JOINT ECONOMIC COMMITTEE
SENATOR CHARLES E. SCHUMER
CHAIRMAN

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**Contact:** Israel Klein or
Kim Magee (202) 224-5171

# SCHUMER'S JOINT ECONOMIC COMMITTEE INVESTIGATES THREAT OF SUBPRIME LENDING TURMOIL TO THE BROADER ECONOMY

*CBO Chief to Testify Along with Top Housing Experts Shiller and Eakes*

*Nearly 2 Million Homeowners Could Face Foreclosure Over the Next 15 Months*

*Solutions to Avert Foreclosure Storm and Limit Broader Economic Damage Will Be Examined in Detail at the Joint Economic Committee Hearing*

Today U.S. Senator Charles E. Schumer and the Joint Economic Committee held a hearing, *"Evolution of an Economic Crisis?: The Subprime Lending Disaster and the Threat to the Broader Economy"* to take a closer look at the direct and indirect economic shocks resulting from the deterioration of the housing market. Below is Schumer's prepared opening statement.

**The hearing witnesses are:**

- **The Honorable Peter R. Orszag, Director, Congressional Budget Office**
- **Dr. Robert J. Shiller, Stanley B. Resor Professor of Economics, Yale University**
- **Mr. Martin Eakes, Chief Executive Officer, Center for Responsible Lending**
- **Mr. Alex J. Pollock, Resident Fellow, American Enterprise Institute**

**Schumer's Opening Statement (as prepared for delivery):**

I would like to welcome my fellow Committee Members, our witnesses and guests here today for this very important hearing on the impact of the subprime mortgage meltdown on the broader economy. My colleagues and I on this committee have been concerned for months about the dangers to the American economy as a result of widespread, unscrupulous subprime lending, and the economic news in last six months has disappointingly confirmed those fears.

Despite all the reassuring statements we've heard from the administration that the impact of this mess would be "contained," it has not been contained, but has been a contagion that has spread to all sectors of the economy.

We've seen it most clearly in the financial markets. This summer's credit crunch was in large measure attributable to the collapse of the U.S. subprime mortgage market. It shook Wall Street and required the emergency intervention of central banks throughout the world to restore liquidity to international credit markets.

The news outside the financial markets, while not so stark, has been little better. We all saw the anemic August jobs report – for the first time in **four** years, the economy actually lost jobs. Consumer spending – the engine behind much of our recent economic growth - has begun to slow down. Most economists have lowered their already weak expectations about GDP growth even further. For the first time in years, the "R word"—recession—is being discussed far and wide as a real possibility.

And, we know that the worst is still yet to come, as the riskiest subprime loans will begin to reset in a very weak housing market over the coming months. This morning, we heard that housing construction fell to its slowest pace in 12 years. The collapse in housing investment has already shaved nearly a full point off of GDP growth. The inventory of unsold homes already stands at record levels. Builder confidence has sunk to record lows. In many parts of the country, real home prices have declined, on a year-to-year basis, for the first time since 1991.

**If there is anyone left who doubted the repercussions of the subprime mess and the risks to the economy, they should look no further than what the Federal Reserve Open Market Committee did yesterday.**

In March, Chairman Bernanke came before this committee and told us that the problems in the subprime market would have little or no impact on the overall economy. Yesterday, the Federal Reserve cut the Federal funds rate by 50 basis points, again primarily in response to the fallout from the subprime crisis.

**When a conservative Fed drops the interest rate this much, it is obvious that they believe the economy is in trouble.** And while yesterday's rate cut is a welcome indication that the Fed realizes the real risks to our economy, it is important to recognize that a half a point reduction will do little to get at the deeper, underlying problems to our overall economic health. It is a temporary solution to bigger problem, and one that must be applied infrequently and with caution.

**My concern, and the reason that I have called this hearing, is that, despite all the bad news, despite the sudden calls for action from those who just a few short months ago were assuring us there was little to worry about, I fear that we still don't appreciate the seriousness of the problem we are facing.** Our policy responses are not matching the magnitude of the risk that still lies ahead:

And what exactly does lie ahead?

- An estimated **1.7 million foreclosures** are predicted to occur in the next two to three years due to adjustable rate mortgages resetting to unaffordable rates.

- The Center for Responsible Lending has predicted that subprime foreclosures will lead to a net loss in homeownership and a cumulative loss of **$164 billion in home equity.**

- The **lost property values** from the spillover effects of these foreclosures could reach up to **$300 billion** in neighborhoods across the country, and **lost property tax revenues could exceed $5 billion.**

These alarming statistics just refer to the **direct** impact of this crisis. The indirect consequences—such as risks to our broader economic growth, household wealth, the health of our financial markets, and our relationship with global markets—are still unknown. I hope that today's hearing will at least serve to clarify some of the dangers that cloud our economic horizon.

One of the gravest dangers we face, as we will hear today from Professor Robert Shiller, is that we are witnessing the bursting of a speculative bubble in the housing market that will impact ALL families – not just subprime borrowers. If, as Professor Shiller suggests, significant real nationwide housing price declines are on the horizon, we face the very real possibility that the housing market will drag the economy down with it.

Our country simply cannot afford a slowdown in economic growth. When income inequality is at historic highs, deficits are looming, and investments in critical infrastructure are drying up, economic growth is our best hope for righting past policy wrongs and getting our country back on track.

**Despite all of this bad news…the good news is that workable solutions are out there, and we have time to put them into place to help limit the damage.**

First, we need to do everything we can to arm the local housing nonprofit groups that are working around the clock with subprime borrowers. Last week, with the help of Senators Brown and Casey, we secured **$100 million in foreclosure prevention** funding targeted to the local nonprofit groups that are pivotal in bringing subprime borrowers and lenders together to achieve loan workouts. I've asked both the administration, and the main private market players in the subprime market, to help us find more funding to channel to these nonprofit groups – particularly as their case loads grow more and more each day.

**Second, we must use the Federal Housing Administration, Fannie Mae and Freddie Mac strategically to target relief to subprime borrowers**. As we all know, government-backed products – FHA-insured mortgages and Fannie and Freddie-guaranteed loans – are the only game in town in terms of providing liquidity to the mortgage markets and safe, sustainable products to subprime borrowers. And while my colleagues and I on the Senate Banking Committee expect to pass an FHA Modernization bill today that will help thousands of families

keep their homes – **we can and must do more with these critical tools that we have in our arsenal to assist more of the 1.7 million families at-risk homeowners.**

That is why I introduced a bill two weeks ago—the **Protecting Access to Safe Mortgages Act—that will temporarily lift the limits on Fannie and Freddie's mortgage portfolios by 10%, which will free up approximately $145 billion for the purchase of new mortgages.** The bill requires that half of this total go directly to refinanced mortgages for borrowers who are stuck in risky adjustable rate mortgages because I believe that targeting the borrowers that are likely to default will help shore up the housing market and assist the broader credit markets and economy as a whole.

**This morning, OHFEO announced that it will adjust Fannie Mae's portfolio cap upwards by only 2% a year, after ideologically opposing a cap increase over the past several weeks. Now that OFHEO has put its toe in the water, it is time to jump in.** Whatever they call it, there is no doubt that this is an increase in the portfolio caps that I have been calling for. This small increase, however, doesn't respect the magnitude of this crisis. Hopefully this ideological-driven and rigid opposition to raising the caps is about to fade.

We all need to work together to adopt common-sense measures that can go a long way to help make SAFE, AFFORDABLE refinancings possible for tens of thousands of Americans trapped in the subprime mess that never needed to be in it in the first place.

**In short, I truly hope that the White House is paying close attention to this crisis – because we are far from solving it.** And I hope that this hearing will draw more attention to the real economic risks that still lay ahead, and what policy actions we can take to curb the damage.

Without further delay, let us get down to business. So we can proceed quickly to the witness testimony, and to allow time for a few rounds of questions, I would ask that we limit opening statements to the Committee's Senior Republican Senator, Senator Brownback and Vice Chair Maloney. We will of course enter everyone's opening statements into the record.

**www.jec.senate.gov**

*The Joint Economic Committee, established under the Employment Act of 1946, was created by Congress to review economic conditions and to analyze the effectiveness of economic policy.*

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