



# David W. Berson—Chief Economist, The PMI Group Inc.

For all but the most casual observer of the housing and mortgage markets, David W. Berson is a familiar name that, until recently, was attached to an equally familiar company.

However, last fall Berson left his post as chief economist at the government-sponsored enterprise (GSE) Fannie Mae after two decades, packed up and moved West to join The PMI Group Inc., Walnut Creek, California.

As The PMI Group's chief economist and strategist, Berson's responsibilities include domestic and global market research and planning support for government relations and public policy. He also acts as a PMI spokesman on topics related to global economic housing, mortgage market conditions, prospects and policy.

Berson had been Fannie Mae's vice president and chief economist since 1989. He was responsible for advising the company on national and regional economic, housing and mortgage policy and conditions, including forecasts and analyses of the economy, interest rates, and housing and mortgage finance markets.

Prior to his stint at Fannie Mae, Berson held senior management positions at Wharton Econometric Forecasting Associates, Philadelphia, overseeing domestic services, financial analysis and modeling. He also has held several teaching positions at the University of Michigan, Ann Arbor, Michigan; Claremont McKenna College, Claremont, California; and Claremont Graduate School, Claremont, California.

Berson earned his doctorate in economics and a master's degree in public policy from the University of Michigan, and a bachelor of arts degree in history and economics from Williams College, Williamstown, Massachusetts.

*Mortgage Banking* recently interviewed Berson about his outlook for the housing market and other housing trends.



company does business in and ultimately the business itself.

But in addition, I'm also the chief strategist. So I will be looking at the corporate strategic plan every year, looking at the company and industry in a more strategic way, and looking at broad environmental issues that will affect the industry and the company.

**Q:** How would you summarize the current state of the housing and mortgage markets? What are some key indicators you are watching to diagnose the general health of the market?

**A:** Well, things aren't good, obviously. Despite the uptick in new sales, the trend in housing is still down and I think it will

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probably remain down for a while. Investors are still pulling out of the market, credit conditions have tightened—at least in the non-prime conforming market—[and] credit conditions have tightened significantly.

It's made it difficult for people to buy homes, and, as a result, the housing market continues to retreat. Unsold inventories continue to climb, putting downward pressure on prices—so the current situation is not very positive.

Now, we're still seeing a decent amount of homes that are sold relative to historical averages, but certainly not relative to what we've seen thus far this decade. Part of that is that we overshot in terms of housing activity for many years of this decade, but part of it also is just simply that the market is weak.

**Q:** What is your outlook specifically for subprime in 2008 and into 2009? When do you expect things to bottom out and start to improve in terms of total origination volume, purchase share and adjustable-rate mortgage [ARM] volume?

**A:** Let me talk first about total originations, then we'll talk about subprime. There is still a fair amount of refinance activity occurring that I think will also be the case [in 2008]. In part [this is] because mortgage rates have gone down, and in part also because there are a lot of homeowners with ARMs who are seeing those ARMs adjust upward and, as long as they have equity in their homes and are of

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**Q:** Can you talk a little about your new role at The PMI Group, following 20 years at Fannie Mae?

**A:** I have a dual role here. One is chief economist, which is similar to what I did at Fannie—looking at the economy, how that will affect the housing and mortgage market and, more importantly, how it affects the company.

So while the firms are different, my role as chief economist is similar in terms of taking the big-picture items and drilling it down to how it will ultimately affect the environment that the



reasonable credit quality, most of them can refinance successfully—and many of them are trying to do that.

But purchase activity—purchase originations—is falling significantly due to a combination of the drop in falling home sales and the decline in home prices. The net effect is that originations [fell] in 2007 and will fall further in 2008.

In 2007, we estimate that originations will have been for the year maybe \$2.4 trillion, but for 2008 it will probably fall to about \$1.9 trillion—maybe slightly over that if we get more refis. That's a pretty big drop.

So the purchase share remains only at about 50 percent, so that's a reasonably high refi share. The ARM share, we think, is going to remain relatively low—probably around 15 percent.

Now, part of that is that 30-year fixed rates have come down. Part of it is also that with a greater decline in subprime and alt-A lending in other parts of the market, and since those were primarily ARM markets, ARM originations are falling much more than fixed-rate originations.

Now, subprime clearly has fallen dramatically, and we think it will stay very weak in 2008. The real problem there [is], if you disassemble subprime lending, it's not subprime per se—it's subprime ARMs, which is about 80 percent of the subprime market.

If you look at the [second-quarter 2007] MBA [Mortgage Bankers Association] *National Delinquency Survey*, subprime fixed rates haven't seen any meaningful pickup in serious delinquency rates—meaning that people who got subprime fixed-rate [loans] and could afford to get them when they first went in and haven't seen any pickup in rates, they can still afford them. [Note: This interview was done prior to the release of third-quarter 2007 MBA delinquency survey results.]

But the subprime ARM serious-delinquency rates have skyrocketed. So once the borrowers [saw] their rates move upward, many of them could no longer afford the loans. Lenders, seeing that, have cut back dramatically on subprime ARMs, and I think it's going to be a while before we see that pick up again—perhaps not until 2009.

**Q:** *When all is said and done, will subprime as we know it cease to exist, or will the subprime market just significantly change?*

**A:** Well, it will have shrunk dramatically, and far more subprime will be fixed-rate subprime. I mean, subprime is an important part of the credit market. It does bring mortgage finance to homebuyers who otherwise couldn't be in the market, but what we've seen is that through subprime there were probably many borrowers who got funds, probably sooner than they could afford to buy homes.

That doesn't mean that subprime lending should go away or that it will go away, but it will change and it will concentrate on subprime borrowers who are creditworthy.

**Q:** *Does the current "subprime meltdown" and overall market correction remind you of a prior period in the industry's history?*

**A:** I think we see similar sorts of events periodically, but they are never exactly the same. For example, in the late 1980s we saw the expansion of lending that, at the time, I and many others viewed as pushing the envelope too much.

There was, for example, in the late 1980s a push toward low-documentation lending, and originally those loans had 60 percent LTVs [loan-to-value ratios]. But ultimately, those loans got to 95 percent LTVs. Well, many of those loans went bad.

So we will see on a periodic basis—every 10, 15 or 20 years—

the credit envelope being pushed too far. So 15 years from now, will similar things occur? The answer is probably yes. The particular products may differ, but pushing the envelope won't.

**Q:** *How would you handicap the dangers of the economy falling into recession? What are some of the indicators you are most carefully watching, and what would most likely be the factor to push us into recession?*

**A:** I think those odds have moved up recently. In August, there was a great liquidity squeeze in [the] capital markets, and the [Federal Reserve] eased several times—particularly lowering the discount rate. [And] not only lowering the discount rate, but expanding the collateral that the Fed would take.

So we saw certain important credit spreads narrow as a result of that. But those credit spreads have widened again over the last month [preceding this Nov. 30 interview], so there is another liquidity squeeze in the capital markets.

And that's one of the things that I think has pushed up the odds of a downturn. Part of whether we get a downturn or not depends upon how quickly and in what form the Fed responds to this. I think they will respond quickly, but I think the odds of a downturn or of a recession have probably increased to about 50 percent. Previously, we were at about [a] 35 [percent] to 40 percent chance.

**Q:** *Can you lay out your forecast for economic growth, and what do you see as the wild card?*

**A:** I still think the most likely course is slow growth in 2008, with growth well below trend—maybe 1.5 [percent] to 2 percent—but it's not a recession. But still, growth at that pace suggests that unemployment rates should move up, but not quickly.

Wild cards? [That would be] the financial markets and whether the liquidity squeeze continues—and if it does, then the odds of a downturn go up, and then we're more likely to have a modest downturn instead of modest growth.

**Q:** *What is your outlook for job growth and employment stability during the next year, and will it help housing or simply not hurt housing?*

**A:** I think it will simply not hurt it. I think job growth, with the slow-growth scenario that we think is most likely, payroll employment numbers will probably rise by somewhere between about 50,000 and about 125,000 [jobs] a month. It may be averaging 80,000 to 90,000 [jobs] a month. Again, not a recession—but not terribly strong, either.

As I mentioned, we would expect unemployment rates to move upward, but not dramatically. Currently, the national unemployment rate is about 4.6 percent, and I can see that rising to about 5 percent, maybe slightly above that. Not recession levels—but not great strength, either.

**Q:** *On loan performance: When we last spoke in May, you spoke of a potential opportunity for mortgage lenders to find creditworthy borrowers in the wake of resetting ARMs. In your estimation, have lenders capitalized on this opportunity to make lemonade from a potential default lemon? Do you see a lot more such opportunities in 2008?*

**A:** I think that we've seen [that], to a more limited extent than perhaps I thought or even hoped that we would, but I think the opportunity is still there. In fact, it may be there to an even greater extent in 2008, because there will be a larger number of subprime ARMs that will be resetting in 2008 than had reset in 2007.

So there is a great opportunity there. Of course, it requires the borrower to be somewhat creditworthy and it also requires the borrower to have equity in the home.

If the subprime borrower is in an area where home prices



have fallen dramatically and the value of the home is well below the current mortgage, then it's a far more difficult process. But still, the opportunity exists for many subprime ARM borrowers who were current with their mortgage to have the opportunity to refinance.

**Q:** *Geographically speaking, what metro regions or sectors are you looking at with particular interest that are either doing exceptionally bad or are showing particular promise?*

**A:** Well, the ones that are doing bad are the ones that are no surprise—the upper Midwest, Michigan, large parts of Ohio, some of Indiana, some of upstate New York and a few other areas in the upstate Midwest—because of basically a recession in heavy manufacturing, much of that tied to autos. But we're also seeing in the housing market significant declines in many parts of the country, where we saw some of the biggest price gains because many of those areas were fueled by investor activity.

As the investors pulled out, it slowed the housing market. So [markets are doing poorly in] a lot of California, but not all of it; a lot of Florida—most of it; D.C.; Boston; perhaps eventually New York, if Wall Street slows dramatically.

On the other hand, we're still seeing pretty good activity in Texas; the Southeast—other than Florida; a lot of the Rocky Mountain areas—they're all still doing pretty well. They didn't have the run-up in investor activity, so they didn't get the run-up now in unsold inventories. So those are parts of the country that should probably continue to do pretty well.

**Q:** *When do you expect the housing inventory overhang to start to move downward, and what must happen to trigger it?*

**A:** Ideally, we get a big pickup in sales, and that would cause inventories to go down, but I don't see that happening for a while. In fact, I don't see sales really flattening out until the second half of [2008], and not even picking up until 2009.

So we need to get inventories down, but more than that, we need a further reduction in the number of new units coming on the market. So I would expect to see starts fall further, but that will be healthy for the market ultimately.

Even if it means a very bad prospect for builders in the near term, ultimately it means that the whole housing market will be healthier. But I don't think the inventory numbers will really start to move down until the end of [2008] or perhaps the beginning of 2009.

**Q:** *Do you see this current correction producing a lasting change in the housing market, or is this just a normal, albeit more harsh, correction? Are there long-term structural effects to this correction—good and bad outcomes?*

**A:** Well, it's some of each of those things. As I mentioned earlier, the mortgage finance market periodically has problems because the credit envelope has been pushed too far, and I think that will occur again—but maybe 10 to 15 to 20 years, again, in the future.

So in the interim period, I think we will see a mortgage market that is far healthier in terms of credit, and I think we will see a housing market where builders are more cautious in the near term—but that means a healthier housing and credit market over the next five to 10 years. **MB**

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Charles Wisniewski is a correspondent for *Mortgage Banking*.

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