

THE FINANCIAL CRISIS AND A CHRISTIAN RESPONSE

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What is a bank – how do they fail?

- Traditional bank

Assets	Liabilities
Liquid assets (cash, government bonds)	Capital
Loans	Retail deposits

- “Modern” bank

Assets	Liabilities
Liquid Assets (cash, government bonds)	Capital
Loans and “Securitisations” (from other banks)	Retail deposits
	Wholesale deposits

Loans being sold off	As “Securitisations”
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How did we get a banking crisis?

- Banking crises are not unusual – over 100 since 1970! Typically 3 phases, vulnerability, shock, response:
- “Vulnerability” (2000-2007)
 - Low real interest rates due to Chinese savings flooding world and easy monetary policy (notably US)
 - Bank’s risk appetite and desire for returns, growth in lending including to “sub prime”, “ninjas”, “buy to let”
 - incentives to underplay risk due to “securitisation”
 - Rising asset prices (for houses and shares) making it all seem sustainable
 - And some errors in financial regulation – especially regarding financial innovations

Figure 1: Real Interest rates in the UK and the US

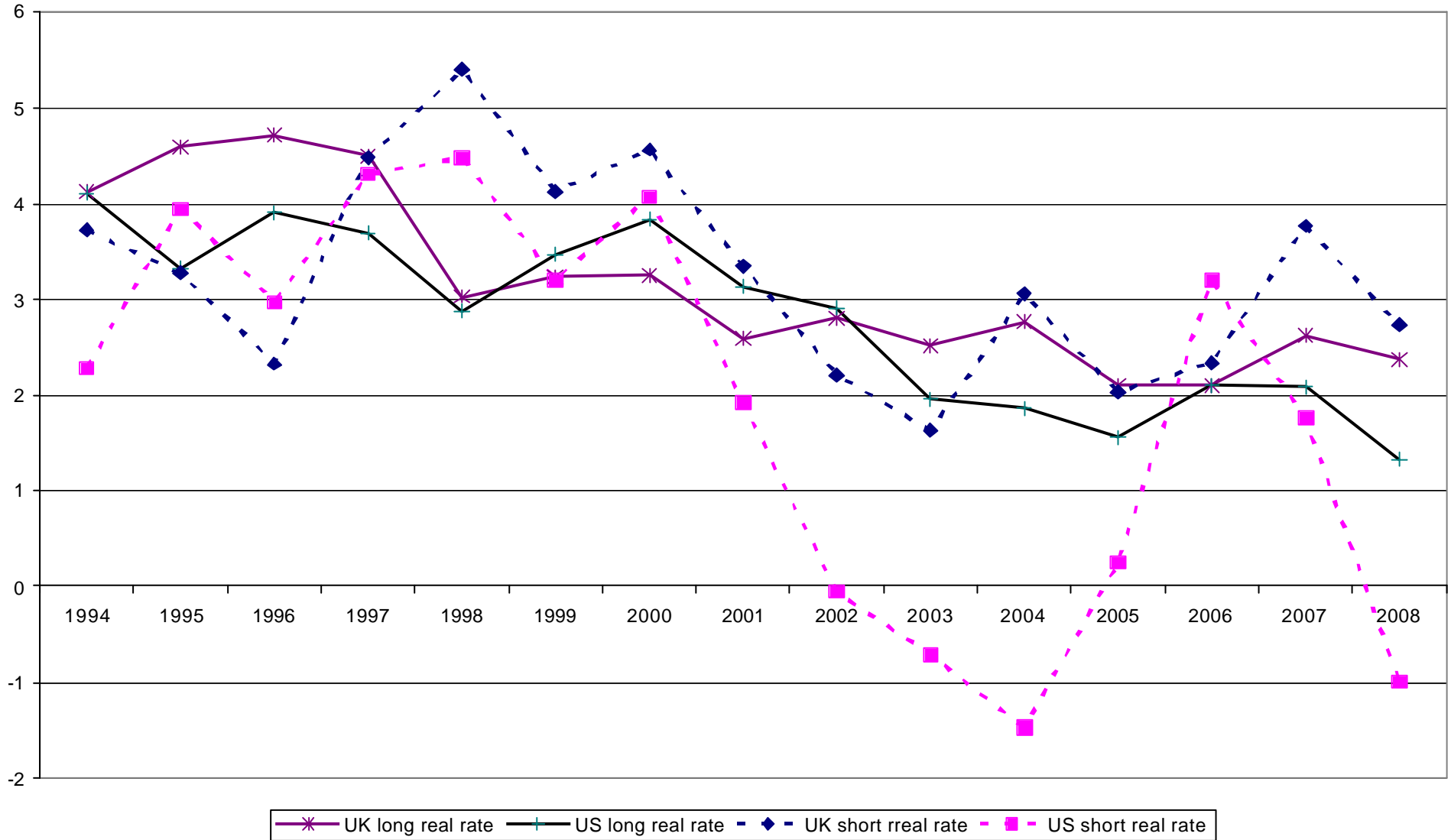


Figure 2 Personal sector borrowing as a proportion of disposable incomes

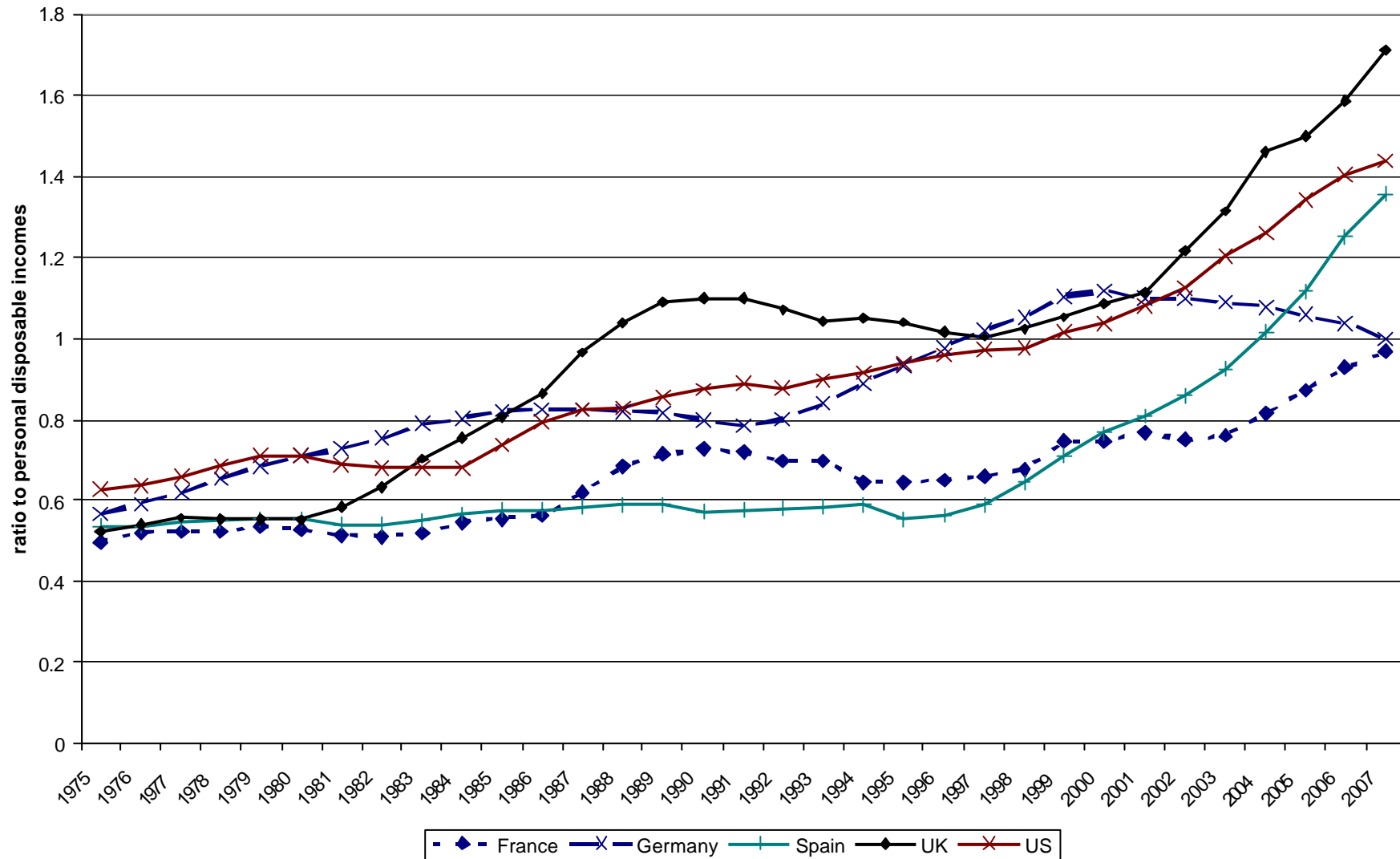


Figure 3 Real House Prices

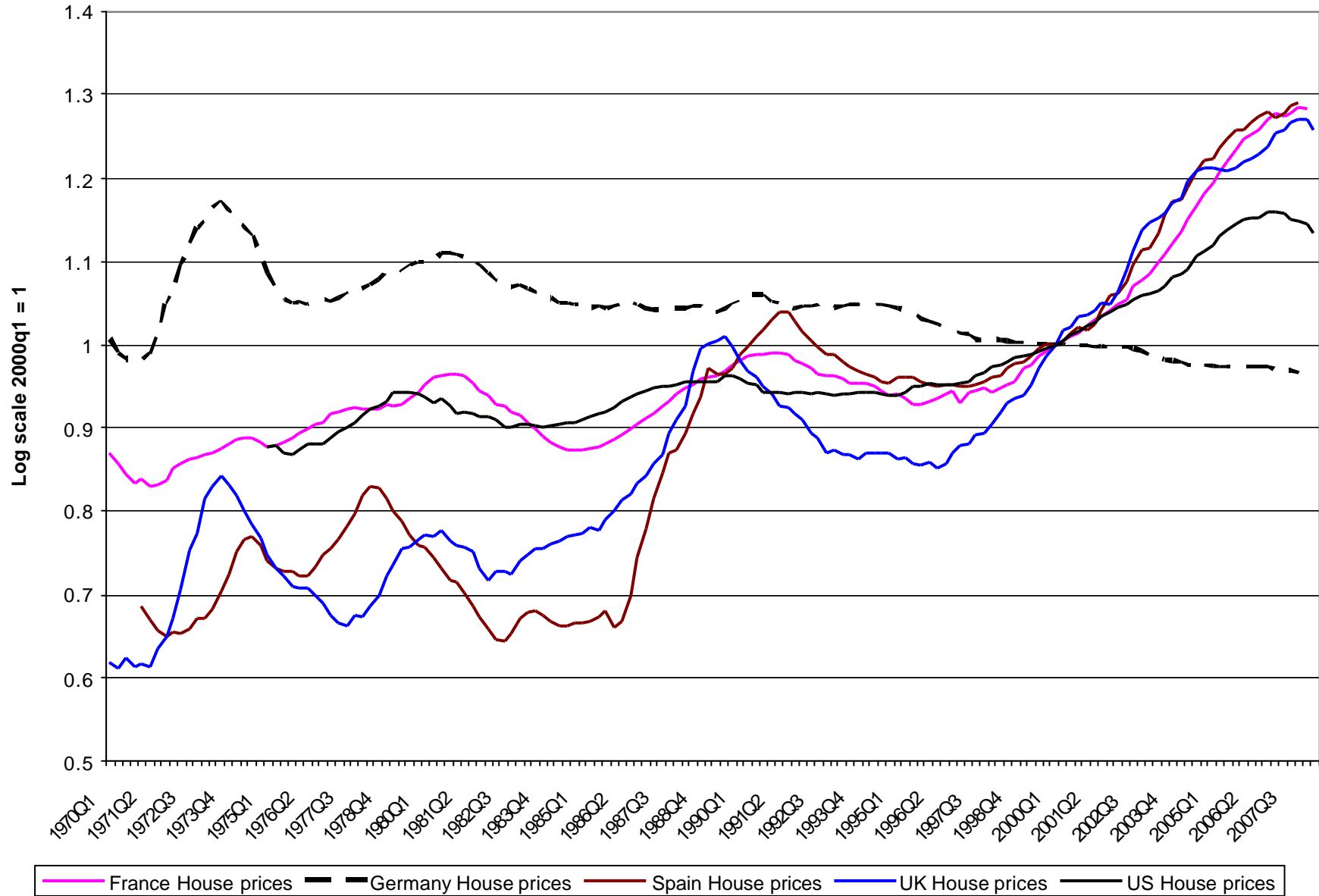
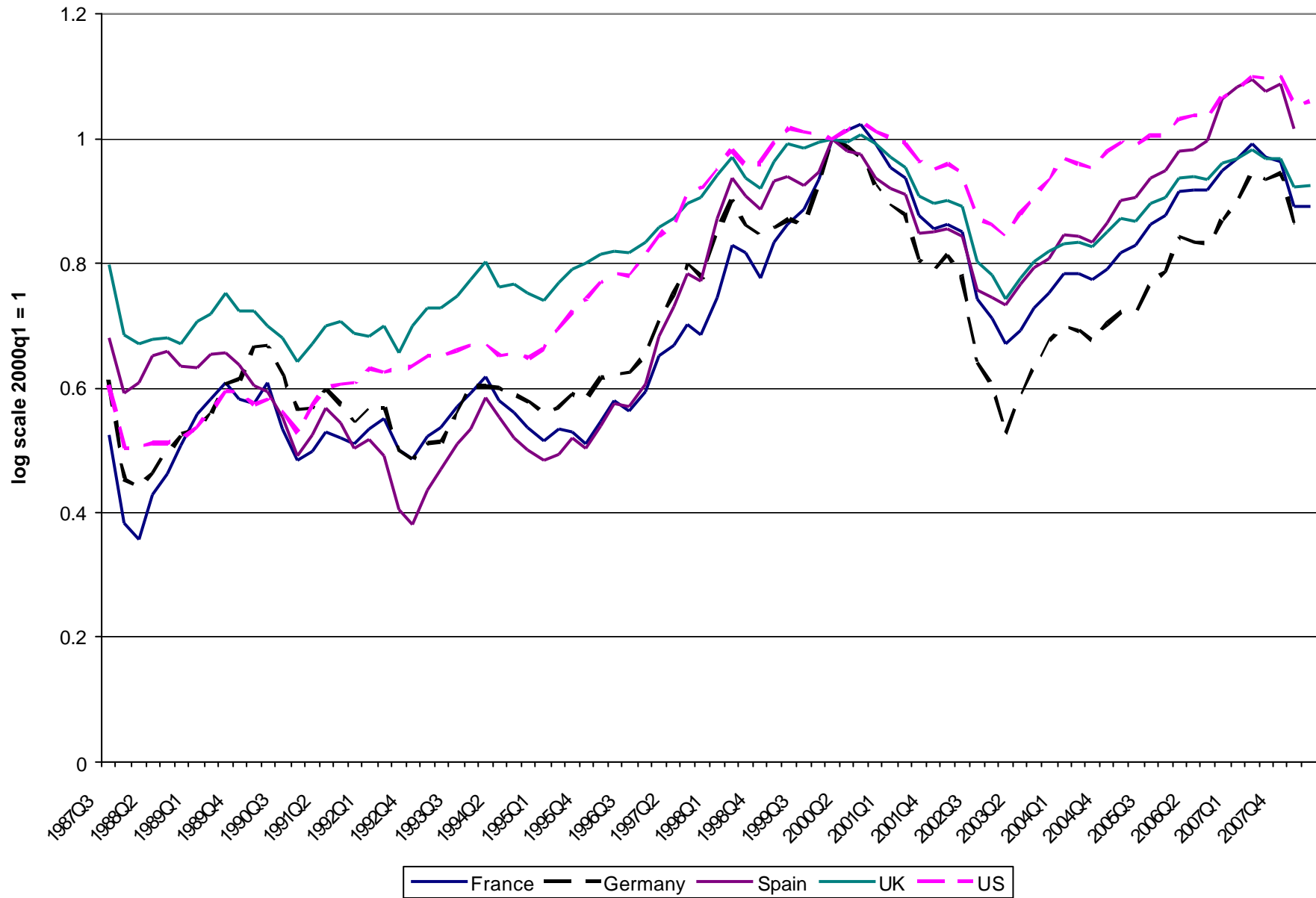


Figure 4 Real Equity Prices



- “Shock” (2007-8)
 - Defaults on loans rising as house prices fall, especially in the US (US loss estimates now \$1.4 trillion)
 - Realisation that US “securitisations” had been overvalued (“toxic assets”) and many banks had them
 - Switch of bankers from risk loving to risk aversion.....
 -closure of wholesale deposit and securitisation markets (and retail run on NR)
 - “Deleveraging” as banks and other institutions try to reduce debt exposure, shrink balance sheets
 - Collapse of bank share prices indicating risk of failure, especially after Lehman bankruptcy

- “Modern” bank

Assets	Liabilities
Liquid Assets (cash, government bonds)	Capital (DEPLETED BY LOSSES)
Loans and “Securitisations” (from other banks) (HEAVY LOSSES)	Retail deposits (STABLE EXCEPT NORTHERN ROCK)
	Wholesale deposits (UNAVAILABLE)

Loans being sold off (NOT POSSIBLE)	As “Securitisations” (MARKET CLOSED)
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- “Response” (2008)
 - Central bank liquidity to substitute for wholesale deposits
 - Government nationalisation of banks risking to fail such as Northern Rock and Bradford and Bingley
 - Recapitalisation of major clearing banks (RBS, HBOS, Lloyds) – quick but could have been quicker
 - International crisis – US, Iceland, Belgium, other EU – with varying government response, e.g. US plan to buy “toxic assets”
 - Banks may be safe but not other institutions
 - And recession now underway, aggravated by credit rationing

Why is there a recession?

- Components of “aggregate demand”
 - Consumption (depends on real incomes, house prices, share prices, credit rationing, uncertainty)
 - Fixed investment (depends on expected economic growth, real interest rates, stock of existing capital, share prices, credit rationing, uncertainty)
 - Government? minus Taxes?
 - Exports (less product demand) minus imports (oil prices still high)

What is likely to happen?

- Continued credit rationing (high price, low availability of mortgages and consumer credit)
- Factory, office and shop closures
- Unemployment
- Further falls in house prices (30% overvalued at peak) and share prices (as they anticipate recession, and people redeem unit trusts etc.)
- Repossessions of houses and further losses for banks
- Difficulties for pensions (hopefully short term)
- Spreading of crisis to poor countries

Elements of a Christian response

- “People who want to get rich fall into temptation and a trap” (1 Timothy 6:9)
- “Do not judge or you too will be judged” (Matthew 7:1)
- “The borrower is servant to the lender” Proverbs 22:7
- “Keep your lives free of the love of money and be content with what you have, because God has said “Never will I leave you, never will I forsake you”” (Hebrews 13:5)
- “Continue to remember the poor” (Galatians 2:10)