

The Stock Market Game™



Week In Review

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Despite the passage of the Wall Street rescue bill, the bears were hunting stocks this week and it appears they've fattened up nicely for winter. The financial contagion spread to Europe and Asia, which helped push the Dow down as much as 800 points during Monday's session. The rest of the week didn't get any better for the index or for the S&P 500. This morning, stocks nosedived, but with minutes to go before the bell, the Dow is in mildly positive territory. The market's looking for a bottom, but forced selling from hedge fund liquidations is making this difficult. Fasten your seat belts folks; it will continue to be a bumpy ride.

The world's [central bankers](#) joined forces and issued a coordinated rate cut on Wednesday. Through various other means the Fed and other central bankers have been pumping [liquidity](#) into the system, effectively throwing life preservers to the world's banks. All these actions are designed to get banks to lend to each other again. So far, however, the banks are still reluctant to hold hands. This has left interbank lending frozen. Let's explore why that's important.

On any given day, banks have either a surplus or deficit of cash. Normally, banks with a surplus will make a short-term loan to banks with a deficit. This lending allows banks with a short-term deficit to have enough money to continue lending to the public. Normally, billions of dollars change hands between banks every day. That lending has stopped. The banks no longer trust that the bank they lend to will be able to pay them back. When that lending stops, banks "hoard cash" which effectively means banks slow down or cease lending to the public. So, why does that affect you and your students?

This is what happened in the Great Depression. If you're a business (or the [government of California](#)), you may have \$1,000,000 in accounts receivable (that's money people owe to you), but not enough in the bank to pay your employees this week. In normal times, you simply access a short-term loan from the bank and pay the bank back when the receivables come in. It's like a student who gets her allowance on Friday and borrows from another student to buy lunch on Thursday with a promise to pay it back the next day. It's borrowing money on the prospect of future income.

However, if you're a business and can't access that credit, you can't make payroll. This forces you to lay people off. When you lay people off, they can't pay their mortgages. When people realize their neighbors aren't paying their mortgages, they know the bank is in trouble so they rush to get their money out of the bank all at once – this is called a "run on the bank." But as George Bailey explained in the Hollywood classic [It's a Wonderful Life](#) most of the bank's money isn't sitting in the bank. It's invested in your neighbor's home, your neighbor's business, and so on. So when people "run on the bank"; the bank doesn't have their money, which causes the bank to fail.

This process is referred to as a negative feedback loop, a chain reaction, or more ominously, a meltdown. Right now, what we have on our hands is [Three Mile Island](#). What the [U.S. Federal Reserve](#), the [U.S. Treasury](#) and other governments around the world are trying to prevent is [Chernobyl](#). We'll all have to wait and see when and if they get it right. In the meantime, a great explanation of how this credit crisis began is available in SMG's "In the News" newsletter entitled "Credit Shards." There's also a lesson called, "What is Risk?" that discusses the Great Depression. Both are available in the [Teacher Support Center](#).

On a lighter note, the holiday season is just around the corner and [PNC's 2008 Christmas Price Index](#) will be available on December 1st. The website reviews the cost of the gifts in the song, "The Twelve Days of Christmas." It's a great tool to help students learn about inflation and the broader economy and SMG has a project in the [Teacher Support Center](#) to help you use it in the classroom. SMG will hold a Webinar on November 5th at 4pm to review the 2008 data and the SMG lesson. All you need to participate is Internet access and a phone. You can register for the Webinar [right now](#). We hope you will join us.

Finally, to keep up on current Wall Street jargon, CNBC has an informative page on the credit crisis lexicon [here](#). It can help you stay abreast of the dizzying volume of technical terms being heard these days.