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# Moral Hazard and Mispriced Systemic Risk in the Lead-Up to the 2007 Subprime Mortgage Crisis in the United States

## **Abstract**

The 2007 subprime crisis was caused by high demand for subprime mortgage products underpinned by the unrealistic assumption that property prices would keep rising indefinitely. The subprime mortgage market worked as expected as long as prices were rising and demand for property was high. When these two conditions were violated and the housing bubble collapsed, the system became dysfunctional, many subprime borrowers defaulted, and mortgage-backed securities lost much of their value. Prevention could have been achieved through regulatory measures to shift the risk back from taxpayers and investors to loan originators. Fair distribution of risk should be the main objective of regulators if such crises are to be avoided in the future.

## **Keywords**

moral hazard, subprime mortgage crisis, risk management, financial crisis, great recession, systematic risk

## **Cover Page Footnote**

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