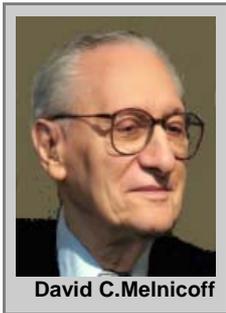


Talking to David Melnicoff, an economist at the Federal Reserve from the mid '40s to the mid '70s

The US housing recession may cause a financial crisis

The burst in real estate is not over. It is unlikely to trigger a recession, unless it sets off a financial crisis. In that case, yes, you have a recession



David C. Melnicoff

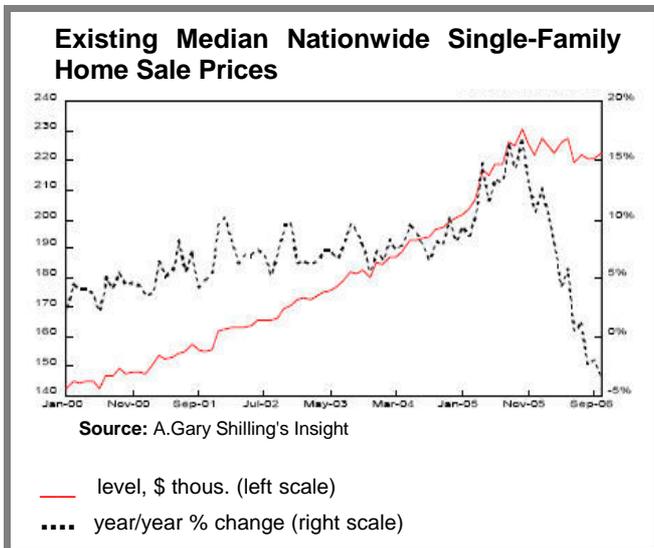
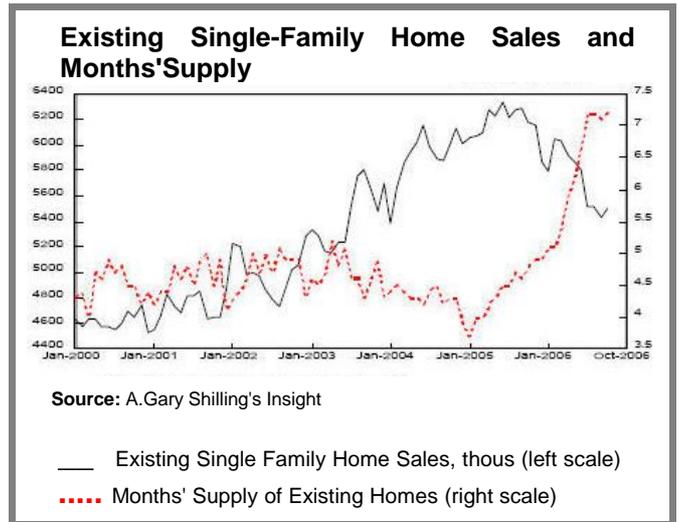
If you are looking for experience, David Melnicoff is the right person for you. He was hired by the Federal Reserve in the mid 1940s and covered several positions within the central bank till he became chief of staff under

chairman Arthur Burns in the first half of the 1970s. "I don't think the United States is on the verge of a recession", he says. "However, there's the possibility of a financial crisis engendered by the huge

also the usual psychological boom-burst cycle."

Some argue that the economic slowdown is going to deteriorate into a recession on account of the housing sector...

"Not necessarily. It certainly will contribute to a slowdown. The only thing that will precipitate a recession is the possibility of a financial crisis. A lot of



amount of derivatives associated with the housing market. If that happens, then, yes, you have a recession."

In the last few weeks, we had a spate of statistics indicating a sharp contraction in the US housing sector. What is your verdict?

"Well, it's likely to go further. It's impossible to say how far it could go, but no doubt it's going a little bit worse. Because once it starts, it develops its own momentum, sometimes beyond the intrinsic value. There's not only the valuation, but

lead to a crisis. It is the financial aspect of the housing market that could create more difficulty. But we don't know that either. How far that will go."

You have a lot of experience. How likely is that crisis?

"I would say it is less than 50%. Not likely to occur, but

fancy borrowing has been done in housing and of course a lot of the mortgages that were made in the last few years have been securitized. Then all those mortgages are now through out the market. We don't know a lot about who holds them. We know they are very widespread. It's possible that the internal mechanisms of those securities could cause a lot of defaults that might

certainly could."

You said 'less than 50%', that looks enough...

"It's enough, yes. Over the ten years and more, the mortgage market, which is the largest part of the debt market, has been transformed and consists mostly of securities. The system has not been tested in bad times yet."

What is your central scenario for the US economy?

"A slowdown. That is the consensus view and that is what I feel is likely to happen. Consumer spending ought to slow down. It hasn't yet, but it will occur."

Vincenzo Sciarretta

