CONCEPT: MONETARY POLICY DURING THE 2008 RECESSION

● During the 2007-2009 recession, the burst of the ____________ bubble caused turmoil throughout the financial system

□ Mortgages were bundled and sold as securities called *mortgage-backed securities*

> These securities bundled "safer" mortgages with "high-risk" sub-prime mortgages

□ As more mortgages defaulted, the MBS, which were owned significantly by investment banks, suffered losses

□ Actions taken during the beginning of the financial crisis:

Date	Action	Goal
March 2008	Allow discount loans to some investment banks	Providing short-term funds to investment banks without them having to sell more securities
March 2008	Loan $200B of Treasury Securities in exchange for MBS	Investment banks had more liquidity to use as collateral when holding many worthless MBS
March 2008	Assist JPMorgan Chase in acquiring the investment bank Bear Stearns	Avoiding a financial panic and domino effect of Bear Stearns failure
September 2008	Federal government takes control of Fannie Mae and Freddie Mac (mortgage purchasing companies)	Confidence in MBS would have decreased further, leading to an even weaker housing market

□ In September 2008, the Fed allowed another investment bank, ________________, to go bankrupt.

> *Moral Hazard* is a problem when it comes to bailing out uninsured risks

> By arranging the purchase of Bear Stearns, the government effectively provided insurance for risky decision making by the management of that bank

- This could lead to future risks taken knowing that the government would "bail them out"

□ In October 2008, the Troubled Asset Relief Program (TARP) passed

> The federal government provided funds to commercial banks in exchange for partial ownership

- Ownership positions in private banks was an unprecedented action for federal government