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Origins of the Financial Crisis: What Happened?

A lot has been said, and a lot has been written, about this crisis and I think books will be written going forward. But I like to think of this, in the broadest possible terms, as a failure of financial engineering. What I mean by this is that securitization markets got going, and new products got introduced onto the market, and I think the truth is that people trusted these products, they were traded in deep markets, people thought that they were reasonable and it turned out that they weren't. When the housing markets turned around, they really failed in a big way and almost all of the big players in financial markets were hit by this. So I think that shows you that it was not something that some people understood and other people didn't understand. It's really that as a market, as a nation, as a world, we didn't really understand what was going on here. So once this failure of financial engineering occurred, now you've got toxic assets spread all around the globe and it's just a big mess that has to be, has to be, fixed. That's in the broadest terms how I like to think about where this crisis came from. If you think of other types of engineering failures that have occurred, one that comes to mind is asbestos in buildings. Asbestos was introduced into buildings - I don't know - in the 50s and 60s. It was great fire retardant, considered to good thing at the time, later found out to have severe health implications. So now you have to trade off the fire retardant against the health risks, and it was in a lot of buildings nationwide. And it just had to be cleaned up, and that's the way it was. So that was a big shock and a big problem, and I think that's how you should think about the failure of financial engineering.