U.S. DEPARTMENT OF THE TREASURY

Press Center

Secretary Paulson Remarks on the U.S. Economy and Financial System

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Washington- Good afternoon. Thank you for the opportunity to provide an update on the current state of the U.S. economy, our implementation of the financial rescue package and strategies for use of the remaining TARP funds.

Today we continue to work through a severe financial crisis. While we are making progress, the journey ahead will continue to be a difficult one. But I have confidence that we are pursuing the right strategy to stabilize the financial system and support the flow of credit into our economy. The new authorities Congress provided in October dramatically expanded the tools available to the federal government to address the needs of our system. As I and my fellow regulators stated clearly at the time, we now have a set of tools - new authorities in addition to our existing ones- that we can deploy in creative combinations to maximize their impact on our system. And we have taken significant collaborative actions that demonstrate that strategy in action.

This consistent effort to strengthen our financial institutions so they can support our economy is critical to our progress through the current economic downturn. Strong financial institutions and a stable financial system will smooth the path to recovery and an eventual return to prosperity.

The root of this financial turmoil is the housing correction that began and accelerated throughout 2007. As home prices have declined and foreclosures have risen, housing-related assets have been hit particularly hard. Fifteen months ago the housing correction spilled over into the financial sector, pushing the banking system into stress. Consequently, the overall economy has suffered. Third quarter GDP this year showed negative 0.5 percent growth. The unemployment rate has risen to a level not seen in 15 years, with a loss of 240,000 jobs in October alone. Data released last week showed that through September, home prices in 10 major cities had fallen 19 percent over the previous year, demonstrating that the housing correction has not abated. And as the economy slows further, it threatens to prolong the housing correction.

There is no single action the Federal Government can take to end the financial market turmoil and the economic downturn. In these extraordinary times, we must instead focus on developing the most effective combination of our tools to further stabilize our financial system and speed the process of recovery.

Financial System Recovery Efforts

We have implemented several programs aimed at improving the flow of credit to businesses and consumers, so they can spend and invest and restore our economy.

Most significantly, we devoted $250 billion to increasing the capital of our banks. A stronger capital base enables banks to take losses as they write down or sell troubled assets. Stronger capitalization is also essential to increasing lending which, although difficult to achieve during times like this, is essential to economic recovery.

Treasury has received hundreds of applications from the regulators, and hundreds more are under review by the regulators. To date we have purchased preferred shares in 52 institutions, putting $150 billion in additional capital into the financial system. And we will work through the remaining applications in the coming weeks and months.

We have announced the terms for participation for most non-publicly traded banks, another important source of credit in our economy. Regulators are already receiving many applications from private banks and are reviewing and processing those now.

In a powerful joint statement on November 12th, our banking regulators have emphasized that the extraordinary government actions taken to stabilize and strengthen the banking system are not merely one-sided; all banks – not just those participating in the Capital Purchase Program – have benefited, so they all also have responsibilities in the areas of lending, dividend and compensation policies, and foreclosure mitigation. We strongly support this regulatory initiative.

We expect banks to increase their lending as a result of these efforts and it is important that they do so. This lending won't materialize as fast as any of us would like, but it will happen much, much faster as confidence is restored as a result of having used the TARP to stabilize our system and to increase the capital in our banks.

As we all know, the non-bank financial sector is a critical source of finance for the consumer spending that fuels our economy. Consumer credit is critical for many households as they consider purchasing a car, new appliances, or other big ticket items. Like other forms of credit, the availability of affordable consumer credit depends on ready access to a liquid and affordable secondary market – in this case, the asset backed credit market. Recent credit market stresses essentially brought this market to a halt in October. As a result, millions of Americans cannot find affordable financing for their basic credit needs. And credit card rates are climbing, making it more expensive for families to finance everyday purchases. The Federal Reserve and the Treasury last week announced an aggressive program to support the normalization of credit markets and the availability of affordable consumer credit to support economic recovery.

To support the return of consumer lending, the Treasury will provide $20 billion in TARP resources to back a Federal Reserve facility that will provide liquidity to issuers of consumer asset backed paper, enabling a broad range of institutions to step up their lending, and enabling borrowers to have access to lower cost consumer finance and small business loans. The facility may be expanded over time and eligible asset classes may be expanded later to include other assets, such as commercial mortgage-backed securities, non-agency residential mortgage-backed securities or other asset classes.

This consumer lending facility is one example of the creative combination of federal government authorities to ease a major obstruction to the flow of credit into our economy. The actions taken last week to support Citigroup similarly demonstrate the creative combination of tools to most effectively strengthen our financial institutions and confidence in our system.

We are actively engaged in developing additional programs to strengthen our financial system so that lending flows into our economy. When these programs are ready for implementation, we will discuss them with the Congress and the next Administration.

We continue to look at additional capital strategies, and as we do so we will assess the impact of the first capital program, and use this information to evaluate the size and focus of an additional program in light of existing economic and market conditions.

And we are continuing to examine potential foreclosure mitigation ideas that may be an appropriate and effective use of TARP resources. This Administration has used a variety of authorities to reduce avoidable foreclosures, through HUD programs, through the FDIC's program with IndyMac, through our support and leadership of the HOPE NOW Alliance, and through the new GSE servicer guidelines announced November 11 th that will set a new standard for the entire industry for streamlined modification procedures.

An important complement to those guidelines was the GSEs' announcement on November 20 th that they will suspend all foreclosures for 90 days. The foreclosure suspension will give homeowners and servicers time to utilize the new streamlined loan modification program and make it possible for more families to work out terms to stay in their homes.

And of course, as we consider potential new TARP programs, we must also maintain flexibility and firepower for this Administration and the next, to address new challenges as they arise.

As I have said for some time, the housing correction is at the root of our economic and market difficulties. The most important thing we can do to mitigate foreclosures and progress through the housing correction is to reduce the cost of mortgage finance, so more families can afford to buy a home, and so homeowners can refinance into more affordable mortgages. The actions we have taken to stabilize and strengthen Fannie Mae and Freddie Mac, and through them to increase the flow of mortgage credit have insulated mortgage rates from the rapid increases and fluctuations in the cost of other credit. But given that we have essentially guaranteed Fannie Mae and Freddie Mac securities, the rates on those securities – and corresponding mortgage rates – have not come down as much as we may have hoped. The Federal Reserve's announcement that it will purchase $100 billion in GSE debt and half a trillion dollars in GSE mortgage backed securities should have a strongly positive impact on the cost of mortgage finance. And we continue to look for additional ways to make mortgage credit more affordable, which will stimulate purchases, help to stabilize prices and end this housing correction.

Conclusion

Until the financial crisis is behind us, we must remain vigilant, ready to respond and to manage unpredictable events as they occur. Our first priority is on recovery. We work every day fully aware of our awesome responsibility to the American people who depend on the financial system to save for college and retirement, for financing homes, cars and companies. I am confident that we will work through this difficult period, and opportunity and prosperity will again flourish. Thank you.

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