



When a large bubble bursts it affects the whole economy. All sorts of people who weren't having any of the fun wake up to a big post-celebration mess.



That happened in 2000 when the dot.com bubbled burst. Investment, spending and employment all dropped in reaction. 9/11 didn't help consumer confidence any, either.



In 2002 when the Federal Reserve, America's central banking system lowered interest rates (making money cheap to borrow to stimulate investment)...



With banks finding easy loan-money and consumers able to borrow cheap, many home mortgages were created. Lenders began selling off these debts to other financial institutions who would often sell bundles of debts to still other groups. Bundles were "securitized" - that is, made into a tradeable thing:



And so mortgages were bundled, sold, unbundled, rebundled, resold, ETC ETC. For original lenders mortgages were no longer long-term contracts with their individual clients, but a product, an asset to sell. Quick and easy money and a slack eye for quality became the norm.



Then: in 2004 congress made sub-prime mortgages tradeable in the same way. These are riskier home loans made to poorer people in more precarious situations. They had crappy terms such as "adjustable rates" - interest-rates on repayment would start low but could quickly leap to unmanageable levels. Higher rates of default made these loans more risky to creditors (the entity receiving the payments), but the higher interest rates brought them higher profits - assuming they were paid.

These were sliced and diced into the huge roiling pot of MBS's already in play. Bundles were rated for risk, tho often UNDERrated.

If a homeowner defaulted so what, the creditor still owned a property that was steadily rising in value.



All was fine.

um,

Until it wasn't.

(If you can do that pop noise with your finger and your mouth please do...)



When the Federal Reserve raised interest rates to address inflation, thousands of homeowners with Adjustable Rate Mortgages faced higher payments and defaulted. Too much housing had been build during the frenzy and now with owners walking away from their homes prices began to drop. Some owners walked away simply because with their houses' plunging value was no longer worth the payments. Mortgage backed securities began defaulting, no one wanted to own those, either. The whole house of cards came down.



Outside the rat nest, a lot of ordinary people lost their money and their homes and their jobs.



And the rats of the financial world woke up to find all their tails had knotted into one inseparable knot. Who owned what debt? Who was in biiiig trouble? Lacking a definitive answer, the best guess was: everyone. The whole Rat-King panicked, credit froze up, lenders went belly up....