



Flow of Funds

March 13th 2008

4Q08 Flow of Funds

- Business profits declined sharply, affected by the ongoing economic and financial turmoil
- We expect further declines in non-residential investment throughout most of 2009
- Financial instability has prompted households to rebalance their financial portfolio towards less risky instruments
- A sharp deterioration in households wealth poses risks on the outlook for consumer spending

Non-residential investment under significant pressures

The ongoing economic recession, financial strains and lower interest rates have reduced the pace of business indebtedness. In 4Q08, total corporate liabilities remained practically unchanged from the previous quarter, while on a year-over-year (yoy) basis they increased at the slowest rate (3.1%) since 1Q04. This deceleration is widespread, yet the impact of the financial turmoil seems to be larger on foreign inflows, trade payables, commercial paper and other loans. A milder effect is occurring on bank loans and corporate bonds, which on 4Q08 accounted for 72% of the increase in total liabilities. The financial and economic downturn is also having a negative impact on business profitability, leaving firms with less internally-generated funds to finance investment needs. Despite monetary policy easing, risk perception remains elevated and firms continue facing high borrowing costs. Plummeting domestic and foreign sales have undermined cash flows. In fact, in 4Q08, corporate business profits declined 24% yoy. This was the eighth consecutive decrease and the sharpest since 1Q02. Meanwhile, the ratio of corporate profits to GDP fell to 5.8%, the lowest since 2Q08. These developments support our prospects of further declines in non-residential investment during 2009.

Downside risks to consumer spending remain

Declines in real estate and financial asset prices reduced households' net worth by 18% yoy, the largest decline on record, driving the ratio of net worth to disposable income to its lowest level since 1Q95. Mortgage equity withdrawal declined for the sixth consecutive quarter, accumulating a loss of \$0.6trn, equal to 4% of GDP. Financial assets went down by the lowest yoy rate since 1952. Financial instability has prompted households to rebalance their financial portfolio towards less risky instruments such as checkable deposits, money funds & time and saving deposits, which reached 18.3% of total financial assets, the highest since 2Q91. This reflects higher risk aversion which increases demand for less volatile assets and increases the personal savings rate, thereby dampening consumer spending. In 4Q08, the savings rate rose to 3.2%, the highest since 3Q01. We expect these trends to continue.

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

	4Q08	3Q08	4Q07	YoY % change
Total assets	28.3	28.7	29.1	-2.9
Tangible assets	14.2	14.8	15.3	-7.2
Real Estate	8.4	8.8	9.6	-12.8
Equipment and Software	4.1	4.0	3.9	4.8
Inventories	1.7	1.9	1.8	-3.0
Financial assets	14.0	14.0	13.8	1.9
Total Liabilities	12.9	12.8	12.6	2.7
Credit market instruments	7.1	7.1	6.8	4.7
Trade payables	2.1	2.1	2.0	5.3
Taxes payable	0.1	0.1	0.1	0.7
Other	3.6	3.5	3.7	-2.5
Net worth (market value)	15.4	16.0	16.6	-7.1

Source: Fed; Nonfarm Nonfinancial Corporate Business

U.S. Household Balance Sheet
US\$ trillions

	4Q08	3Q08	4Q07	YoY % change
Total assets	65.7	71.1	77.0	-14.7
Tangible assets	24.9	25.8	27.3	-8.7
Real Estate	20.5	21.4	23.0	-10.8
Other tangible assets	4.4	4.4	4.3	2.8
Financial assets	40.8	45.4	49.8	-18.0
Checkable deposits and money funds	1.7	1.5	1.4	19.8
Time and savings deposits	5.9	6.0	5.8	1.5
Credit market instruments	3.9	3.9	3.9	-1.7
Equities (direct)	5.5	7.2	9.2	-39.9
Mutual funds	3.3	4.1	4.9	-33.2
Life insurance and pension reserves	11.4	12.9	14.4	-20.8
Equity in unincorporated business	7.5	8.0	8.4	-10.7
Other financial assets	1.5	1.8	1.6	-2.8
Total Liabilities	14.2	14.6	14.3	-0.6
Mortgages	10.5	10.5	10.5	-0.4
Consumer credit	2.6	2.6	2.6	1.7
Other	1.2	1.4	1.3	-7.0
Net worth	51.5	56.6	62.7	-17.9
Financial net worth (financial assets minus total liabilities)	26.6	30.8	35.4	-25.0

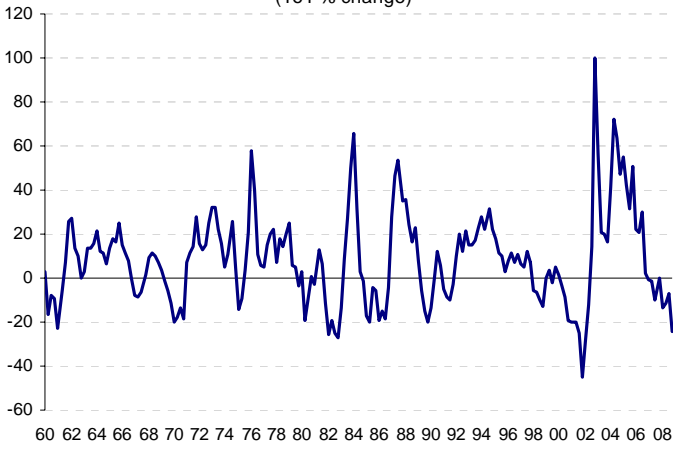
Source: Fed; includes nonprofit organizations

Business Sector

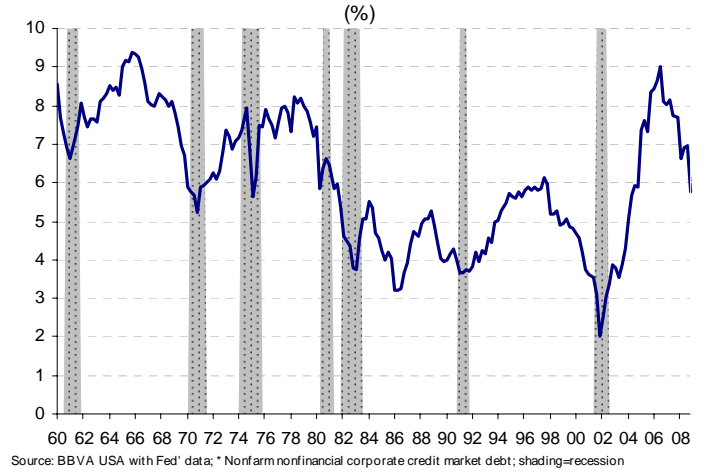
The economic recession is lowering business profits...

...which we expect to decline further in the next quarters

Business Profits
(YoY % change)



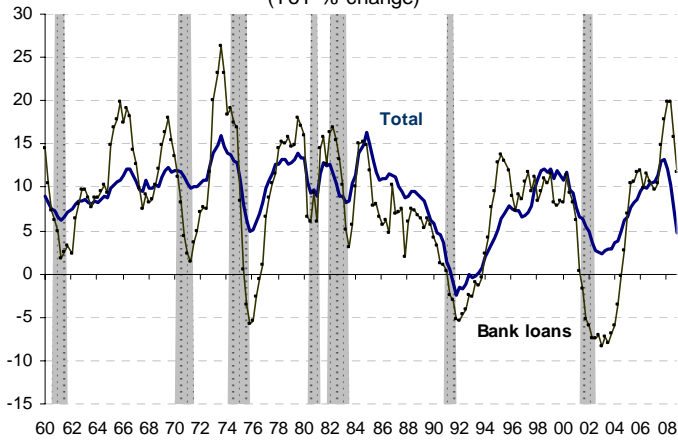
Economic Profits as a Share of GDP
(%)



Source: BBVA USA with Fed' data; * Nonfarm nonfinancial corporate credit market debt; shading=recession

Businesses financial needs have adjusted...

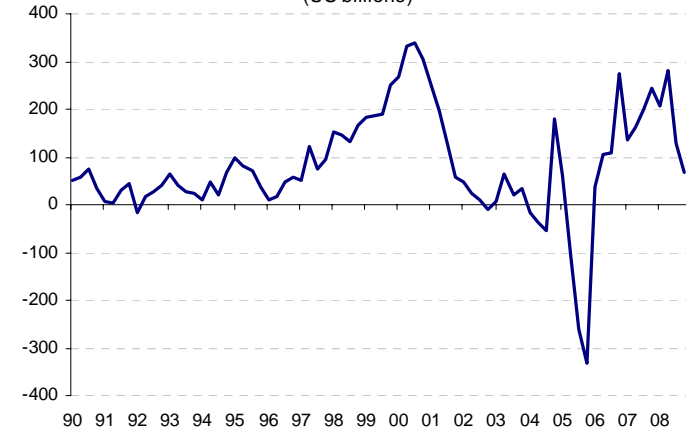
Business Debt
(YoY % change)



Source: BBVA USA with Fed' data; * Nonfarm nonfinancial business credit market debt; shading=recession

... in response to lower sales and credit constraints.

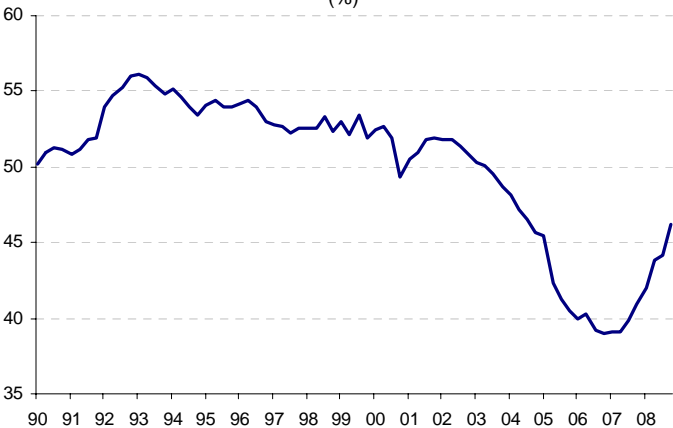
Financing Gap
(US billions)



Source: Fed; * Capital expenditures minus internally generated funds & inventory valuation adjustment

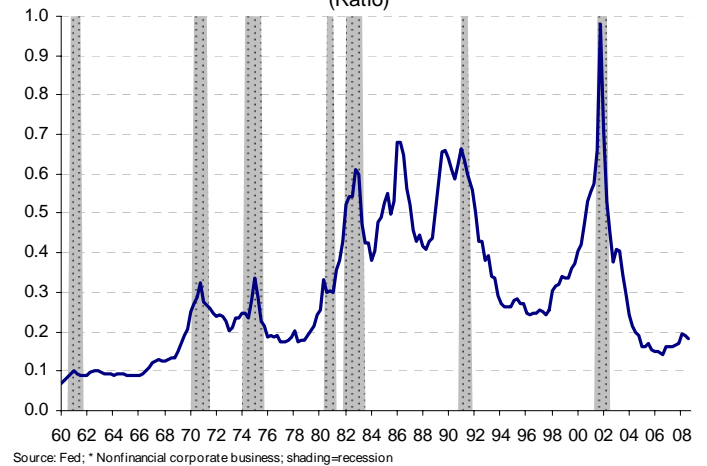
Despite expansionary monetary policy, the debt burden has increased...

Debt to Net Worth Ratio
(%)



...rising the risk of insolvencies.

Net Interest Payments to Economic Profits
(Ratio)



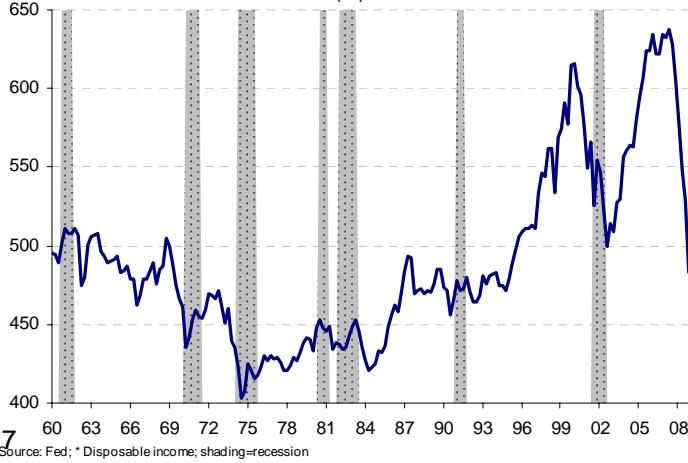
Source: Fed; * Nonfinancial corporate business; shading=recession

Household Sector

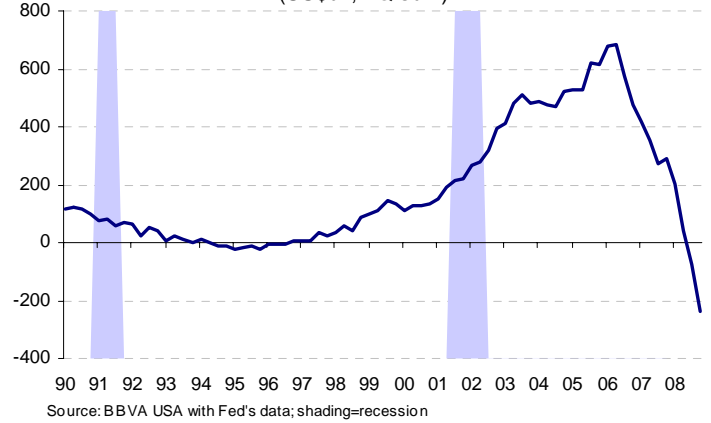
Declining home prices have eroded households' wealth...

...and equity extraction.

Household Net Worth as a Share of Income (%)

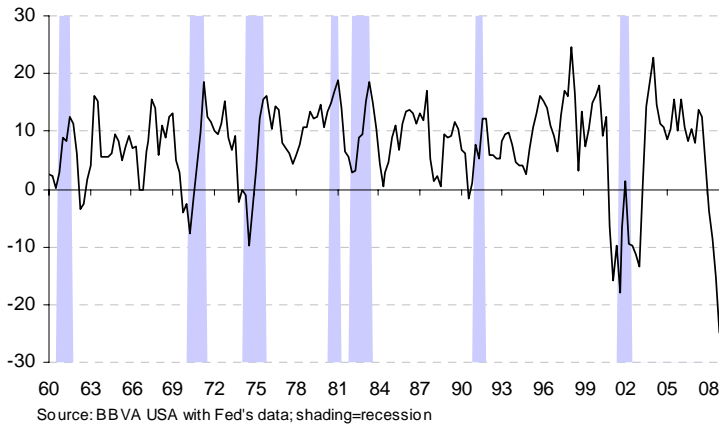


Mortgage Equity Withdrawal (US\$bn, 4Q sum)



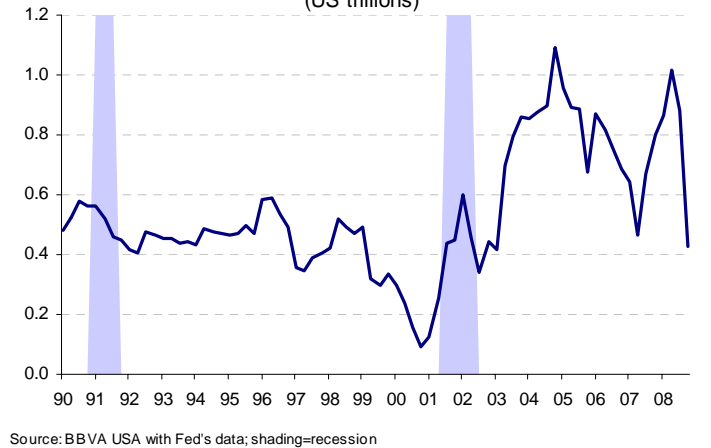
Financial net worth has fallen dramatically

Financial net worth (YoY % change)



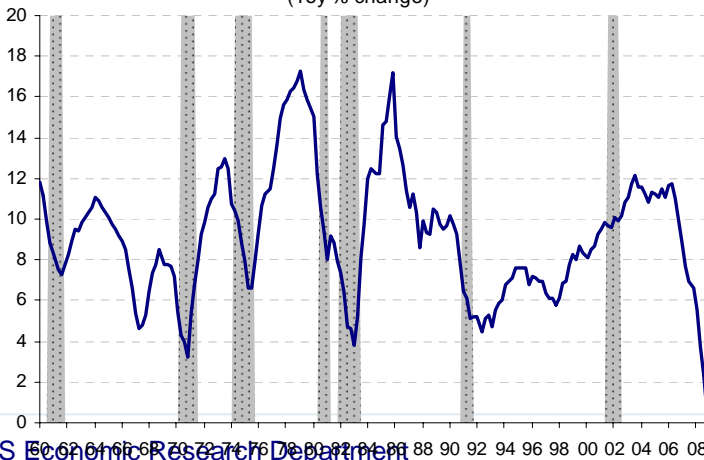
Households are scaling back their purchases of financial assets.

Net Acquisition of Financial Assets (US trillions)



Household debt is also adjusting briskly.

Household Debt (YoY % change)



With a higher savings rate, consumption will remain under pressure

Personal Savings Rate (% of disposable income)

