

Conference on Mortgage Credit and Subprime Lending:

Implications of a Deflating Bubble

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Opening Remarks

Alex J. Pollock

Welcome to our discussion of “Mortgage Credit and Subprime Lending: Implications of a Deflating Bubble.” This conference is co-sponsored by the American Enterprise Institute and the Professional Risk Managers’ International Association. On behalf of both, let me say how pleased we are to have you all here.

I am Alex Pollock, a resident fellow at AEI, and we have an excellent panel today, whom I will introduce in a moment.

Briefly to set the context: We have had a housing boom, with unprecedented increases in real house prices, facilitated by a mortgage lending boom, and notably a subprime mortgage lending boom. As we all know, the subprime boom is over; the bust is here. Former enthusiasm has been replaced by large financial losses, the bankruptcy of numerous subprime lenders, layoffs, accelerating defaults and foreclosures, what Moody’s has just referred to as a “stunning erosion in mortgage credit quality,” a liquidity squeeze—and of course, escalating political recriminations. What was not so long ago praised as “creative” and “innovative” expansion of home ownership is now described as an irresponsible and culpable activity.

How much more bust will we have? Is this problem confined to the subprime sector, as a whole panel of regulators told the Congress yesterday? Or will problems spread to other parts of the mortgage market? What are the implications for house prices, that is, the market value of the most important household asset by far; the market for mortgage-related securities; and the housing industry? Are there wider implications for monetary policy and the overall economy?

Of course, booms and busts are hardly new. As they recur in financial history, they differ in detail, but display the same general patterns. You would think that we would learn, but we don’t. I can never think about this subject without recalling the marvelous Victorian prose of Walter Bagehot in Lombard Street, published in 1873, which I quote:

“The mercantile community will have been unusually fortunate if during the period of rising prices it has not made great mistakes. Such a period naturally excites the sanguine and the ardent; they fancy the prosperity they see will last always, that it is only the beginning of a

greater prosperity. They altogether overestimate the demand for the article they deal in, or the work they do. They all in their degree—and the ablest and cleverest the most—trade far above their means. Every great crisis reveals the excessive speculations of many houses no one before suspected.”

Bagehot continues:

“The good times of too high price almost always engender much fraud. All people are most credulous when they are most happy; and when much money has just been made, when some people are really making it, when most people think they are making it, there is a happy opportunity for ingenious mendacity. Almost everything will be believed for a little while.”

Alas, how true.

We have a distinguished panel to discuss the implications of the deflation of our most recent bubble. Their detailed biographies are in your conference material.

We will hear first from Desmond Lachman, who is a resident fellow at AEI, having previously been a Wall Street economic strategist. His research includes global currencies, emerging market economies, multilateral lending institutions, and lately the housing bubble. (Desmond and I have been reinforcing each other’s bearish outlook on the latter for some time.)

Next will be Nouriel Roubini, who is a professor of economics at the New York University Stern School of Business, as well as chairman of Roubini Global Economics. He has served as the senior economist for international affairs at the White House Council of Economic Advisers, among many other assignments, and written provocatively on today’s topic.

Our third speaker will be Chris Whalen, senior vice president and managing director of Institutional Risk Analytics, to which he brings experience as an investment banker, research analyst and journalist, including working in both equities and fixed income, as well as risk management. Chris has been my excellent partner in organizing this conference.

Tom Zimmerman will be our last speaker, bringing us a first-hand securities market perspective. Tom is a managing director at UBS Investment Bank, where he manages the firm’s mortgage credit and asset-backed securities research. His research has appeared in numerous fixed-income reference works, and he is a member of the UBS team voted first in the latest Institutional Investor survey of fixed-income analysts.

Each member of the panel will speak for 12 to 15 minutes, after which we will give the panel a chance to respond to each other. Then we will open the floor for your questions, with adjournment at 4:00. And now the panel.