

## **The Sound of Ice Cracking – Risks Ahead to the Economy**

Rod J. Howard, November 16, 2010

After surfacing over the summer, the issues of sloppy mortgage paperwork, perjured foreclosure affidavits, and, even more ominously, potentially fatally defective title recording and transfer practices is now getting attention from Congress. An article (<http://www.washingtonpost.com/wp-dyn/content/article/2010/11/16/AR2010111600022.html>) by two Washington Post staffers, presents a fairly good summary of what's at stake.

What's striking is the sense of a gathering storm:

- Banks and financial industry players watching the hearings very closely, and "everyone's very nervous".
- The assumption that the "foreclosure problems" do not pose a systemic risk now coming into question.
- The morphing of the "foreclosure" crisis into something else and vastly bigger -- into the possible "collapse" of the "foundation" of clear and certain property rights and title on which markets, including the housing market but also other markets, are built.

Striking too is the unspoken assumption that anything short of a "systemic risk" would be a good outcome. A systemic-risk threshold isn't much comfort. Individual firms can fail by the thousands and people by the millions can lose their shirts before a problem becomes a "systemic impact."

Now, even that cold comfort is being questioned. Maybe there is a systemic risk after all.

Worse still, maybe the systemic risk is bigger than just the banking system. The questions being raised are not just about mortgage banking, loss reserves or bank capital. They go to the heart of national and individual prosperity and economic activity: confidence in title to assets and assurance of ownership. Confidence that the seller owns what he's selling to you.

The sell-off in financial-sector stocks a few months ago may have been an early sign of concern. At least some players, it seems, read the signs and put the pieces of the puzzle together, saw the potential for problems that are only now coming into fuller focus and only now getting wider media coverage, and they decided to get out -- or at least to hedge their bets, cash in some chips, and take some money off the table.

In any event, this is a story that needs to be followed closely. It will be a hard story to follow. Though the Washington Post would naturally focus on what's happening in Washington, the New York Times would naturally focus on what happens in New York, and the Wall Street Journal would focus on what happens on Wall Street, this is a story that is likely to play out not just in Washington and New York and not just on Wall Street.

Even if pigs grow wings and fly and the newly divided federal government can reach consensus on what to do, there are serious questions of whether the federal government has the constitutional power to change state laws and rules on title to real property and fix the mess -- and to fix it retroactively.

So look for the story to play out in 50 state capitals and thousands

of courtrooms in obscure localities around the country. And look for it to play out with a volatile brew of law, politics and money, in a space where and federalism and populism, big-money politics and anti-Wall Street fury may come together to generate different outcomes that, for now, are impossible to predict.

It's astonishing reading, and it's astonishing that it fails to astonish more than it does. We are, it seems, becoming accustomed to the unthinkable. Or have we just been lucky so far? And how long will the luck last?

The Larsen B ice shelf in Antarctica was 650 feet deep and the size of Rhode Island, 1250 square miles. The ice shelf was stable -- until one day it wasn't, and then it disintegrated and vanished in less than a month (<http://www.msnbc.msn.com/id/3313340>). In complex systems, the accepted learning is that they collapse catastrophically and suddenly. So too in markets, where historians have observed that when markets turn, they tend to turn suddenly.

Already signs of stress may be appearing -- rather than falling in response to the Fed's recent QE2 announcement, as the Fed hoped and as conventional wisdom would predict, interest rates have risen. Stresses abound in many corners of our financial system and economy.

So listen carefully this week for the groan of ice shifting. And listen for the funny sound that ice sheets make when they start to crack; they say it sounds like Star Wars blasters.

