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## Analyst foresaw economic crisis

**A push to increase home ownership along with Wall Street's desire for new securities to trade and a lack of oversight led to a crisis Christopher Whalen says will be the worst since the Depression.**



BY JANE BUSSEY

Investment banker, financial analyst and newsletter publisher Christopher Whalen has explored the ins and outs of Washington, Wall Street and Latin America for more than two decades.

Following stints on Capitol Hill, the Federal Reserve of New York and Bear, Stearns & Co., Whalen founded the newsletters The Mexico Report and Washington & Wall Street.

In 2003, he co-founded Institutional Risk Analytics, which offers risk analysis and consulting. Besides editing the firm's newsletter, The Institutional Risk Analyst, he writes articles, testifies in Washington and speaks frequently to financial groups.

Whalen, who has worked in New York, London and Washington, frequently looks to economic history to put the present in perspective. He points out that when President Franklin Delano Roosevelt took office on March 4, 1933, banks in 32 of the 50 states were closed because of panic.

Whalen spoke with The Miami Herald during a visit to South Florida to address the Insurer Investment Forum, "The Times They Are A-Changin," at the Diplomat

Country Club & Spa in Hallandale Beach.

**Q:** The U.S. economic picture was much rosier when you founded Institutional Risk Analytics. Are you surprised about the turn of events?

**A:** We saw that our colleagues had so badly skewed their thinking on risks that we knew eventually there would be a swing back the other way. This one was so severe and everyone was so impetuous; whether you are talking about home buyers -- borrowing 100 percent of their mortgages -- or banks -- people packaging securities up and selling them. It evidenced the mania. We said: "Wow! Why don't we set up our lemonade stand here and people will come?"

**Q:** How serious is this financial crisis?

**A:** We are in the worst financial crisis in this country in 100 years. This is going to make the savings and loan crisis look like a party.

It won't be as bad as 1930 and 1931 when you had a 30 percent unemployment rate. But it is going to get bad. A lot of value is going to be destroyed.

If you think of the way your parents lived and think of today, we've gone from people buying a house and staying there, to people buying houses like baseball cards. People are using credit cards and their home equity financing and pretending things are going to be OK. But we are running out of gas.

**Q:** How did we get in this trouble both in the housing market and with subprime mortgages?

**A:** Right after the real estate crunch in the early 1990s, the government-sponsored enterprises -- Fannie Mae, Freddie Mac, the Housing and Urban Development department, the Federal Housing Authority, the Office of Federal Housing Enterprise Oversight, the Federal Home Loan Banks, the whole cast of characters, they put together this public/private partnership to push for home ownership. The Realtors, mortgage brokers and regulators picked up this theme. Then the banks picked up the theme.

The United States had the highest home ownership rates in the world, 65 percent. They pushed that to 70 percent. Unfortunately, many of these were marginal buyers and they are walking away. If you got into one of the adjustable-rate mortgages and you have no equity in it, there's not a whole lot of incentive to stay.

The Street was looking for something to trade. The banks were looking to securitize stuff. They all got a fee. But no one took responsibility for the overall outcomes.

The banks are now being forced to write this down. All these loans and securities

derived from the loans have become illiquid.

It's amazing. We have to ask how did we do this? Foreign friends ask me, "How did we screw up so badly?"

**Q:** Was no one looking at what was happening?

**A:** They were actively ignoring it. They were beating up on Brooksley Born [former chairwoman of the Commodity Futures Trading Commission] and saying: "No, no, you are not going to regulate over-the-counter securities." They argued competitiveness. But these are not innovation. These are opaque securities that no one can value.

It's also how the dealers could make money. Over-the-counter is 10 times as profitable as the exchange trade model.

**Q:** What is your assessment of the government's actions so far and what should be done?

**A:** The Bush administration has been totally asleep. But there were a lot of people responsible, including former Federal Reserve Chairman Alan Greenspan. Everybody focuses on his interest-rate policy, holding interest rates down for so long. But the real fault of Greenspan was allowing the banks to get more and more into securities, like mortgage-backed securities, and allowing them to move off balance sheet.

None of this over-the-counter paper was registered with the Securities and Exchange Commission.

That's why you have about \$7 trillion in government-sponsored-enterprises paper and \$3 trillion in private-label securities. That is all being redeemed. The banking system can't pick up the slack. So it's crunch time.

By election time, I think that the economy will be the only issue. We could be contracting economically for the next couple of years. That will shock America because Americans are not used to this kind of environment. Whoever wins the White House will be in crisis mode from day one.

We have to have a discussion about market structure; what has to be registered with the Securities and Exchange Commission and what doesn't. Anything a bank buys and sells or a pension fund buys and sells need to be registered.

We have to remake this marketplace in a much more transparent fashion.