The global financial community had been lulled into complacency. The world economy was humming along at a fast clip, financial markets remained generally calm, and private financial institutions were making impressive profits. The International Monetary Fund was running out of clients and suffering from an identity crisis. Suggestions that the Fund was no longer needed, or was at best useful as a provider of analyses and statistics, were becoming commonplace. And the IMF itself failed in detecting signs that the global financial system was becoming dangerously vulnerable. It was certainly not alone in missing the onset of a new and truly frightening crisis that threatened to bring down some of the world’s largest banks and in its wake burn to ashes large swaths of other parts of the economy. But there were a few voices that had issued well-argued warnings of a possible financial cataclysm. William White, the perceptive Canadian-born Chief Economist of the Bank for International Settlements (BIS), was on record as highlighting the dangerous course the global system was taking. As an experienced central banker, he was sensitive to the fuel that excessive liquidity creation was providing to asset markets. Moreover, he issued repeated warnings about the increasingly obscure securitization practices and the dubious role of rating agencies. But White’s admonitions mostly fell on deaf ears. At the IMF, apparently following the line taken by the Federal Reserve, rapid growth of monetary aggregates and credit was largely ignored. And it was this easy availability of cheap money that allowed the housing boom in the United States to get out of hand, leading to widespread foreclosures and securitized mortgages becoming toxic. Nouriel Roubini, an original thinker from the Stern School of Business at New York University, at an early stage predicted that a dangerous housing bubble had developed in the United States and that it was going to burst. His repeated warnings earned him the sobriquet Dr Doom. At a talk Roubini gave at the IMF in 2006 he warned of an impending collapse of house prices, foreclosures, and other misfortunes. I was impressed by his predictions, but got the impression that most of the
audience thought Roubini a *Cassandra*. Intriguingly, a year earlier Raghurum Rajan, then Chief Economist at the IMF, had warned against the buildup of excessive risk in the financial system in an address to a gathering of the world’s foremost central bankers.\(^2\) This was apparently a completely private view, as it is not to be found in a single official Fund publication. To be sure, the IMF had for a long time warned about global imbalances (the combination of very large current account deficits in the United States and excessive surpluses in China and oil exporting countries), but it never sounded a critical note on developments in the American financial system, from which the catastrophe originated. It can be argued that, even if the IMF had joined the few dissenting voices, a crisis would still have occurred, but its depth and spillovers would likely have been more limited. And, without a doubt, if the Federal Reserve and other American financial supervisors plus their European counterparts had taken timely preventive action, the course of events could have been quite different. But it has to be kept in mind that going against the conventional wisdom, which strongly supported a lightly regulated system, especially in the United States and the United Kingdom, requires not only courage but also very impressive powers of persuasion.

**An unquiet day in August**

As the vast majority of the world’s financial activities are conducted in the Northern hemisphere, the month of August is usually a boring one for financial markets. Masses of people head for the beaches and mountains. Financial executives, traders and policymakers take a break from the hectic activities that occupy them for much of the rest of the year. But once in a while a financial fire breaks out in the middle of summer that has suntanned CEOs, ministers of finance, central bank governors and IMF officials rushing back to their workplaces. And when, in August 2007, the first signs of a widespread liquidity crisis appeared in the United States and the advanced countries of Europe, shock waves reverberated around the world.

August 2007 began quietly. While there had been some worries earlier in the summer about the state of the housing market in the United States, the general opinion remained that, except for some short-term blips, house prices in the US could only go up. Some eyebrows had also been raised because of the extension of easy mortgage financing, especially to individuals with questionable creditworthiness. In addition, some smaller banks and mortgage financiers in the United States had gone bankrupt. Whereas this would have rung alarm bells in other countries, such events were viewed without panic in the United States, where large numbers of small financial institutions go under every year. Other signs of impending disaster – such as the ballooning of credit derivates and banks’ massive evasion of capital requirements through off balance sheet