19. Title: Iceland Financial Crisis

Abstract: This video explores the causes and implications of Iceland's financial crisis.

Key Concepts: global capital markets, global economy, globalization

Notes: Things are feeling chilly in Iceland thanks to a financial cold front that is blowing through the country. Iceland's banks have had their credit lines cut off, a situation that is threatening the solvency of the nation as a whole. At the moment the entire country is facing bankruptcy. According to Iceland's prime minister, the country has never faced such a dire situation. The prime minister noted that the country is now taking measures to ensure that it has a functioning banking system.

Iceland's troubles began when its banks changed their traditional business model in an effort to make more money. For years, Iceland's banks followed a relatively low risk strategy of lending money to fund local business expansion, but in recent years, banks also agreed to lend money to local firms that wanted to expand overseas. In addition, Iceland's banks went after new business in Britain, and provided credit to British companies like House of Fraser, Hamley's and Oasis, borrowing as much as five times the value of Iceland's total economic output. Then the global credit crisis hit, credit lines were pulled, and the new business model started to unravel.

Now the country is struggling to find a way out of the mess. Already, the government has instituted new powers to ensure that people's savings are safe and it may force bank mergers. Still, Iceland's people remain optimistic. One woman states that she is not sure how the situation will be fixed, but that she knows that it will be. However, the situation remains grim, and it could get worse. If Iceland pulls credit lines, it could create a domino effect that is felt throughout the global economy.

Discussion Questions:

1. Iceland is currently in the midst of a serious financial crisis. What are the common macroeconomic causes of financial crises? How do these causes apply the situation in Iceland?

2. The currency crisis that spread across Southeast Asia in 1997 was caused by actions taken a decade earlier when the countries were experiencing strong economic growth. How does Iceland's financial crisis compare to the Asian currency crisis?

3. What type of crisis is Iceland currently experiencing? Is it a currency crisis, a banking crisis, or a foreign debt crisis?

4. In an effort to get its economy back on track, Iceland recently took a loan from the International Monetary Fund. What is the International Monetary Fund? What is its role in the global monetary system?

5. How does the Iceland's financial crisis affect companies that do business in the country? How should companies manage the volatility in the market?

6. How did Iceland get into its current mess? How did the traditional strategy followed by Iceland's banks change? How did the globalization of markets influence the situation?

7. At the moment, people in Iceland are optimistic that the country will recover from its current crisis. What role does investor psychology play in the global capital markets?

8. What are global capital markets? Where role do Iceland's banks play in the global capital market?

9. How did the fact that capital markets are global in nature contribute to the situation currently facing Iceland?

10. What do global capital markets mean for companies like House of Fraser and Hamley's? What opportunities do the markets provide? What risks do they imply?

11. What is moral hazard? How does it apply to the banking crisis in Iceland?

12. Iceland's banks are in a dire situation and some may be forced to merge in order to survive. What is a banking crisis? How does a banking crisis differ from a foreign debt crisis? Chapter 10 in the text explores two recent financial crises – the Mexican Currency Crisis of 1995 and the Asian Crisis. In your opinion, which of these crises is most similar to what Iceland is experiencing