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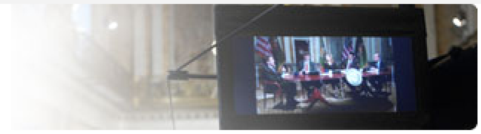
U.S. DEPARTMENT OF THE TREASURY

Press Center



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London – Thank you, Padraic. I am pleased to be here in London to discuss the U.S. economy. A lot is happening at the Treasury now; I will give you a quick rundown of four key items--the macro outlook; fiscal stimulus; the housing market; and U.S. financial markets.

– Thank you, Padraic. I am pleased to be here in London to discuss the U.S. economy. A lot is happening at the Treasury now; I will give you a quick rundown of four key items--the macro outlook; fiscal stimulus; the housing market; and U.S. financial markets.

Macro Outlook

On the macro outlook, the fundamental drivers that make the U.S. economy healthy over the long term remain the same, including the flexibility, innovation, and entrepreneurship that characterize our nation. At the same time, we are undergoing a significant housing correction, and U.S. GDP growth looks to remain slow in the first part of 2008. Americans have become accustomed to good economic performance, such as we saw from mid-2003 to mid-2007, so even the modest slowdown so far has been keenly felt.

Fiscal Stimulus

The recent fiscal growth package will help support the broad economy as we weather this housing downturn. The package was signed into law by the President two weeks ago and we're going to implement it quickly. More than $110 billion will be sent directly to American families starting in May, with the process largely complete by mid-summer. This will provide a needed boost to household spending, while incentives for business investment will bring forward capital spending. We look for the pace of growth to quicken as we go through 2008. But we understand that a resumption of strong and sustainable growth depends on a resolution of the difficulties in housing and credit markets.

The Housing Market

Let me now turn to the U.S. housing market. In the Midwest and the Gulf Coast States slow growth and weak hiring translated into sagging home values and construction. Other areas--notably California, Arizona, Nevada, and Florida--experienced a sharp run-up in prices that reflected low interest rates, weak underwriting standards, and unreasonable expectations of continued price increases. The acceleration of home building has now left a large overhang of inventories. The resulting price correction was the key initial impetus for rising foreclosures in the bubble areas because many subprime borrowers relied on financing strategies that were sustainable only with rising prices and access to easy credit. The dislocation in credit markets has limited refinancing opportunities, and this then feeds back into foreclosures.

We're in the middle now of adjusting out of this downturn. The consensus of forecasts is for new home sales to bottom out in the first half of the year and this will whittle away at the inventory overhang and in turn signal to builders to increase construction. In the meantime, however, residential construction looks like it may subtract a full percentage point from growth this year following two consecutive years of nearly as much drag.

The Administration has focused on avoiding preventable foreclosures, through expanding federal mortgage financing and through the private-sector HOPE NOW Alliance, which is applying a streamlined process to refinance and modify loans for borrowers with the financial wherewithal to stay in their houses. These initiatives are demonstrating initial and growing success, though we are far from a satisfactory resolution to the problem.

We are looking carefully at all further options with regard to housing. I must tell you, though, that it is hard to be enthusiastic about plans that provide bailouts to investors or a shift of risk from a private balance sheet to the public one.

U.S. Financial Markets

As part of Secretary Paulson's Capital Markets Competitiveness agenda, Treasury is looking carefully at the structure of financial market oversight. Treasury will release a blueprint for regulatory modernization in the coming weeks. The goal of any reform will be to lay the framework for a more effective and safer regulatory system while being mindful that over-regulation can squelch valuable innovation and incentives for risk-taking, risk-dispersion, and due diligence.

Secretary Paulson is leading the President's Working Group to evaluate the lessons learned from current challenges, and where appropriate, make recommendations for change. Not surprisingly, the oversight of mortgage origination is getting a close look, as is securitization, in both cases to make sure that there is effective market discipline so that appropriate disclosure and due diligence occur and so that borrowers are not misled. The scope of this review includes the spectrum of market participants, including brokers, originators, issuers and underwriters, credit rating agencies, and investors. Regulators are looking as well to identify areas needing improvement in global financial institutions' risk management practices. Finally, the reform process will look inward to consider policies that contributed to, or failed to mitigate, the underlying problems. The list here includes policies regarding regulatory capital, disclosure, accounting, and valuation. We look forward as well later this year to the report of the Financial Stability Forum on the lessons of the recent turmoil.

These efforts are aimed at reducing the odds of a similar problem happening in the future. A criticism could be made that any proposed regulatory reforms, while worthwhile, amount to fixing the barn door after the horse has escaped. I worry, though, about proposals that solve the problem of the horse escaping by demolishing the barn. By this I have in mind proposals that would greatly restrict the terms on which credit can be offered to borrowers with imperfect credit or that would retroactively change contracts on existing loans. Both types of action would make it difficult for future subprime borrowers to get into a house in the first place. And this would be unfortunate given that today, about 77 percent of subprime borrowers--over 5 million of them--are keeping up with their mortgage payments.

One final lesson of recent events in the United States is in regard to the availability and use of information. The originate-to-securitize model succeeded in dispersing risk--only too well to the regret of many investors--but had the unwelcome effect of also dispersing information. The lack of information about the quality of the mortgages underlying MBS, CDOs and the gamut of related instruments has made pricing difficult, and this in turn has contributed to a flight to quality. Limited access to and limited demand for information throughout the securitization chain also facilitated fraud and lax underwriting standards. Uncertainty about asset performance is in part fundamental, in that loan performance depends on economic outcomes that we can forecast only imperfectly. But some of the uncertainty can be overcome by improved access to and use of finely grained information on loan characteristics and performance. Market participants had the incentive to demand such information, but in retrospect we see that unreasonable expectations about continued price increases reduced due diligence. Careful investors can actually be at a disadvantage when the analysis of others is lax. We are encouraged now that efforts are being made by private-sector participants to develop a standard framework for the collection and disclosure of mortgage-level information. Better information will help investors price risk and thereby aid the market adjustment. A basic lesson is that there is nothing wrong with complex financial structures so long as they are not opaque--so long as disclosure and analysis can pierce complexity. Making loan-level data more accessible will facilitate the needed analysis.

Providing better information is a desirable step in any environment. In the present situation, a lack of transparency and easy access to information is at the heart of the disruption that has affected both market participants and global economies more broadly. Getting the long-term policy right in this case can have a positive effect in speeding the alleviation of current stresses.

Thank you again for the opportunity to be here and to kick off an excellent conference. I would be glad to answer questions.

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