



The History of Money

Money and building banks

Narrator:

The History of money in 10 minutes. Number 6, Money and building banks.

By the 19th century, banking had become a thoroughly respectable business. Making a profit by basic money lending, banks paid a lower rate of interest for the money they took in, than they charged on the money they loaned out. But the banks soon realised that as long as depositors didn't all ask for their money at once, they could in fact lend out many times more money than they had on deposit. This is known as fractional reserve banking. On rare occasions when depositors all tried to get their money out at once, there was a run on the bank. And the effect on the wider economy was so serious that government started to ensure customers' deposits to prevent it happening, and thereby enabling banks to loan out more and more. By the 21st century, some banks had taken fractional reserve banking to a whole new level, funding most of their loans not from cash deposits from savers, but with loans from other banks, often secured against bundles of previous loans. So when there was a run on the bank in 2007, banks like Northern Rock not only didn't have enough money to pay out, but the effect went way beyond just one bank.