

# **The Global Financial Crisis**

## **Module 1 Introduction**

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# **What is a Financial Crisis?**

## **Conceptual Framework**

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**Almost all wealth is embodied in long-lived assets that pay off slowly over time.**

**Some fraction of that wealth is needed to back short-term safe assets used in transactions (“money”).**

**Collectively, we cannot all convert our long-term assets to money at the same time.**

**A “panic” happens when enough people get nervous and try to convert.**

**A “financial crisis” occurs when a panic (or fear of panic) affects the functioning of the financial system.**

## **Why Study the Global Financial Crisis?**

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**It is an important part of history, by far the most important economic event since the 1930s, and crucial for understanding the world that followed.**

**It could happen again.**

**We would like to prevent it from happening again.**

**If it happens again, we need to be prepared to fight the fire together.**

## Course Themes

**01**

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**Asset Bubbles**

**02**

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**New Kinds of  
Money**

**03**

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**The Anatomy  
of a Modern  
Panic**

**04**

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**Fighting the  
Panic**

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## **Course Theme 01: Asset Bubbles**

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**“This time is different ...” (Reinhart and Rogoff, 2008).**

**Prior to all financial crises, there is a large increase in the price of at least one asset class. When this price later falls, we retroactively label the original increase to be a “bubble”.**

**In the Global Financial Crisis, the bubble was in housing.**

**Housing bubbles have been associated with every major financial crisis since WWII.**

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## **Course Theme 02: New Kinds of Money**

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**Through most of the history of civilization, our monetary needs were met primarily by metal-based currencies.**

**The rise of the modern state has allowed for sovereign-backed “fiat” money.**

**But ... even stable governments have limits and the demand for money can exceed the supply of metal and sustainable fiat money.**

**Additional monies are then “manufactured” by the financial system, using private debt backed by collateral.**

**The history of financial crises is a tour through sad stories of new monies gone bad.**



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## **Course Theme 03: The Anatomy of a Modern Panic**

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**For hundreds of years, panics were easy to spot: depositors would “run” to banks to exchange their banknotes for gold, or to remove their deposits.**

**The Global Financial Crisis was different, with the panics occurring out of public sight, in the non-bank part of the financial sector. This area of the financial system is often called the “shadow banking” system.**

**To fully understand the Global Financial Crisis and the efforts required to fight the panic, it is important to understand the mechanics of this modern system.**

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## **Course Theme 04: Fighting the Panic**

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**Going into the Global Financial Crisis, governments all over the world were underprepared, with the available tools built for fighting an old-fashioned bank run, not a modern crisis.**

**To fight this crisis, these tools – emergency lending, guarantees, capital injections – were extended to creative new uses.**

**The evidence shows that this panic-fighting was a success, but this success came at the cost of political backlash, in some cases reduced our firefighting capabilities for the next crisis.**

## Course Organization

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|-----------|--|-----------|--|
| <b>01</b> | <b>Introduction</b>                            | <b>08</b> | <b>Panic</b>                                 |
| <b>02</b> | <b>The Common Causes of Financial Crises</b>   | <b>09</b> | <b>Our Responses to the Crisis</b>           |
| <b>03</b> | <b>Housing and Mortgages</b>                   | <b>10</b> | <b>Responding to Future Crises</b>           |
| <b>04</b> | <b>Safe Assets and the Global Savings Glut</b> | <b>11</b> | <b>Europe in the Global Financial Crisis</b> |
| <b>05</b> | <b>The Housing Crisis</b>                      | <b>12</b> | <b>The Eurozone Crisis</b>                   |
| <b>06</b> | <b>Anxiety, Part 1</b>                         | <b>13</b> | <b>Course Summary</b>                        |
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