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## Paulson, Bernanke Say Housing Woes May Last

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The immediate sense of crisis that enveloped world financial markets in August has mostly passed. But the troubles surrounding the U.S. housing market are only beginning, the nation's two top economic policymakers said in separate speeches this week.

[Federal Reserve Chairman Ben S. Bernanke](#) and Treasury Secretary [Henry M. Paulson Jr.](#) both expressed worry that the weak housing market will continue to be a drag on the economy next year. As if underscoring the policymakers' concern, the [National Association of Home Builders](#) said its index of builders' confidence fell this month to its lowest level since the survey was launched in 1985.

"Both Bernanke and Paulson were pounding on this theme that the problem is going to be with us for a long time," said Ed Rombach, a senior analyst with [Thomson Financial](#)'s IFR Markets.

In comments at Georgetown University Law Center yesterday morning, Paulson advocated changes in the ways banks, mortgage brokers and other key financial players are regulated to fix some of the problems laid bare by the housing downturn and related market turbulence.

As it tries to turn Paulson's broad ideas into specific policies, however, the Bush administration may find that there are complicated trade-offs and potential unintended consequences that could come from tinkering with the nation's financial infrastructure.

For example, in the current system, no single regulator oversees all lenders. That is part of the reason borrowers were able to take on complicated new mortgage products in recent years, frequently without understanding the risks involved. Instead, there is a complex system of federal and state regulators that oversee the banks and bank-like entities that issue mortgages.

"This patchwork structure should be streamlined and modernized," Paulson said, and added that [the Treasury Department](#) plans to release a "blueprint" for a thorough overhaul early next year.

There is wide agreement between Democrats and Republicans that banking regulators should be made less fragmented. Yet past efforts have run into political headwinds. For example, in the Clinton administration, the [Federal Reserve](#) fended off an attempt to reduce its bank regulation, arguing that that role helps it monitor risks to the economy from a banking crisis, said Douglas Elmendorf, a senior fellow at the [Brookings Institution](#) and former Treasury Department official.

Moreover, an abrupt change to bank regulation could create new problems while solving existing ones. For example, if state banking regulators' role were reduced, it could shut out of the oversight process thousands of bank regulators with longtime, close-up knowledge of individual institutions.

"Taking apart the whole regulatory structure would be a very disruptive enterprise," Elmendorf said. "It's taking a system that is functioning, imperfectly, and replacing it with a system that in principle seems better, and ultimately maybe will be, but would take time to get up to speed."

Paulson also advocated, for the first time, national licensing requirements for those who issue mortgages, an idea backed by many Democrats in Congress. Currently, states regulate these institutions, but many have standards so weak that unqualified brokers can get licenses.

"A nationwide monitoring system that covers all mortgage originators could help prevent unscrupulous mortgage

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originators from moving across state lines or switching employers to evade detection," Paulson said. "This is worth considering."

But there is some risk, if such a system offers just a cursory check of mortgage brokers' qualifications, that it would make people feel their mortgage broker has a federal stamp of approval and make borrowers less wary of unscrupulous brokers. "The worst possible thing would be to give a federal seal of approval to institutions that didn't really deserve it," Elmendorf said.

Paulson also indicated interest in changing some of the nuts and bolts of the nation's financial infrastructure, though he offered few details. He said policymakers should examine conflicts of interest at credit-rating agencies, the risk management techniques of financial institutions and how capital requirements for banks deal with off-balance-sheet investment vehicles.

Like Paulson, Bernanke stressed housing as his biggest worry about the economy -- and a major reason the Fed aggressively cut the federal funds rate on Sept. 18.

A key issue at the meeting of the Fed's policymaking committee that day, Bernanke told the Economic Club of [New York](#) on Monday night, "was the extent to which the market disturbances had affected the outlook for the housing sector."

He added: "A further sharp contraction in residential construction seemed likely to hold down overall economic growth in the fourth quarter and in early 2008." But he also said the housing problems had not spilled over into consumer and business spending, which signaled to analysts that it's an open question as to whether the Fed will cut rates again at its next meeting in two weeks.

"Bernanke appeared to be striking a cautious tone that did not give much signal regarding future policy moves," Dean Maki, U.S. chief economist of Barclay's Capital, said in a written report.

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