Great Moderation”.
  - No bubbles in sight. Fundamentals are strong.
- Reality: biggest debt, equity, commodity, and real estate bubbles in history.
- Propped up by Big Government and Big Bank—No cleansing through debt deflation dynamics.

GFC 2007: It all started with Goldilocks

- 1996: US Federal Government begins surpluses; continued for 2.5 years.
- Clinton projects surpluses for next 15 years.
  - All Government debt will be retired.
  - Fuels securitization
- Private debt explodes. Why? The Three Balances.
- The Meaning of Zero:

0=Private Balance + Government Balance + Foreign Balance


Sector Financial Balances as a % of GDP, 1952q1 to 2010q4
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
-15.00%
19521
19541
19561
19581
19601
19621
19641
19661
19681
19701
19721
19741
19761
19781
19801
19821
19841
19861
19881
19901
19921
19941
19961
19981
20001
20021
20041
20061
20081
20101
Domestic Private Sector Balance
Govt Balance
Capital Account

Bail-out!

- Fiscal Stimulus $800B.
- Hank Paulson $800B. Don’t ask, don’t tell.
  - Toxic asset purchases, capital injections
- Fed: Unprecedented effort
  - Peak $1.7 Trillion
  - $29 TRILLION cumulatively

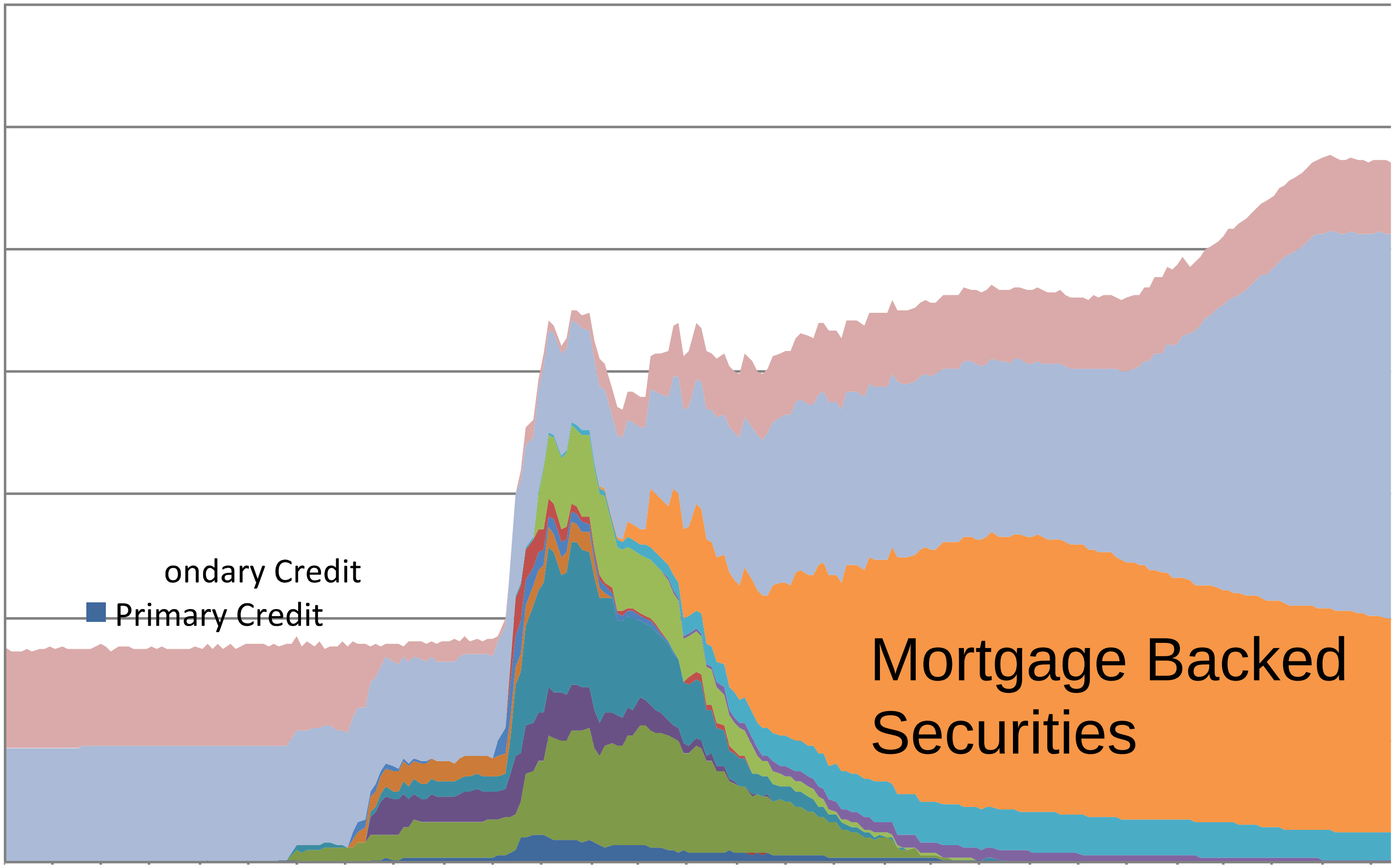
Unusual and Exigent Circumstances

- Liquidity or Solvency Crisis?
  - Bagehot: lend w/o limit, against good collateral, at penalty rate
  - Banks relied on extremely short-term finance, questionable assets→ refusal to roll-over: solvency problems→liquidity crisis
- "Liquidity provisions" through alphabet soup facilities
- Let's Make a Deal!
  - Treas-Fed Negotiations, bridge loans, "orderly solutions"
  - Subvert mkt processes, force losses on owners, rescue creditors
- Fed's Special Purpose Vehicles subvert 13(3) constraints
  - Lending to SPVs to lend and buy toxic waste
  - And to Real Housewives of Wall Street through nonrecourse loans
- QE 1, 2…..3?

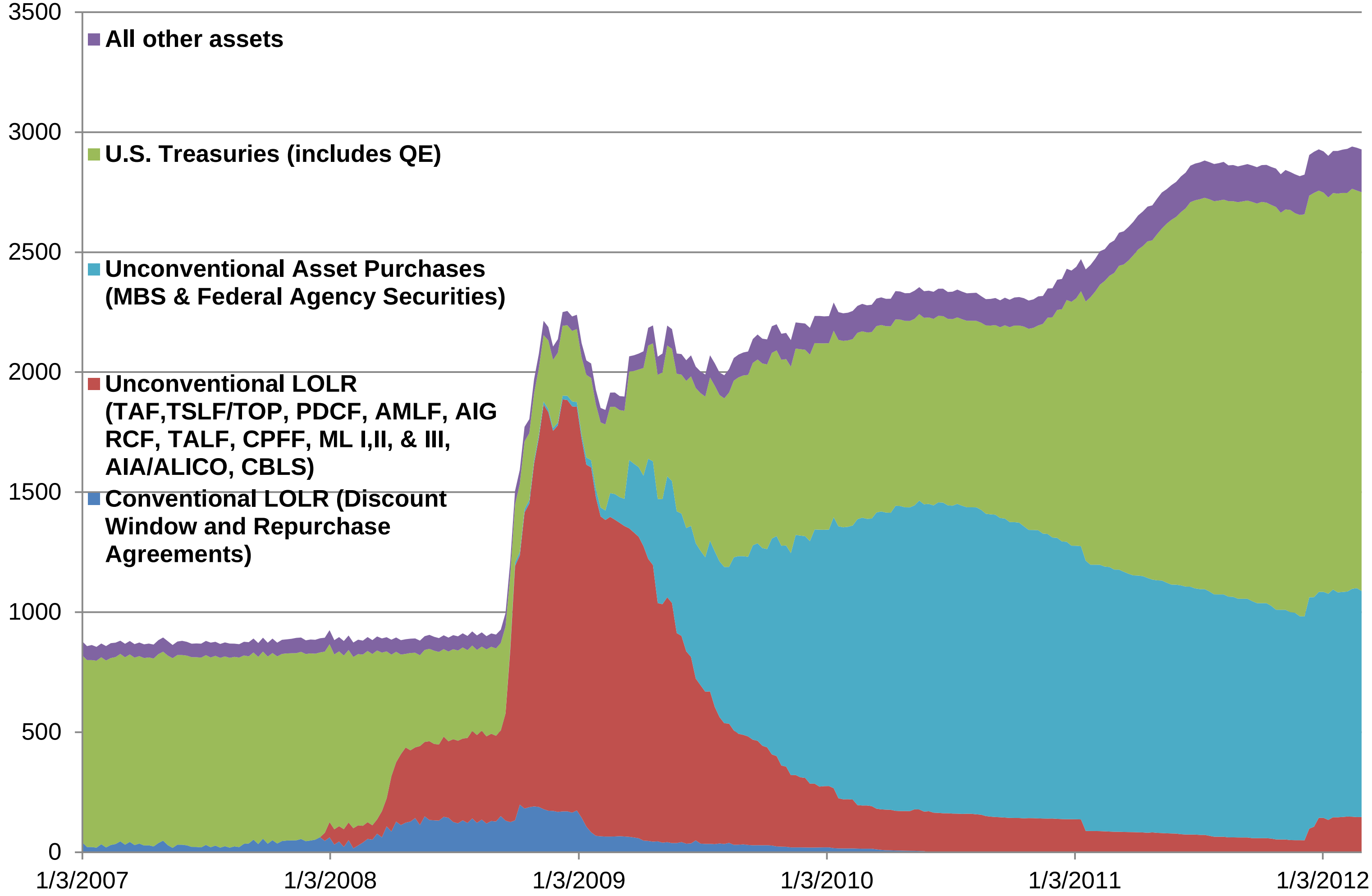
Accounting for the Bail-out

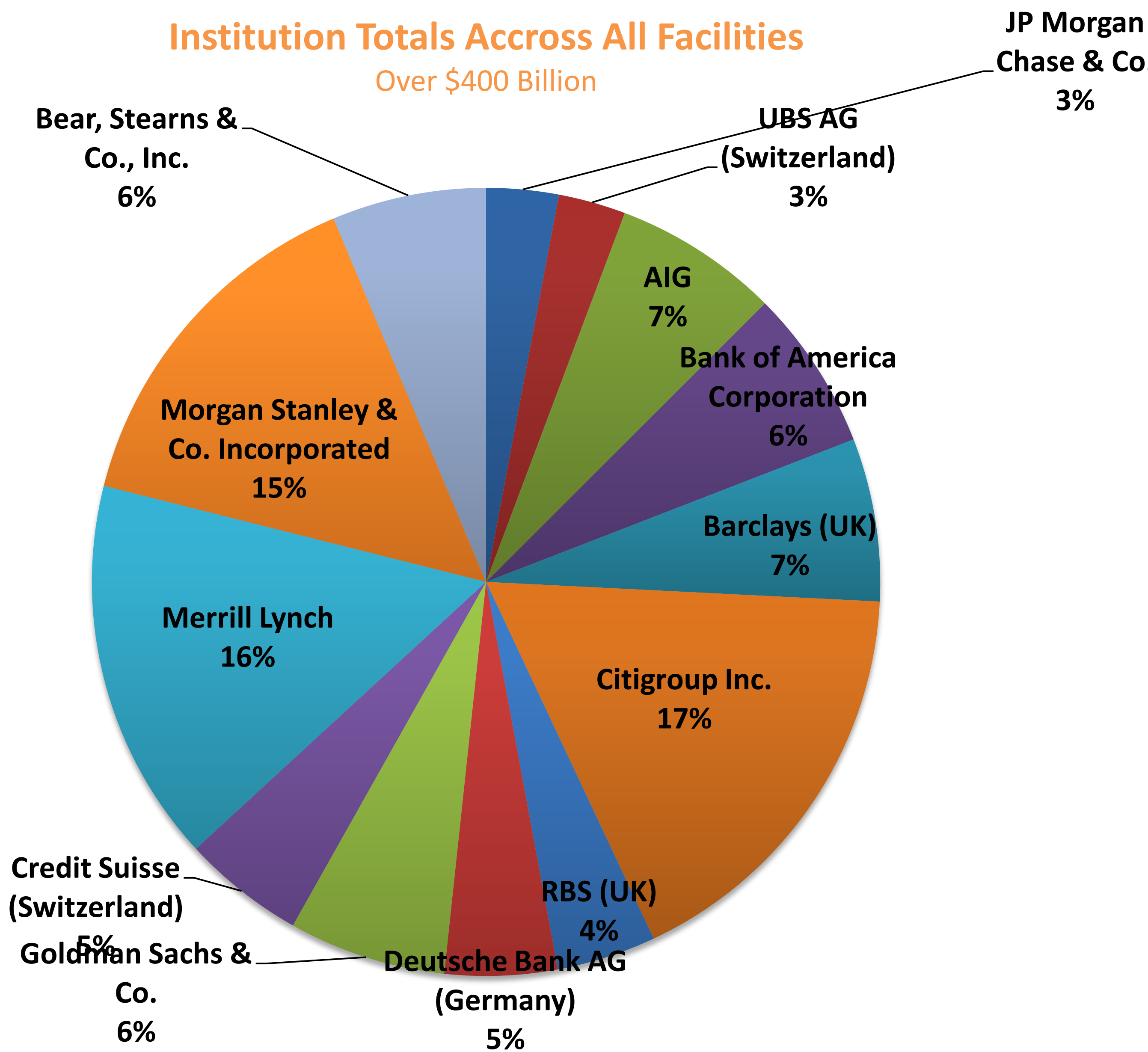
- Act of Congress and FOIA by Bloomberg
- How to measure? Peak versus Cumulative
- Peak: Dec 2008, $1.7 T
- Cumulative through Nov 2009: $29,000,000,000,000
  - Individual institutions funded up to two years
  - 20% “conventional” to depository institutions
  - 80% “nonconventionable” (nondepository, markets, assets)
  - 40% “questionable” by 13(3) restrictions: $11T
  - Highly concentrated among biggest domestic and foreign institutions
  - These figures exclude QE

Select Fed Assets, 1/3/2007-9/2011

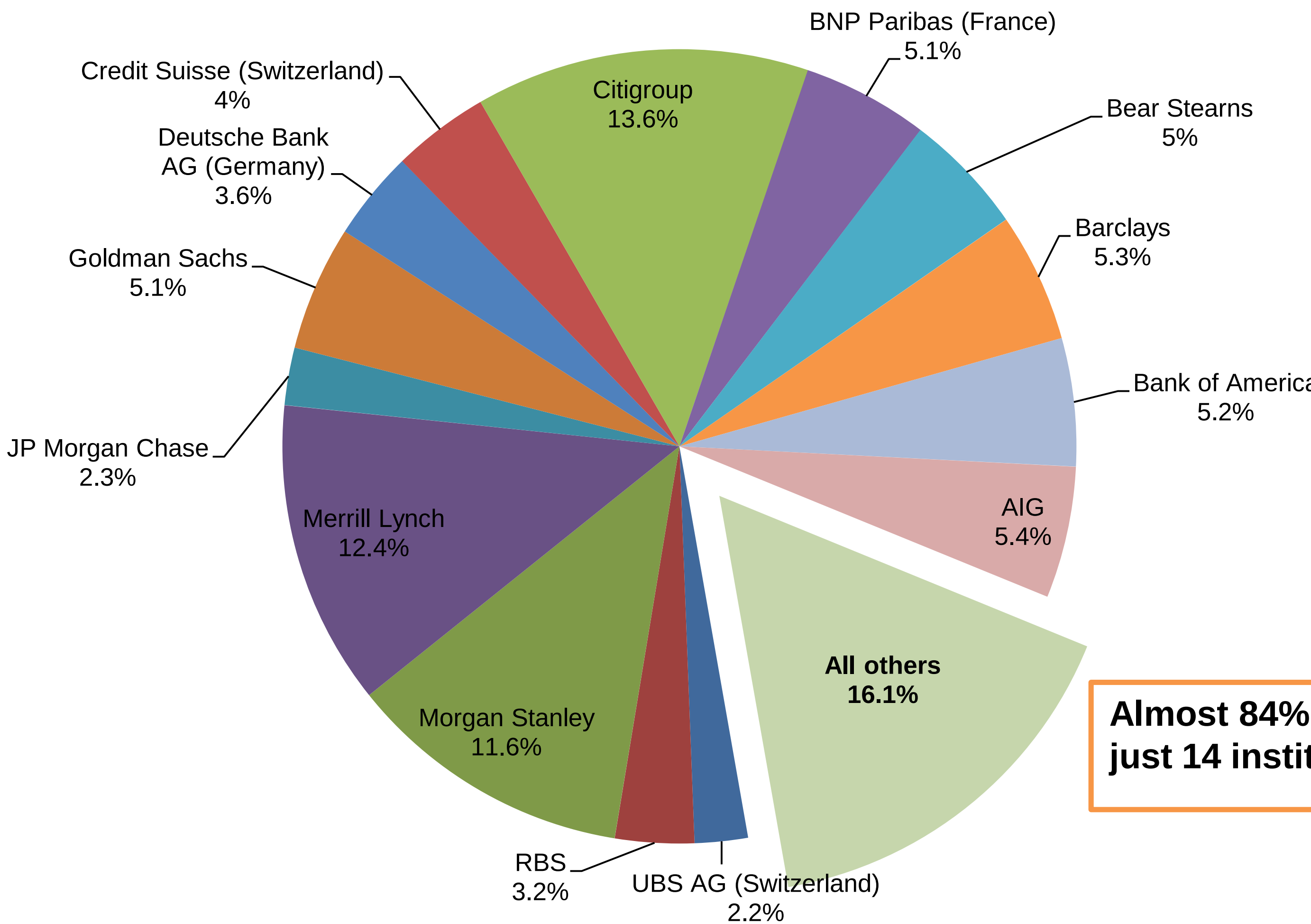


Select Fed Assets, 1/3/2007-3/1/2012




Institution Totals Accross All Facilities
Over $400 Billion
JP Morgan Chase & Co. 3%
UBS AG (Switzerland) 3%
AIG 7%
Bank of America Corporation 6%
Barclays (UK) 7%
Citigroup Inc. 17%
RBS (UK) 4%
Deutsche Bank AG (Germany) 5%
Goldman Sachs & Co. 6%
Credit Suisse (Switzerland) 5%
Merrill Lynch 16%
Morgan Stanley & Co. Incorporated 15%
Bear, Stearns & Co., Inc. 6%

Total Institutional Participation, excluding CBLS



Almost 84% involved just 14 institutions!

Summary: $29,785,420,000,000

Conventional			Unconventional		
Facility	Total	Percentage	Facility	Total	Percentage
TAF	$3,818.41	12.8%	CBLS	$10,057.4	33.77%
TSLF/ TOP	2,005.7	6.7	ST OMO	855	2.87
			PDCF	8,950.99	30.05
			Bear Stearns Bridge Loan	12.9	0.04
			Maiden Lane I	28.82	0.10
			Maiden Lane II	19.5	0.07
			Maiden Lane III	24.30	0.08
			AIA/ ALICO	25	0.08
			AIG RCF	140.32	0.47
			AIG SBF	802.32	2.69
			AMLF	217.45	0.73
			CPFF	737.07	2.47
			TALF	71.09	0.24
			GSE	169.01	0.57
			MBS	1,850.14	6.21
TOTALS	**$5,824.12**	**19.55%**		**$23,961.48**	**80.45%**

End Game for Money Manager Capitalism

- Renewed problem at major banks could set off GFC 2.0
- Radical euthanasia: major banks will fail.
- Managed funds will fail: pensions, sovereign wealth funds, mutual funds, insurers, hedge funds.
  - That is a good thing!
  - Minsky's "simplification" of the financial system.
- Will emerge with little private debt, massive government debt → robust financial system; Constrained with new laws, supervision.
- Return to underwriting, hold to maturity.
- Financialization replaced with New Deal 2.0: Higher Wages, Full employment, Domestic Consumption.

THANK YOU

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