

Subprime Mortgage Meltdown: Paulson's Quick Draw

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Treasury Secretary Henry Paulson, the man who said that subprime was contained and that the Bazooka in his pocket would never be used, now assures us that the bailout of Fannie Mae and Freddie Mac will be costless to taxpayers. Despite the near euphoria that the plan has sparked on Wall Street, the move will go down in history as the biggest policy blunder of all time, and will be credited as a pivotal point in the financial collapse of the American economy. The ultimate cost to United States citizens will be in the range of hundreds of billions of dollars, perhaps more.

The original idea that gave birth to Freddie and Fannie, which is to make housing more affordable to average Americans, should now be seen as farcical. Their new goal is to keep housing prices high. Absent Freddie and Fannie, housing prices would fall sharply and the mortgage market would stabilize. Americans would once again be able to buy affordable houses with mortgages they could actually repay – just like their grandparents did. Instead they will keep overpaying for houses, burdening themselves with excessive payments in the process, and ultimately sticking taxpayers with the bill when they default.

In contrast to Paulson's continuous misreading of the market, I have consistently predicted the failure of Freddie and Fannie. I did so in my book *Crash Proof*, and in numerous speeches, commentaries and television appearances. If you have not yet done so, click here to watch these eight YouTube clips of my presentation back in 2006 to a convention of mortgage bankers. I also was quick to point out that Paulson's Bazooka would not remain holstered for long.

There is absolutely no substance to Paulson's insistence that based on the government's first claim on the future profits of Fannie and Freddie, the plan offers protection for taxpayers. There will be no future profits, just more heavy losses. Americans will now have unlimited ability to continue to overpay for houses and commit to mortgages they can't afford. In fact, the plan ensures that eventual public sector losses will vastly exceed those that would have befallen the private sector in a free-market resolution.

Paulson claims that his goal is to stabilize the mortgage market. But the best way to do so would be to allow housing prices to fall to a market clearing level. As long as home prices remain artificially high, the risks of mortgage lending will keep credit tight, and the high costs of mortgage payments will keep potential buyers on the side-lines. With private lenders justly cautious, the government intends to hold open the lending spigots, without the pesky concerns over losses or financial risk. The hope is that the new lending will prevent home prices from falling further. It won't work. The government "solution" will

simply delay the fall of artificially high home valuations and temporarily preserve the illusion of prosperity.

In order to preserve current home prices, the government will be forced to maintain the lax lending standards that got us into this mess in the first place. Since all the losses will now be borne by taxpayers, those lax standards will be much more problematic. The moral hazard that existed prior to this bailout has become that much more hazardous. Every mortgage now insured by Fannie and Freddie is the equivalent of a U.S. Treasury bond. This allows anyone to borrow on the full faith and credit of the U.S. government so long as the money is used to buy a house. In addition, mortgage lending will now be a government function, run with Post Office-like efficiency.

Of course the biggest collateral damage caused by Paulson's bazooka is the large hole ripped through the already tattered U.S. Constitution. If the government can do this, does anyone believe there is anything it can't do? In effect the Federal government now has absolute power to corrupt absolutely.

For a more in depth analysis of our financial problems and the inherent dangers they pose for the U.S. economy and U.S. dollar denominated investments, read my book "Crash Proof: How to Profit from the Coming Economic Collapse." Click here to buy a copy today.

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