



Flow of Funds

June 6th 2008

1Q08 Flow of Funds

- Business debt grew at a solid pace benefiting from low interest rates
- A potential risk in corporate America is a continuous need for external financing that is higher than in previous years
- All sectors, except for the federal government, saw their debt decelerate when compared to previous quarters
- Mortgage equity withdrawal continued to fall, as household net worth fell 11.3% in annualized terms

Credit continued to decelerate in the first quarter of 2008. Total debt of the domestic nonfinancial sectors grew at a seasonally adjusted annual rate of 6.5% (1 pp lower than in the previous quarter and the lowest rate since 2001). Even when the reduction in debt growth was not as pronounced as the one in 2007Q4, when debt eased from 9.1% to 7.5%, the decelerating trend shows no signs of abating. This bleak assertion is based in the yet strong deceleration of households' debt, segment which remains the main driver of the current downtrend (households' debt grew a meager 3.5% compared with the previously seasonally annualized growth of 6.1% in the previous quarter). Debt in almost all sectors grew at a lower pace than anytime during 2007. The only exception was the federal government's debt, which grew at an impressive annualized rate of 9.5%.

Business debt continued to expand at a healthy pace

Business's debt grew 10.8% yoy. With interest payments at historical lows (relative to profits) debt growth in corporate America was robust. This explains why businesses have been shifting the means to finance itself, from bond issuance to bank loans. But risks are growing: the financial gap remains at a high level, indicating the need for external financing in order to keep current operations.

Households become poorer as the housing sector falls.

As a direct consequence of the plunge in home prices, household wealth continued to fall in the first quarter of the year. Household net worth fell 11.3% in 1Q08 (annualized seasonally adjusted rate). This is different to the burst of the tech bubble in 2001, when homeowners' equity was not significantly affected. The ingredients for a prolonged vicious cycle are in place. These numbers reaffirm our conviction that the current downturn will continue as long as house prices keep on falling.

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U.S. Nonfarm Nonfinancial Business Balance Sheet
US\$ trillions

	1Q08	4Q07	1Q07	YoY % change
Total assets	28.5	28.2	26.3	8.3
Tangible assets	14.8	14.6	13.4	10.5
Real Estate	9.0	8.9	7.9	13.7
Equipment and Software	3.9	3.9	3.8	4.6
Inventories	1.8	1.8	1.7	8.5
Financial assets	13.7	13.7	12.9	6.1
Total Liabilities	12.6	12.5	12.0	4.9
Credit market instruments	6.5	6.3	5.8	10.8
Trade payables	2.0	2.0	1.9	9.3
Taxes payable	0.1	0.1	0.1	0.8
Other	4.0	4.0	4.2	-5.1
Net worth (market value)	15.9	15.8	14.3	11.1

Source: Fed; Nonfarm Nonfinancial Corporate Business

U.S. Household Balance Sheet
US\$ trillions

	1Q08	4Q07	1Q07	YoY % change
Total assets	70.5	72.1	70.2	0.4
Tangible assets	26.4	26.7	26.3	0.4
Real Estate	22.1	22.4	22.1	-0.4
Other tangible assets	4.3	4.3	4.1	4.3
Financial assets	44.1	45.4	43.9	0.5
Checkable deposits and money funds	1.5	1.4	1.3	17.7
Time and savings deposits	6.0	5.9	5.6	7.3
Credit market instruments	3.9	4.1	3.7	4.7
Equities (direct)	4.9	5.5	6.0	-18.5
Mutual funds	4.7	5.1	4.8	-0.4
Life insurance and pension reserves	13.3	14.0	13.6	-1.7
Equity in unincorporated business	7.9	7.9	7.5	5.7
Other financial assets	1.7	1.6	1.3	25.4
Total Liabilities	14.5	14.4	13.6	6.4
Mortgages	10.6	10.5	10.0	5.5
Consumer credit	2.5	2.6	2.4	6.0
Other	1.4	1.3	1.2	14.7
Net worth	56.0	57.7	56.5	-1.0
Financial net worth (financial assets minus total liabilities)	29.6	31.0	30.2	-2.2

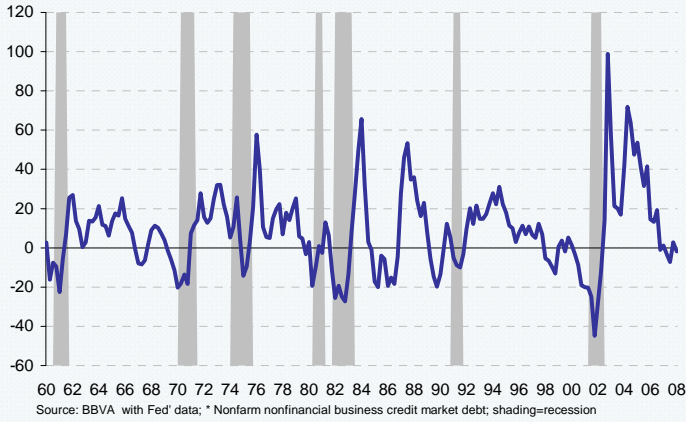
Source: Fed; includes nonprofit organizations

Business Sector

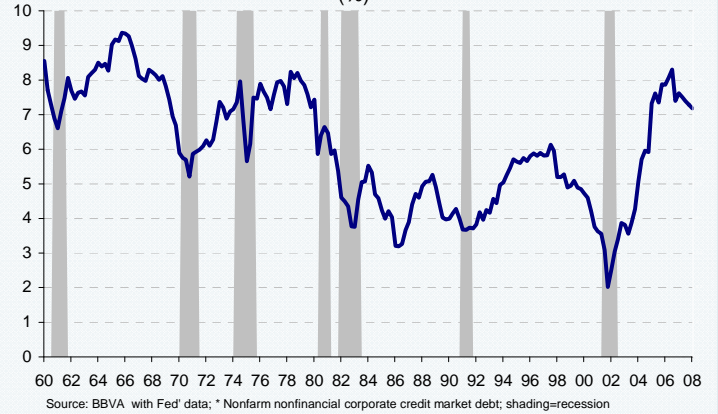
Profits decreased 1.8% yoy;...

...however, they remain solid, notwithstanding the financial turmoil

Business Profits
(YoY % change)



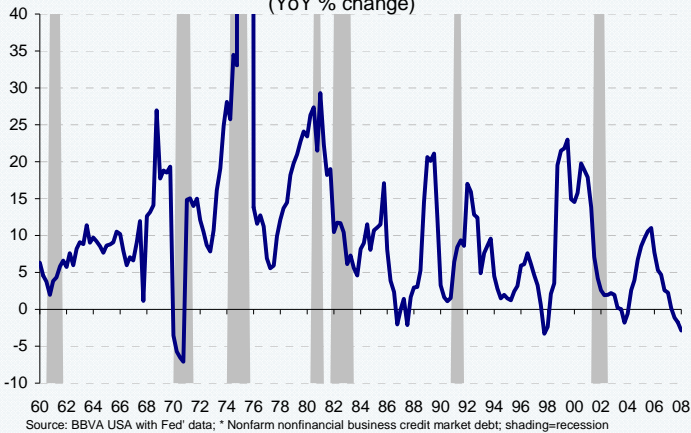
Economic Profits as a Share of GDP
(%)



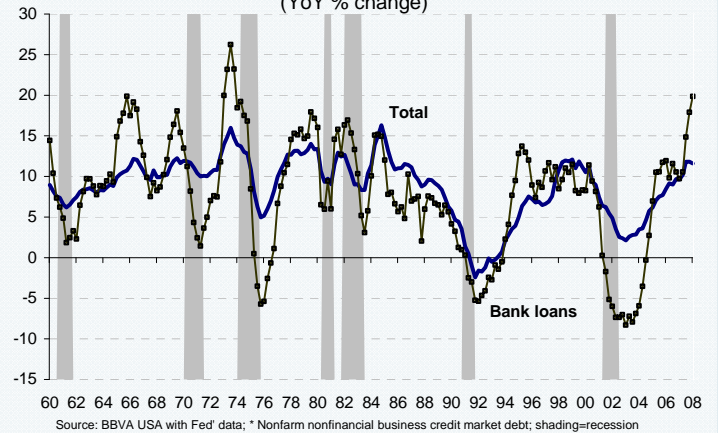
Net corporate bonds fell significantly,...

... they seem to have been substituted by cheap bank lending. Business debt continued to grow above 10%

Business Debt, Corporate Bonds
(YoY % change)



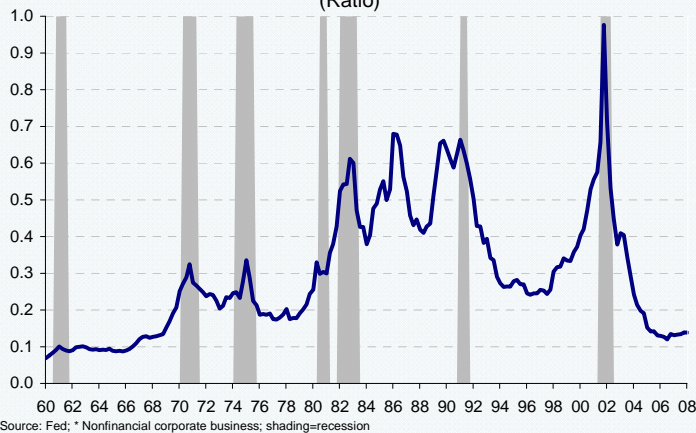
Business Debt
(YoY % change)



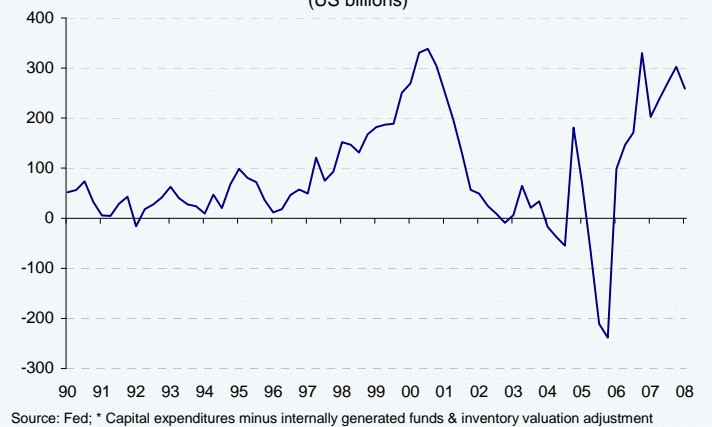
Interest payments remained low relative to profits

... but the need for external financing has remained elevated, posing potential risks

Net Interest Payments to Economic Profits
(Ratio)



Financing Gap
(US billions)

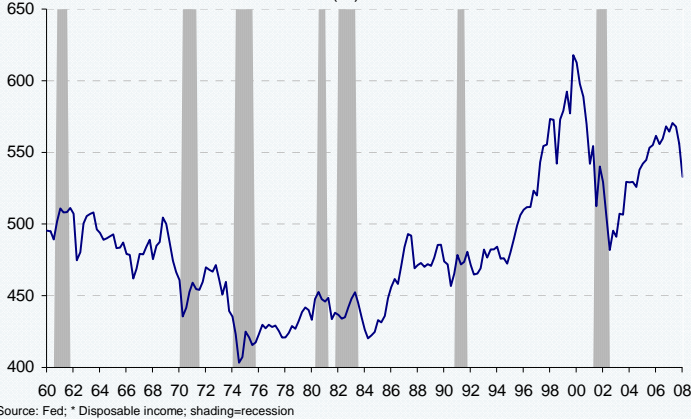


Household Sector

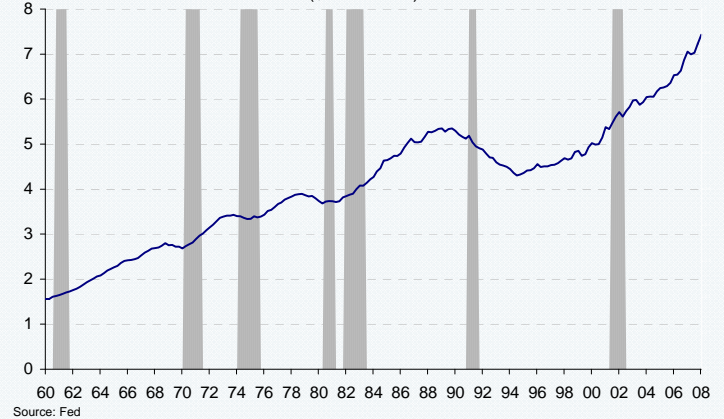
Household net worth fell 3%, something not seen since 2002

Households continued to raise their tenure of liquid assets

Household Net Worth as a Share of Income
(%)



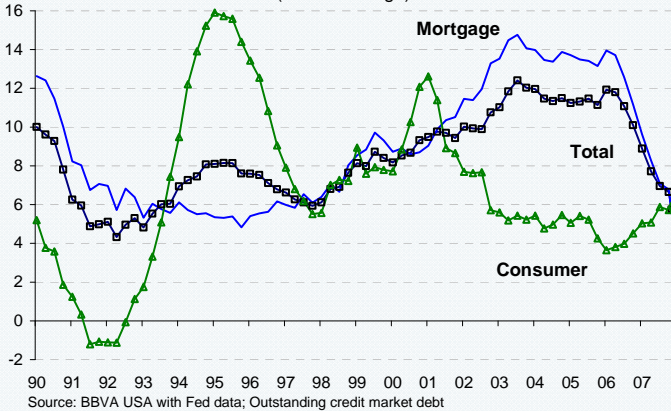
Real Household Liquid Assets
(\$US trillions)



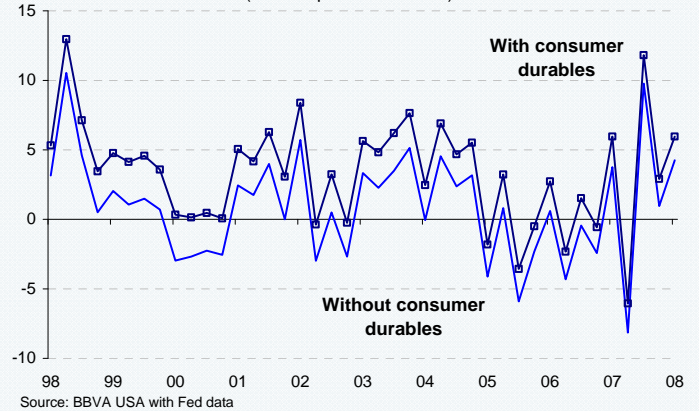
Mortgages continue to decelerate, together now with consumer credit

Low consumer confidence and credit restrictions have raised the savings rate

Household Debt
(YoY % change)



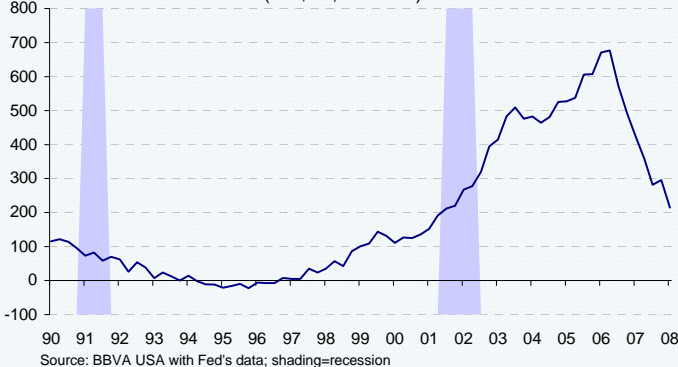
Personal Savings Rate
(% of disposable income)



Channels to withdraw mortgage equity are narrowing

With no support from financial net worth, households are likely to reduce spending

Mortgage Equity Withdrawal
(US\$bn, 4Q sum)



Financial net worth & owners' equity in household real estate
(YoY % change)

