# Part II
# The Genesis of the Crisis

The genesis of the 2007–2010 financial crisis may be distilled into two complementary processes. The first is a boom in housing (see Chapter 3). This was provoked by a series of government interventions earmarked to improve the lot of the disadvantaged, but which led to increased demand for houses, and thus to an increase in housing construction and in house prices, the granting of a large number of injudicious mortgage contracts and ultimately the failure of a large number of the parties to fulfil those contracts. The second process was the growth of securitization[1] in general, and the securitization of mortgages in particular (see Chapter 3). This growth multiplied the impact of government interventions to increase ownership and supported the explosive growth of mortgages, even among people unable to support mortgage payments.

The two processes had two effects. On the ground, a large number of people saw their homes foreclosed as they failed to make mortgage payments. In the financial world, a large number of investors discovered that the 'nearly risk-free' securities were in fact of very uncertain value. It is this latter issue that is at the heart of the financial crisis, rather than

1. Securitization is explained in Chapter 2. If you own something that can make money on a reliable basis, in finance-speak you have an asset that generates cash flow. If you want, you can sell the opportunity to share in that cash flow. You could even sell the rights to all of the cash flow and make a little profit by selling those rights at a higher price than you paid for the asset. This is securitization, and that little profit when earned a multitude of times made the securitization of mortgage loans a sustainable business. Unfortunately, the purchase of those securities was predicated on the faulty assumption that real estate values were going to continue to increase in value uninterruptedly.

the former issue. The nearly total seizing up of the credit markets was due in large measure to these 'nearly risk-free' securities.

In order to understand the genesis of the crisis, we must first examine the roots before studying the sequence of events leading up to the bust of 2007: the historical context of the crisis and the mechanics behind the sequence of events. That examination is the topic of Chapter 2.