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INTERVIEW WITH SECRETARY HENRY PAULSON, U.S. TREASURY

**BY
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KATHLEEN HAYS: Thank you so much. Yes, I'm here at the National Association for Business Economics Policy Conference in Washington, D.C. Treasury Secretary Henry Paulson just delivered a keynote address talking about the housing market, the issues that are being faced there.

Secretary Paulson, thanks for taking the time to taking the time to talk to us.

SECRETARY HENRY PAULSON: Kathleen, it's great to be here.

MS. HAYS: Now, you've just made an intriguing remark. You said the president's working group is going to come out with some policy responses to the lessons learned from the housing crisis. Could you elaborate? What do you have in mind?

SEC. PAULSON: Well, it wasn't, Kathleen, directly focused on the housing crisis; it's on the capital markets turmoil more generally, and this period of stress we've been going through. And so we've – for some time we've been focused on this, and we've always said that we have two – two main focuses. First, getting through this period with as little impact on the overall economy as possible, and secondly the policy response. And here we're looking at the mortgage origination process. We're looking at the securitization process. We're looking at rating agencies. We're looking at disclosure

issues. We're looking at capital issues, regulatory issues. So we're looking at it in a number of things.

MS. HAYS: Are you ready to tell us any specifics?

SEC. PAULSON: Not ready to tell you specifics now. That will be in the weeks ahead.

MS. HAYS: Okay, we're certainly going to look forward to that. I wanted to ask you, though, you know, you also said this morning that you remained open to good ideas. So I want to ask you about Barney Frank's proposal, for example, is you'd have a federal agency that would buy up distressed mortgages that lenders have written down. Is this a viable solution?

SEC. PAULSON: Well, you're noticing there is a lot of ideas, but what I said today is I really believe that a number of these ideas are focused more on bailing out lenders and investors than homeowners that need help. And so I don't see a need for a big government intervention right here. I just don't think that's called for.

MS. HAYS: So are you ruling out any new government initiatives or only those that might involve taxpayer money as Barney Franks would?

SEC. PAULSON: Well, let me say this. First of all, I've very much enjoyed working with Barney Frank, and we've worked together on a number of initiatives including this Homeowner Now Initiative. And so there's a lot we're working on, and we're working with him on FHA modernization. We're working with him on GSE reform. But, yeah, I'm not looking at initiatives that would involve taxpayer money to take investors off the hook.

MS. HAYS: So that's a non-starter.

SEC. PAULSON: That's a non-starter.

MS. HAYS: Now, is it maybe a necessary evil? For example, if you want to stop some of the foreclosures, if you bail out a few lenders but you keep some people in their homes, it's worth it? Is it just maybe a fall-out of the situation we're in?

SEC. PAULSON: Well, again. We've – we've got a program that's – it's really aimed at keeping people in their homes if they can afford to stay in their homes and they want to stay in their home. So we've got a program that I believe is going to be effective at doing that, and that's really the focused.

MS. HAYS: Now, you recently announced project lifeline plan. Now, that gives mortgage companies the green light to give people this 30-day grace period so they don't get foreclosed. Do you have any more approaches on the radar screen you want to tell us about?

SEC. PAULSON: Well, right now we're focused on making our approaches work and getting the industry to work together with some success. We don't have anything else that we're prepared to announce now, but we're continuing to look at other market-based, industry-based ways to get at this problem.

MS. HAYS: Speaking of industry-based steps, some congressional law makers have criticized the slow rate at which the mortgage services are stepping up to redo these loans. Anything the Bush administration and Congress can do to get them to pick up the speed on the modifications, keep people in their homes?

SEC. PAULSON: Well, I would say – remember, this was – this ASF protocol is complex. There were technical issues or accounting issues or legal issues. We got the SEC to sign off on the key accounting issue in early January, so I think there's progress being made. But some of the services are – I just can't underestimate the fact that some are more aggressive, that they're better prepared, and they are ready to move ahead even without this effort. They are independently providing their results, making them public, but the key thing here is to make this industry-wide and better to get everyone involved, and because that's going to be better for the country and homeowners. So I think we're making progress.

MS. HAYS: Are you satisfied with the pace then?

SEC. PAULSON: Well, I'm never satisfied with the pace, so that's the wrong question to ask me, but I am satisfied that we have the right approach, and I think we're making very substantial progress.

MS. HAYS: Now, the head of the Office of Thrift Supervision – John –

SEC. PAULSON: Let me just sit back and say one other thing.

MS. HAYS: Oh, sure. Go ahead.

SEC. PAULSON: We've had – you know, as I mentioned in the speech, we've had a million homeowners that have had a modification since July. And the number I look at very closely is we see the number of modifications is growing quicker than the number of foreclosure starts and the number of workouts is growing quicker than foreclosure starts, and modifications as a percentage of workouts are increasing.

MS. HAYS: Okay. So that is a good measure.

I just wanted to ask you about John Reich, Office of Thrift Supervision – their proposal to allow a borrower, the stressed borrower to go into an FHA refinanced loan and issue a negative equity certificate that would allow the new mortgage to reflect a lower value of the home. Are you in favor of this proposal?

SEC. PAULSON: Well, listen, I'm in favor of any kind of imaginative proposal that the industry can do, and there's no – nothing from a regulatory standpoint to keep servicers and lenders from proceeding with a plan like that. But, again, as I mentioned in my remarks today, I think that there has been almost too much made out of homeowners being under water. You know, that's not insignificant to them, but if you're a homeowner and you can afford your mortgage payment, the fact that you're under water should be largely irrelevant. If they're going to walk away from their obligation just because you're underwater, you're a speculator, and I think you should live up to your obligation there.

MS. HAYS: You know, you mentioned also in your speech what a big difference lower short-term rates have made to –

SEC. PAULSON: Huge.

MS. HAYS: – many distressed borrowers. So how big of a difference, number one, and is there need to see more of that. Would you like to see short-term rates even lower to help homeowners?

SEC. PAULSON: Well, I would just say, first of all, it's made a huge difference, because remember our ASF protocol was focused on sub-prime mortgages where the rate was going to be reset, and the borrower could afford the initial rate, wasn't going to be able to afford the stepped-up rate. Well, with interest rates being reduced, this has been a big, big help. I use the example that in December, you had an 8.5 percent mortgage; the reset would have gone to 10.8 percent. For a \$200,000 mortgage, that would have been an increase of more than \$300 a month reset, is more likely to go from 8.5 to nine, which is \$70. So, again, the affordability issue is being solved by interest rate declines. And, again, in terms of what's going to happen in the future, that's up to Ben Bernanke, and I've got great confidence in him.

MS. HAYS: I know you do, but how about the economy. We certainly – we saw the Institute of Supply Management's manufacturing index well below 50 today. Any people see that as another sign that we are sinking rapidly into recession if not already there.

SEC. PAULSON: Well, we've said for some time that the economy is slowing down, slowed down dramatically, that the risks were to the downside. I continue to believe that we are going to grow, albeit more slowly. We're going to grow this year, and that's my best judgment. But, again, because the risks are to the downside, we've moved very quickly with this stimulus plan, and I would like to, again, remind you the beginning – at the very beginning of May, we're going to be getting these payments out to Americans.

MS. HAYS: Now, the – certainly the weakness of the economy – these numbers we're seeing are one of the factors that seem to go hand in hand with the dollar's decline – the dollar at a three-year low versus the yen today after five days of declines. It's

within a cent of it's all-time low against the euro. Is there a point where you feel the dollar's decline has gone too far?

SEC. PAULSON: Listening, Kathleen, you know how strongly I believe that a dollar, a strong dollar is in our nation's interest. (Audio break) – I've said to people is our economy, like any other, is going to go through its ups and downs. I've just told you I believe it's going to continue to grow this year. I believe that the long-term fundamentals are very solid and that they're going to be reflected in our currency.

MS. HAYS: Why do you think the economy is going to keep growing and avoid recession? What's your number-one reason for that?

SEC. PAULSON: Well, my number-one – we've got a resilient, diversified economy, and we've – we're looking at positives. There is a number of positives right now including exports, which are growing much quicker than imports. But I would say to you, again, I've emphasized that the important point is that it is slowing down and we're taking actions to deal with it.

MS. HAYS: I'm glad you mentioned exports. Has the falling dollar actually been good for the U.S. economy?

SEC. PAULSON: Well, I would say this – as I said, I believe in a strong dollar and I'd say there is good growth outside of the U.S., and that to me has been a key. We have the backdrop of a very strong global economy, which is – which is benefiting us.

MS. HAYS: And just for the benefit of our viewers who are trying to understand how this all fits together, we talk about a strong dollar – the dollar has been down five of the last six years. How do you define a strong dollar at a time when a dollar – we have it falling just year after year?

SEC. PAULSON: Kathleen, again, as I've said to you – and I don't want to say it any differently – I strongly believe that it's in our nation's interests. And, again, we're going to have our ups and downs with the economy, but we've got an economy that is structurally sound and got long-term – real long-term strength, and I believe that's going to be reflected in our dollar.

MS. HAYS: Mr. Treasury Secretary, I know you're busy. I want to ask you one more question, though, about the budget deficit and funding it because there are some estimates on Wall Street that the funding needs are going to be increasing by – I think UBS had a, like 145 percent. Are you going to be able to keep funding that in the Treasury market? What kind of vision do you have for that?

SEC. PAULSON: Well, again, as you look at funding, which I think is interesting that despite the costs of the war and despite the costs of the hurricanes and so on over the last number of years, we see a – money has continued to come in quite rapidly into the Treasury, and our deficit at the end of last year was 1.2 percent of GDP, and it continued

to decline as a percentage of GDP. The issue we have and the issue I'm concerned about is in the intermediate term issue – and it's a serious issue, and it has to do with paying for entitlement's programs – Medicare, Medicaid, Social Security, and this is something that we're going to have to deal with, we can deal with, but it's a significant problem.

MS. HAYS: Any concern that low long-term yields, though, are not going to attract sufficient borrowers to fund the deficit at continued low rates?

SEC. PAULSON: Well, let me say this, we have great interest in our Treasury securities. When you look at the U.S. as a place to put money over any period of time, you know, we've got great macro economic fundamentals. It's a competitive efficient markets – Treasury markets give a very good risk-adjusted rate of return. So there is great interest in our Treasury securities. Thank you.

MS. HAYS: Thank you for joining us today, Treasury Secretary Paulson. We appreciate very, very much.

SEC. PAULSON: Thank you.

MS. HAYS: So, Treasury Secretary Paulson after his remarks here at the National Association for Business Economics sharing his views. I'll be back of course – going to be doing “On the Economy” live here at 2:00 Eastern. For now, back to our New York Studio.

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