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Dr. Doom

By STEPHEN MIHM

On Sept. 7, 2006, Nouriel Roubini, an economics professor at [New York University](#), stood before an audience of economists at the [International Monetary Fund](#) and announced that a crisis was brewing. In the coming months and years, he warned, the United States was likely to face a once-in-a-lifetime housing bust, an oil shock, sharply declining consumer confidence and, ultimately, a deep recession. He laid out a bleak sequence of events: homeowners defaulting on mortgages, trillions of dollars of mortgage-backed securities unraveling worldwide and the global financial system shuddering to a halt. These developments, he went on, could cripple or destroy hedge funds, investment banks and other major financial institutions like [Fannie Mae](#) and [Freddie Mac](#).

The audience seemed skeptical, even dismissive. As Roubini stepped down from the lectern after his talk, the moderator of the event quipped, “I think perhaps we will need a stiff drink after that.” People laughed — and not without reason. At the time, unemployment and inflation remained low, and the economy, while weak, was still growing, despite rising oil prices and a softening housing market. And then there was the espouser of doom himself: Roubini was known to be a perpetual pessimist, what economists call a “permabear.” When the economist Anirvan Banerji delivered his response to Roubini’s talk, he noted that Roubini’s predictions did not make use of mathematical models and dismissed his hunches as those of a career naysayer.

But Roubini was soon vindicated. In the year that followed, subprime lenders began entering bankruptcy, hedge funds began going under and the stock market plunged. There was declining employment, a deteriorating dollar, ever-increasing evidence of a huge housing bust and a growing air of panic in financial markets as the credit crisis deepened. By late summer, the [Federal Reserve](#) was rushing to the rescue, making the first of many unorthodox interventions in the economy, including cutting the lending rate by 50 basis

points and buying up tens of billions of dollars in mortgage-backed securities. When Roubini returned to the I.M.F. last September, he delivered a second talk, predicting a growing crisis of solvency that would infect every sector of the financial system. This time, no one laughed. “He sounded like a madman in 2006,” recalls the I.M.F. economist Prakash Loungani, who invited Roubini on both occasions. “He was a prophet when he returned in 2007.”

Over the past year, whenever optimists have declared the worst of the economic crisis behind us, Roubini has countered with steadfast pessimism. In February, when the conventional wisdom held that the venerable investment firms of Wall Street would weather the crisis, Roubini warned that one or more of them would go “belly up” — and six weeks later, [Bear Stearns](#) collapsed. Following the Fed’s further extraordinary actions in the spring — including making lines of credit available to selected investment banks and brokerage houses — many economists made note of the ensuing economic rally and proclaimed the credit crisis over and a recession averted. Roubini, who dismissed the rally as nothing more than a “delusional complacency” encouraged by a “bunch of self-serving spinmasters,” stuck to his script of “nightmare” events: waves of corporate bankruptcies, collapses in markets like commercial real estate and municipal bonds and, most alarming, the possible bankruptcy of a large regional or national bank that would trigger a panic by depositors. Not all of these developments have come to pass (and perhaps never will), but the demise last month of the California bank IndyMac — one of the largest such failures in U.S. history — drew only more attention to Roubini’s seeming prescience.

As a result, Roubini, a respected but formerly obscure academic, has become a major figure in the public debate about the economy: the seer who saw it coming. He has been summoned to speak before Congress, the [Council on Foreign Relations](#) and the [World Economic Forum](#) at Davos. He is now a sought-after adviser, spending much of his time shuttling between meetings with central bank governors and finance ministers in Europe and Asia. Though he continues to issue colorful doomsday prophecies of a decidedly nonmainstream sort — especially on his popular and polemical blog, where he offers visions of “equity market slaughter” and the “Coming Systemic Bust of the U.S. Banking System” — the mainstream economic establishment appears to be moving closer, however fitfully, to his way of seeing things. “I have in the

last few months become more pessimistic than the consensus,” the former Treasury secretary [Lawrence Summers](#) told me earlier this year. “Certainly, Nouriel’s writings have been a contributor to that.”

On a cold and dreary day last winter, I met Roubini over lunch in the TriBeCa neighborhood of New York City. “I’m not a pessimist by nature,” he insisted. “I’m not someone who sees things in a bleak way.” Just looking at him, I found the assertion hard to credit. With a dour manner and an aura of gloom about him, Roubini gives the impression of being permanently pained, as if the burden of what he knows is almost too much for him to bear. He rarely smiles, and when he does, his face, topped by an unruly mop of brown hair, contorts into something more closely resembling a grimace.

When I pressed him on his claim that he wasn’t pessimistic, he paused for a moment and then relented a little. “I have more concerns about potential risks and vulnerabilities than most people,” he said, with glum understatement. But these concerns, he argued, make him more of a realist than a pessimist and put him in the role of the cleareyed outsider — unsettling complacency and puncturing pieties.

Roubini, who is 50, has been an outsider his entire life. He was born in Istanbul, the child of Iranian Jews, and his family moved to Tehran when he was 2, then to Tel Aviv and finally to Italy, where he grew up and attended college. He moved to the United States to pursue his doctorate in international economics at [Harvard](#). Along the way he became fluent in Farsi, Hebrew, Italian and English. His accent, an inimitable polyglot growl, radiates a weariness that comes with being what he calls a “global nomad.”

As a graduate student at Harvard, Roubini was an unusual talent, according to his adviser, the Columbia economist [Jeffrey Sachs](#). He was as comfortable in the world of arcane mathematics as he was studying political and economic institutions. “It’s a mix of skills that rarely comes packaged in one person,” Sachs told me. After completing his Ph.D. in 1988, Roubini joined the economics department at [Yale](#), where he first met and began sharing ideas with Robert Shiller, the economist now known for his prescient warnings about the 1990s tech bubble.

The '90s were an eventful time for an international economist like Roubini. Throughout the decade, one emerging economy after another was beset by crisis, beginning with Mexico's in 1994. Panics swept Asia, including Thailand, Indonesia and Korea, in 1997 and 1998. The economies of Brazil and Russia imploded in 1998. Argentina's followed in 2000. Roubini began studying these countries and soon identified what he saw as their common weaknesses. On the eve of the crises that befell them, he noticed, most had huge current-account deficits (meaning, basically, that they spent far more than they made), and they typically financed these deficits by borrowing from abroad in ways that exposed them to the national equivalent of bank runs. Most of these countries also had poorly regulated banking systems plagued by excessive borrowing and reckless lending. Corporate governance was often weak, with cronyism in abundance.

Roubini's work was distinguished not only by his conclusions but also by his approach. By making extensive use of transnational comparisons and historical analogies, he was employing a subjective, nontechnical framework, the sort embraced by popular economists like the Times Op-Ed columnist Paul Krugman and [Joseph Stiglitz](#) in order to reach a nonacademic audience. Roubini takes pains to note that he remains a rigorous scholarly economist — “When I weigh evidence,” he told me, “I'm drawing on 20 years of accumulated experience using models” — but his approach is not the contemporary scholarly ideal in which an economist builds a model in order to constrain his subjective impressions and abide by a discrete set of data. As Shiller told me, “Nouriel has a different way of seeing things than most economists: he gets into everything.”

Roubini likens his style to that of a policy maker like [Alan Greenspan](#), the former Fed chairman who was said (perhaps apocryphally) to pore over vast quantities of technical economic data while sitting in the bathtub, looking to sniff out where the economy was headed. Roubini also cites, as a more ideologically congenial example, the sweeping, cosmopolitan approach of the legendary economist [John Maynard Keynes](#), whom Roubini, with only slight exaggeration, calls “the most brilliant economist who never wrote down an equation.” The book that Roubini ultimately wrote (with the economist Brad Setser) on the emerging market crises, “Bailouts or Bail-Ins?” contains not a single equation in its 400-plus pages.

After analyzing the markets that collapsed in the '90s, Roubini set out to determine which country's economy would be the next to succumb to the same pressures. His surprising answer: the United States'. "The United States," Roubini remembers thinking, "looked like the biggest emerging market of all." Of course, the United States wasn't an emerging market; it was (and still is) the largest economy in the world. But Roubini was unnerved by what he saw in the U.S. economy, in particular its 2004 current-account deficit of \$600 billion. He began writing extensively about the dangers of that deficit and then branched out, researching the various effects of the credit boom — including the biggest housing bubble in the nation's history — that began after the Federal Reserve cut rates to close to zero in 2003. Roubini became convinced that the housing bubble was going to pop.

By late 2004 he had started to write about a "nightmare hard landing scenario for the United States." He predicted that foreign investors would stop financing the fiscal and current-account deficit and abandon the dollar, wreaking havoc on the economy. He said that these problems, which he called the "twin financial train wrecks," might manifest themselves in 2005 or, at the latest, 2006. "You have been warned here first," he wrote ominously on his blog. But by the end of 2006, the train wrecks hadn't occurred.

Recessions are signal events in any modern economy. And yet remarkably, the profession of economics is quite bad at predicting them. A recent study looked at "consensus forecasts" (the predictions of large groups of economists) that were made in advance of 60 different national recessions that hit around the world in the '90s: in 97 percent of the cases, the study found, the economists failed to predict the coming contraction a year in advance. On those rare occasions when economists did successfully predict recessions, they significantly underestimated the severity of the downturns. Worse, many of the economists failed to anticipate recessions that occurred as soon as two months later.

The dismal science, it seems, is an optimistic profession. Many economists, Roubini among them, argue that some of the optimism is built into the very machinery, the mathematics, of modern economic theory. Econometric models typically rely on the assumption that the near future is likely to be similar to the recent past, and thus it is rare that the models anticipate breaks

in the economy. And if the models can't foresee a relatively minor break like a recession, they have even more trouble modeling and predicting a major rupture like a full-blown financial crisis. Only a handful of 20th-century economists have even bothered to study financial panics. (The most notable example is probably the late economist Hyman Minsky, of whom Roubini is an avid reader.) "These are things most economists barely understand," Roubini told me. "We're in uncharted territory where standard economic theory isn't helpful."

True though this may be, Roubini's critics do not agree that his approach is any more accurate. Anirvan Banerji, the economist who challenged Roubini's first I.M.F. talk, points out that Roubini has been peddling pessimism for years; Banerji contends that Roubini's apparent foresight is nothing more than an unhappy coincidence of events. "Even a stopped clock is right twice a day," he told me. "The justification for his bearish call has evolved over the years," Banerji went on, ticking off the different reasons that Roubini has used to justify his predictions of recessions and crises: rising trade deficits, exploding current-account deficits, [Hurricane Katrina](#), soaring oil prices. All of Roubini's predictions, Banerji observed, have been based on analogies with past experience. "This forecasting by analogy is a tempting thing to do," he said. "But you have to pick the right analogy. The danger of this more subjective approach is that instead of letting the objective facts shape your views, you will choose the facts that confirm your existing views."

Kenneth Rogoff, an economist at Harvard who has known Roubini for decades, told me that he sees great value in Roubini's willingness to entertain possible situations that are far outside the consensus view of most economists. "If you're sitting around at the [European Central Bank](#)," he said, "and you're asking what's the worst thing that could happen, the first thing people will say is, 'Let's see what Nouriel says.'" But Rogoff cautioned against equating that skill with forecasting. Roubini, in other words, might be the kind of economist you want to consult about the possibility of the collapse of the municipal-bond market, but he is not necessarily the kind you ask to predict, say, the rise in global demand for paper clips.

His defenders contend that Roubini is not unduly pessimistic. Jeffrey Sachs, his former adviser, told me that "if the underlying conditions call for

optimism, Nouriel would be optimistic.” And to be sure, Roubini is capable of being optimistic — or at least of steering clear of absolute worst-case prognostications. He agrees, for example, with the conventional economic wisdom that oil will drop below \$100 a barrel in the coming months as global demand weakens. “I’m not comfortable saying that we’re going to end up in the Great Depression,” he told me. “I’m a reasonable person.”

What economic developments does Roubini see on the horizon? And what does he think we should do about them? The first step, he told me in a recent conversation, is to acknowledge the extent of the problem. “We are in a recession, and denying it is nonsense,” he said. When [Jim Nussle](#), the White House budget director, announced last month that the nation had “avoided a recession,” Roubini was incredulous. For months, he has been predicting that the United States will suffer through an 18-month recession that will eventually rank as the “worst since the Great Depression.” Though he is confident that the economy will enter a technical recovery toward the end of next year, he says that job losses, corporate bankruptcies and other drags on growth will continue to take a toll for years.

Roubini has counseled various policy makers, including Federal Reserve governors and senior Treasury Department officials, to mount an aggressive response to the crisis. He applauded when the Federal Reserve cut interest rates to 2 percent from 5.25 percent beginning last summer. He also supported the Fed’s willingness to engineer a takeover of Bear Stearns. Roubini argues that the Fed’s actions averted catastrophe, though he says he believes that future bailouts should focus on mortgage owners, not investors. Accordingly, he sees the choice facing the United States as stark but simple: either the government backs up a trillion-plus dollars’ worth of high-risk mortgages (in exchange for the lenders’ agreement to reduce monthly mortgage payments), or the banks and other institutions holding those mortgages — or the complex securities derived from them — go under. “You either nationalize the banks or you nationalize the mortgages,” he said. “Otherwise, they’re all toast.”

For months Roubini has been arguing that the true cost of the housing crisis will not be a mere \$300 billion — the amount allowed for by the housing legislation sponsored by Representative [Barney Frank](#) and Senator

[Christopher Dodd](#) — but something between a trillion and a trillion and a half dollars. But most important, in Roubini's opinion, is to realize that the problem is deeper than the housing crisis. "Reckless people have deluded themselves that this was a subprime crisis," he told me. "But we have problems with credit-card debt, student-loan debt, auto loans, commercial real estate loans, home-equity loans, corporate debt and loans that financed leveraged buyouts." All of these forms of debt, he argues, suffer from some or all of the same traits that first surfaced in the housing market: shoddy underwriting, securitization, negligence on the part of the credit-rating agencies and lax government oversight. "We have a subprime financial system," he said, "not a subprime mortgage market."

Roubini argues that most of the losses from this bad debt have yet to be written off, and the toll from bad commercial real estate loans alone may help send hundreds of local banks into the arms of the [Federal Deposit Insurance Corporation](#). "A good third of the regional banks won't make it," he predicted. In turn, these bailouts will add hundreds of billions of dollars to an already gargantuan federal debt, and someone, somewhere, is going to have to finance that debt, along with all the other debt accumulated by consumers and corporations. "Our biggest financiers are China, Russia and the gulf states," Roubini noted. "These are rivals, not allies."

The United States, Roubini went on, will likely muddle through the crisis but will emerge from it a different nation, with a different place in the world. "Once you run current-account deficits, you depend on the kindness of strangers," he said, pausing to let out a resigned sigh. "This might be the beginning of the end of the American empire."

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