

# The beautiful and the damned

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## Roots of this crisis

- U.S.'s Dot com bubble in late 1990s — spending in information technology and communication
- Taiwan was a major supplier
- A bust in early 2000 and Taiwan was in recession

## Fed's reaction

- Fed lowers interest rate to induce investment
- However, firms had already invested too much
- Lower interest rate prompted U.S. consumers to buy houses
- A significant portion of money goes to the so-called subprime lending

## Lenders from all the world

- Not only the U.S. Fed, Germany, Japanese, Chinese, and Taiwanese all supply loans to the U.S. firms and consumers
- Most of the huge foreign reserves were used to buy US bonds
- How the lenders assess the risk of their loans?
- The sophisticated U.S. financial sector played a role made risk evaluation difficult or impossible

# Inequality

- Rajan, Raghuram G., *Fault Lines*, Princeton University Press, 2010
- Rajan argued that inequality also played a role
- In 2007 America's income share of the richest percentile reached 18.3%
- The last time America was such an unequal place was in 1929

## Technological progress

- Technological progress increased the relative demand for skilled workers, leading to a widening gap in wages between them and the rest of the workforce
- Ideally, more should have been spent on education and training
- But in the short run, credit was an easy way to prop up the living standards of those at the bottom of the economic pile

## Subprime crisis

- America in the early 2000s saw a boom in lending to the poor
- Government put pressure on the two state-backed housing giants, Fannie Mae and Freddie Mac, to lend more to poorer people
- Subprime mortgage's share (of the total mortgages) rose from less than 4% to 15% before the crisis

# Bubble

- The credit boom also inflated an enormous housing bubble
- The collapse of housing bubble precipitated a financial crisis on the subprime mortgages