

Viewing the Financial Crisis from 20,000 Feet Up

by Stephen Figlewski¹

ABSTRACT

The financial system is currently being battered by huge losses and extreme uncertainty that are arising in the real estate sector of the real economy, and it is breaking down.

Solution: Disconnect the financial system from the risk that is too big for it to handle. The Federal government could take over bearing this risk just by guaranteeing that all mortgage payments will henceforth be made to the lender as scheduled.

The financial markets would stabilize because all mortgage-backed securities, no matter how complicated, would immediately become as safe and as marketable as US Treasury bonds.

The government would then work with homeowners to restructure their monthly payments so they can afford to stay in their homes. Defaults and foreclosures would go down sharply.

This approach is much more cost effective than alternative proposals that would have the government buy up bad mortgage loans. For example, on a \$200,000 mortgage at 7% interest, taking over the loan would cost \$200,000, while under this plan, the government would just guarantee the mortgage payments at a cost of about \$1300 a month, most or all of which would come from the homeowner.

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