



Flow of Funds

March 11th 2008

4Q07 Flow of Funds

- Businesses debt growth remains solid
- Mortgage equity withdrawal has declined \$400bn in two years, and reached its lowest level since 1Q02
- Households' data confirm our scenario of sluggish PCE growth

Business debt expanded solidly

Corporate profits declined 0.5% for the third consecutive quarter, as firms confront ongoing cost pressures and a slowing domestic demand. Consequently, profits' share of GDP softened to 7.3%, the lowest since 4Q04. Business debt continued to expand rapidly with a gain of 11.7% year-over-year, the strongest since 3Q99. Over the last two years, businesses liabilities have shifted toward bonds and bank loans, away from miscellaneous (funding subsidiaries, finance company subsidiaries, etc.) and commercial paper. As a result, bank loans increased 18% yoy in 4Q07, the fastest pace in almost 30 years.

The financing gap reached \$303.3 billion, its highest level since 4Q00. This may be positive for C&I lending and nonresidential investment; however, it is also risky given that credit standards are tightening and corporate profits are decelerating. Weak cash flows and credit scarcity could dampen capital spending plans. Nonetheless, the ratio of net interest payments to economic profits was low and similar to its two-year average.

Households' real estate wealth extraction declined significantly

Households' real estate assets decreased to \$22.5 trillion in 4Q07 from \$22.6 trillion in 3Q07, the first quarterly drop since 1Q93, reflecting the impact of falling home prices. In fact, homeowners' equity in real state assets declined 3.9% yoy, the lowest on record. Moreover, mortgage equity withdrawal decreased 43.5% in 4Q07, following five consecutive quarters of negative readings. Households' financial assets declined to \$45.3 trillion from \$45.6 trillion in 3Q07. This was the first time since 2Q05 that financial assets decrease.

Mortgages liabilities rose to \$10.5 billion in 4Q07 from \$10.4 trillion in 3Q07, the slowest quarterly growth rate since 4Q97. The pace of consumer credit flattened in 4Q07, reflecting deeper credit constraints. As a result, credit market debt slowed to 6.8% yoy in 4Q07 down from 7.4% in 3Q07, its lowest rate since 2Q98. Tighter lending standards will dampen the pace of credit in the next quarters. Households' net worth decreased by a quarterly rate of \$533 billion to \$57.7 trillion in 4Q07. This was the first quarterly decline since 3Q02.

These readings confirm that the housing adjustment and the financial turmoil are taking their toll on household wealth, in line with our scenario of slower consumer spending.

Marcial Nava

marcial.nava@bbvausa.com

U.S. Nonfarm Nonfinancial Business Balance Sheet

US\$ trillions

	4Q07	3Q07	4Q06	YoY % change
Total assets	27.4	26.8	25.4	8.0
Tangible assets	14.5	14.1	13.1	11.3
Real Estate	8.9	8.5	7.7	15.4
Equipment and Software	3.9	3.8	3.7	4.9
Inventories	1.8	1.7	1.7	6.4
Financial assets	12.9	12.7	12.3	4.5
Total Liabilities	11.3	11.3	11.1	1.9
Credit market instruments	6.3	6.1	5.7	11.1
Trade payables	0.1	0.1	0.1	1.4
Taxes payable	3.1	3.2	3.6	-13.9
Other	16.1	15.6	14.3	12.7
Net worth (market value)	16.1	15.6	14.3	12.7

Source: Fed; Nonfarm Nonfinancial Corporate Business

U.S. Household Balance Sheet

US\$ trillions

	4Q07	3Q07	4Q06	YoY % change
Total assets	72.1	72.4	69.3	4.1
Tangible assets	26.8	26.8	26.0	2.8
Real Estate	22.5	22.6	21.9	2.5
Other tangible assets	4.3	4.2	4.1	4.2
Financial assets	45.3	45.6	43.2	4.9
Checkable deposits and money funds	1.4	1.3	1.2	15.0
Time and savings deposits	5.9	5.8	5.4	8.3
Credit market instruments	4.0	3.9	3.7	8.5
Equities (direct)	5.4	5.9	6.2	-11.8
Mutual funds	5.1	5.2	4.5	12.0
Life insurance and pension reserves	14.0	14.2	13.5	3.7
Equity in unincorporated business	7.9	7.8	7.3	7.7
Other financial assets	1.6	1.5	1.3	21.4
Total Liabilities	14.4	14.1	13.5	6.8
Mortgages	10.5	10.4	9.9	6.6
Consumer credit	2.6	2.5	2.4	5.5
Other	1.3	1.3	1.2	11.2
Net worth	57.7	58.3	55.8	3.4
Financial net worth	31.0	31.4	29.8	4.0

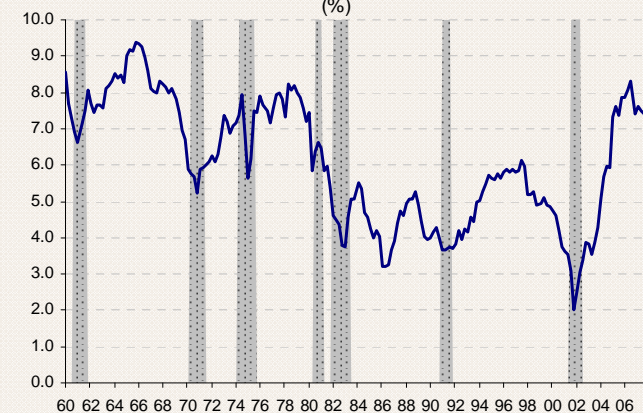
(financial assets minus total liabilities)

Source: Fed; includes nonprofit organizations

Business Sector

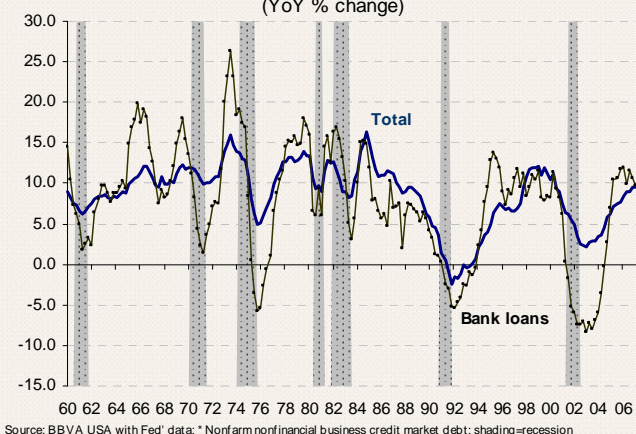
Profits as a share of GDP remained high; however, they are decelerating

Economic Profits as a Share of GDP
(%)



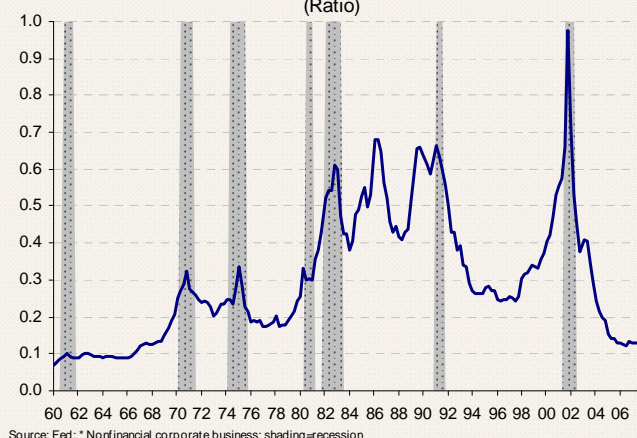
The financial turmoil has had a limited impact on business debt

Business Debt
(YoY % change)



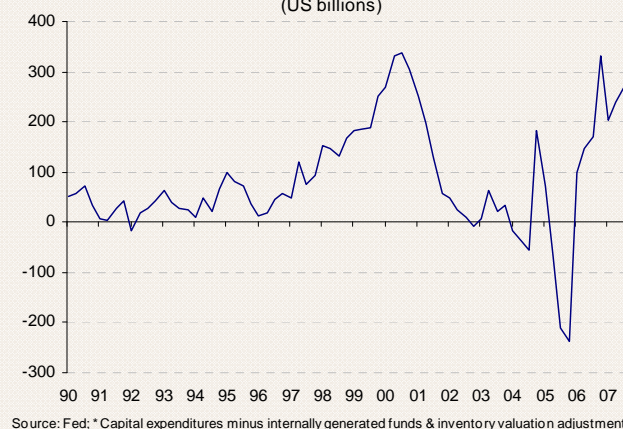
The ratio of net interest payments to economic profits remains similar to its two-year average

Net Interest Payments to Economic Profits
(Ratio)



As profits decelerate, businesses maintain a high dependency on external sources to fund investment

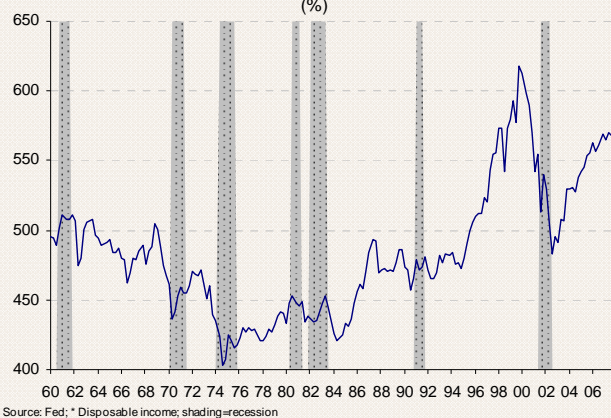
Financing Gap
(US billions)



Household Sector

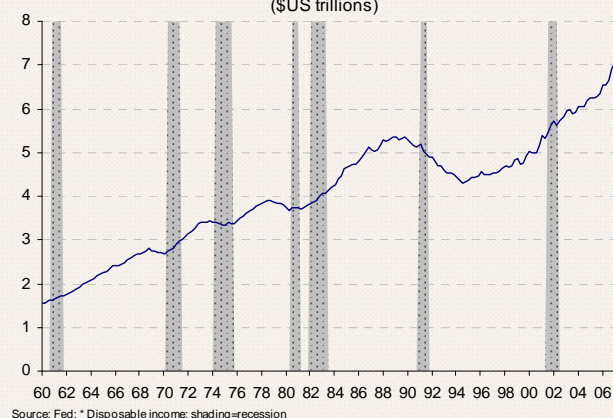
Household net worth decreased for the first time since 3Q02

Household Net Worth as a Share of Income
(%)

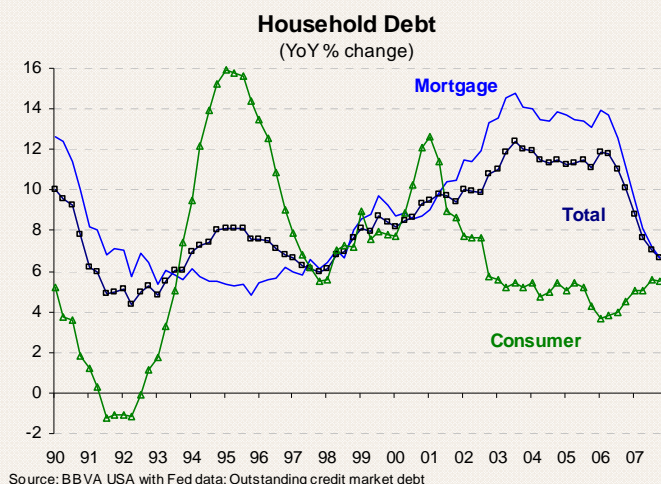


Households moderated their tenure of liquid assets

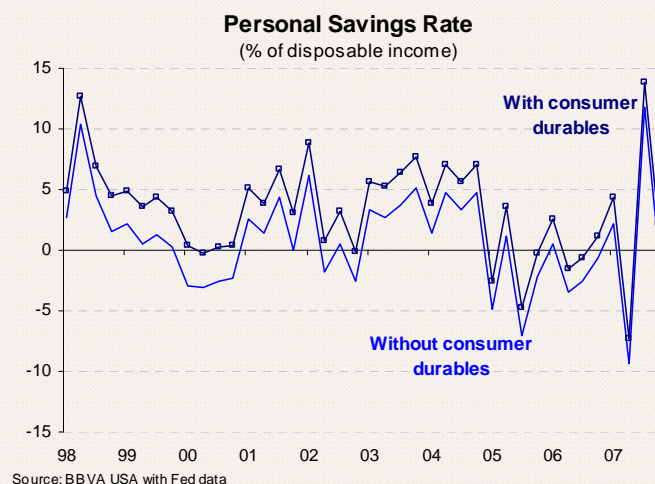
Real Household Liquid Assets
(\$US trillions)



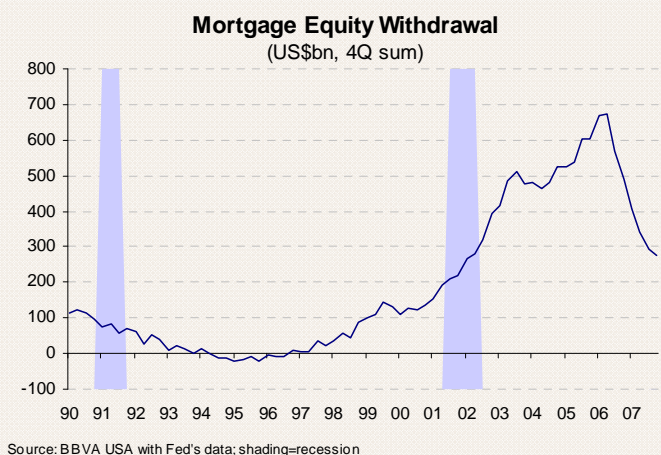
In 4Q07, mortgage debt continued to decelerate while consumer loans softened



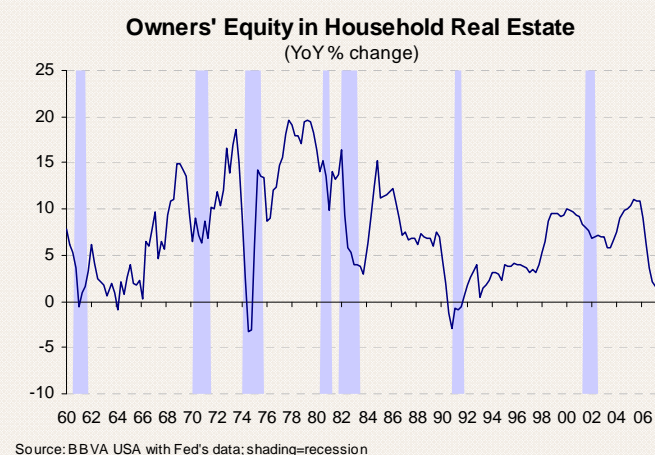
The personal saving returned to previous levels



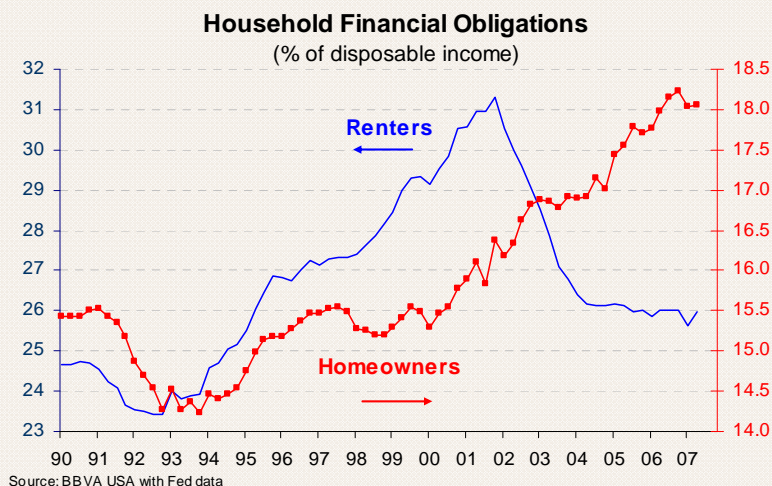
MEW adjusts downwards as the housing adjustment continues



Owners' equity in real estate declined 3.9% yoy, the lowest rate on record



Financial obligations for renters remained stable while those for homeowners flattened in 4Q07



In 4Q07, the pace of net financial assets acquisitions was virtually unaltered

