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Understanding the Great Financial Crisis, 2007-2009

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16-18 years later, let's summarize what happened. The GFC began as a financial crisis, with widening credit risk spreads and very sloppy asset management on the part of banks and non-bank financial institutions. The Fed incorrectly treated the problem as one of inadequate liquidity (that is, as "monetary"), rather than of counter-party risk. Easy money led the dollar to weaken to its lowest-ever exchange against the euro, while commodity prices soared -- nevertheless, credit risk spreads remained high. A pattern emerged (still not resolved in many accounts) of different monetary measures pointing to different inferences. We consider money growth, the Taylor rule, inflation or NGDP targeting, etc.

The dollar recovered rapidly as money became tighter after July 2008 -- which correlated with the Lehman collapse in September, and fears of default contagion. Banks were recapitalized by US Treasury in October 2008, which eased counter-party concerns -- yet the downturn worsened. By this time, the financial crisis had been superseded by a monetary-driven downturn. For different reasons, Right and Left both misunderstood the monetary problem (the latter persisted for years), and what to do about it. Quantitative easing (QE) by the Federal Reserve injected new reserves beginning in March 2009, which facilitated a slow US recovery. But QE

Biography:

Clark Johnson worked for much of two decades in economic development in the Middle East and central Asia, including as a contractor, direct employee and team leader with the US State and Defense Departments. He is the author of Uncommon Arguments on Common Topics: Essays on Political Economy and Diplomacy (KSP Books, 2022), and of Gold, France, and the Great Depression, 1919-1932 (Yale, 1997), which received an award from the Association of American Publishers. Recent papers include “Did Keynes Make His Case?” (2016), “Supply-side Economics and the 2017 Tax Act” (2018), “A Different Cold War? the 1963 European Settlement and Aftermath (2022), and “From Keynes’ Clearing Union to the Eurozone and the Renminbi”(2022). He is an economics advisor to Trade Engine LLC, a software development firm, and tutors students in economics, finance, French and German. He has taught finance or international economics at three universities. He has a PhD (1994) in Economic and Diplomatic History from Yale University.