How was it possible for problems in one relatively small sector in the global financial system – the American sub-prime mortgage market – to lead to the most serious economic crisis in living memory?

Alistair Milne untangles the complex world of modern banking and examines solutions to the crisis. He shows how the banks misused their ability to securitize loans and, by borrowing short and lending long, exposed themselves to exceptional risks when asset prices started to fall. But it has been above all a collapse in trust and confidence, rather than poor lending decisions, which has fuelled the crisis. Despite all the talk of ‘toxic’ assets, the book argues that most assets are sound and can be repaid. The imperative is to restore confidence through collective action involving asset purchases, guarantees and recapitalization. Failure to do so will mean that taxpayers will be carrying a crippling tax burden for generations to come.

Alistair Milne is Reader in Banking and Finance at the Cass Business School, City University, London. He has also worked for the Bank of England and HM Treasury.
The Fall of the House of Credit

What went wrong in banking and what can be done to repair the damage?

ALISTAIR MILNE
To J, K, L and all the Ms
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1 Where did all the money go? An analysis of the causes and cure of the current global banking crisis 24

Presents the argument of the book, that a policy of holding safe but illiquid long-term structured credit securities, financed using short-term borrowing, created a bank funding crisis that was the principal mechanism creating the credit crisis. Presents a key Figure 1.1, which illustrates this new feedback loop in wholesale funding markets that makes this crisis different from any others. Compares other analyses of the crisis and argues that it can be addressed through a policy of taxpayers providing insurance against extreme systemic credit losses. Considers some practical details.

2 Build-up, meltdown and intervention 50

The macroeconomics of the story and the role of banks in recycling global savings. The threat of a massive global economic downturn if this recycling is not maintained. An overview of bank involvement in the structured credit markets. An estimate of the amount of exposure and some projections of prospective losses, distinguishing permanent credit impairment from short-term liquidity losses. An overview of actions taken by policymakers.
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impact of the initial losses on US sub-prime. Structured credit markets became illiquid, resulting in write-offs of many bank portfolios. The disruption of money markets and global impact.

8 The flood of losses

The narrative continued, up to the failure of AIG. A series of case studies both discusses the major losses experienced by many individual institutions (UBS, Merrill, Citigroup, Fannie and Freddie, AIG) and provides an overview of losses across the banking sector. Discusses also many of the knock-on effects on monolines and municipal bond markets.

9 Central banks and money markets

Goes into the details of central bank monetary and liquidity operations, pointing out the limitations of central bank liquidity provision. Explains how banks use money markets to raise short-term funding. Compares orthodox and unorthodox approaches to monetary policy. Notes that there are substantial limits on the ability of central banks to provide commercial banks with new funds for lending.

10 The run on the world's banks

The failure of Lehman and the four-week run on the global banking system and government rescues that followed. An assessment of the policy measures taken, showing how they are moving in the direction of taxpayer provision of long-term systemic risk insurance.

Conclusions: repairing the house of credit

Explains how a global slump can be avoided and briefly considers longer-term measures to restore global prosperity.

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Acknowledgements

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To Rudy, I apologize that while I have been able to include the financial equivalent of a car chase, I could not satisfy your other request for some steamy bedroom scenes. Let’s hope that despite this the text still has some general appeal. My children have had much less of my time over the past eight months than I would have liked. My partner has been the most long-suffering of all, putting up with many weekends and evenings when I have been devoted only to the computer screen. She tells me in no uncertain terms that this has to be a one-book relationship. On my side I am determined that this will be the only book I ever write – at least on such a topical subject and to such a tight deadline.

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