# Flow of Funds

June 22nd, 2009

## 1Q09 Flow of Funds

- **Business profits increased 6.1%, but remain low due to feeble demand at home and abroad**
- **Non-residential investment will decline further in 2Q09, albeit at a slower pace**
- **Households increased savings and risk aversion in response to financial instability**
- **Consumer spending is expected to remain weak due to the continuing decline in household wealth**

**Kristin Lomicka**
Kristin.Lomicka@bbvacompass.com

### Downward pressure to non-residential investment remains

The pace of business indebtedness slowed further in 1Q09 as financial strains resulting from the ongoing recession inhibit investment. In 1Q09, total corporate liabilities remained relatively unchanged from the previous quarter, while they increased at the slowest rate (2.3%) since 1Q04 on a year-over-year basis. Even though corporate bond issuance rose 3.8%, the largest monthly increase since 2Q01, its positive effect was more than compensated for by declines in trade payables, bank loans, commercial paper and other loans. On a positive note, business profitability improved in the first quarter in comparison to the fourth quarter of last year. Profits increased 6.1%, but remained 24.7% below those of last year due to plummeting sales at home and abroad. This is the ninth consecutive year-over-year decrease in profits. Additionally, corporate profits as a percentage of GDP rose to 5.0% from 4.7% in 4Q08. Although businesses benefited from an increase in profits this quarter, they still remain low and access to credit is limited, which supports our forecast of further declines in non-residential investment, but at a slower pace, in the remainder of 2009.

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

| | 1Q09 | 4Q08 | 1Q08 | YoY % change |
|---|---|---|---|---|
| **Total assets** | 27.3 | 27.8 | 28.5 | -4.3 |
| Tangible assets | 13.2 | 13.7 | 14.7 | -10.3 |
| Real Estate | 7.4 | 7.9 | 8.9 | -16.8 |
| Equipment and Software | 4.1 | 4.1 | 3.9 | 3.8 |
| Inventories | 1.7 | 1.7 | 1.9 | -9.4 |
| Financial assets | 14.1 | 14.0 | 13.8 | 2.0 |
| **Total Liabilities** | 13.3 | 13.3 | 12.9 | 2.8 |
| Credit market instruments | 7.2 | 7.2 | 6.9 | 4.3 |
| Trade payables | 1.7 | 1.8 | 1.9 | -11.6 |
| Taxes payable | 0.1 | 0.1 | 0.1 | 0.6 |
| Other | 4.3 | 4.2 | 4.0 | 7.2 |
| **Net worth** (market value) | 14.0 | 14.5 | 15.6 | -10.3 |

Source: Fed; Nonfarm Nonfinancial Corporate Business

### Household risk aversion rises due to financial instability

Declines in real estate equity and financial asset prices reduced households' net worth for the seventh consecutive quarter. Nevertheless, the pace of decline eased to -16.2% yoy from -17.4% yoy in 4Q08. Owner's equity in household real estate dropped year-over-year for the eleventh consecutive quarter and financial net worth fell for the fifth quarter in a row. As a result, households are increasing their risk aversion and investing in less risky assets. The percentage of households' liquid assets to total assets has risen to 14.5%, the highest since 4Q92, while total credit market debt fell by 0.6% yoy, the first decline in the history of the data (beginning in 1952). Furthermore, the personal savings rate has risen to 4.4% of disposable income, the highest point since 2Q98. The trend of increased savings and risk adversion is expected to endure as consumer suffer from an uncertain job market. As a result, consumption expenditures are anticipated to remain weak for the near future.

**U.S. Household Balance Sheet**
US$ trillions

| | 1Q09 | 4Q08 | 1Q08 | YoY % change |
|---|---|---|---|---|
| **Total assets** | 64.5 | 66.0 | 74.6 | -13.5 |
| Tangible assets | 24.2 | 24.8 | 26.4 | -8.3 |
| Real Estate | 19.8 | 20.4 | 22.1 | -10.3 |
| Other tangible assets | 4.4 | 4.4 | 4.3 | 1.7 |
| Financial assets | 40.3 | 41.2 | 48.2 | -16.3 |
| Checkable deposits and money funds | 1.8 | 1.8 | 1.6 | 14.7 |
| Time and savings deposits | 6.0 | 6.0 | 5.9 | 1.6 |
| Credit market instruments | 4.3 | 3.8 | 3.8 | 12.1 |
| Equities (direct) | 5.2 | 5.5 | 8.5 | -39.1 |
| Mutual funds | 3.3 | 3.4 | 4.6 | -28.4 |
| Life insurance and pension reserves | 11.1 | 11.6 | 13.8 | -19.5 |
| Equity in unincorporated business | 7.2 | 7.5 | 8.2 | -12.8 |
| Other financial assets | 1.4 | 1.5 | 1.7 | -15.7 |
| **Total Liabilities** | 14.1 | 14.3 | 14.4 | -2.1 |
| Mortgages | 10.5 | 10.5 | 10.6 | -1.0 |
| Consumer credit | 2.5 | 2.6 | 2.5 | -0.4 |
| Other | 1.2 | 1.2 | 1.3 | -13.7 |
| **Net worth** | 50.4 | 51.7 | 60.2 | -16.2 |
| **Financial net worth** (financial assets minus total liabilities) | 26.2 | 26.9 | 33.7 | -22.4 |

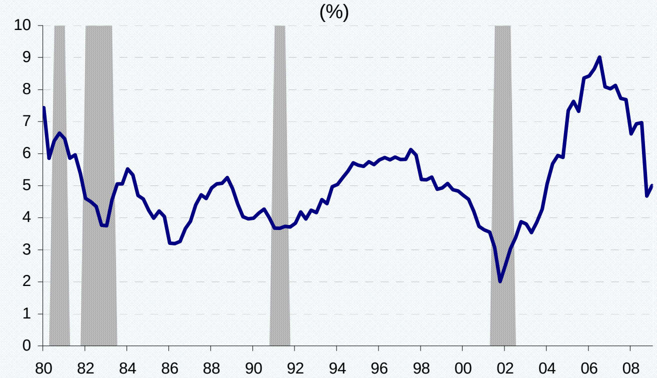
Source: Fed; includes nonprofit organizations

# Business Sector

## Business profits rose slightly...

**Economic Profits as a Share of GDP**

(%)

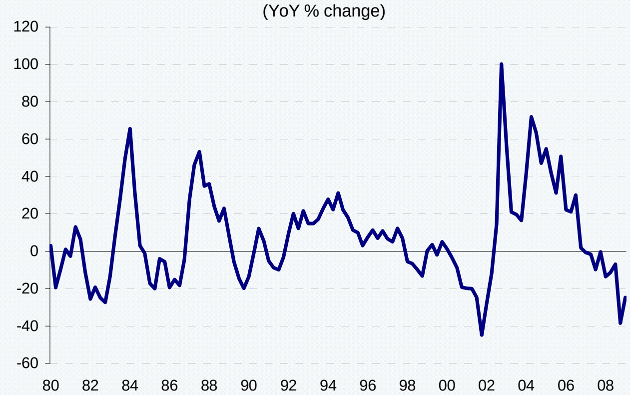



Source: BBVA USA with Fed' data; * Nonfarm nonfinancial corporate credit market debt; shading=recession

## ...but remain low due to weak demand in response to the global recession

**Business Profits**

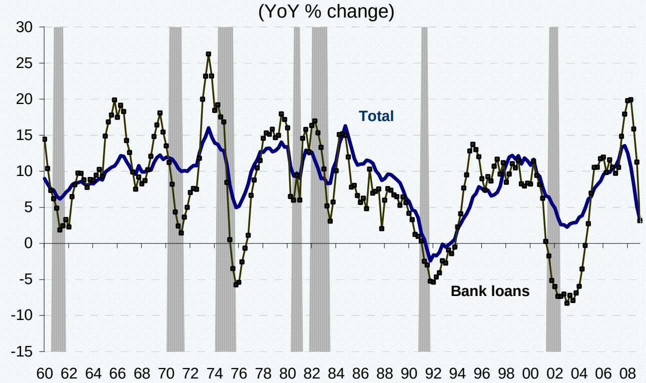
(YoY % change)




## Businesses are lowering capital expenditures...

**Business Debt**

(YoY % change)

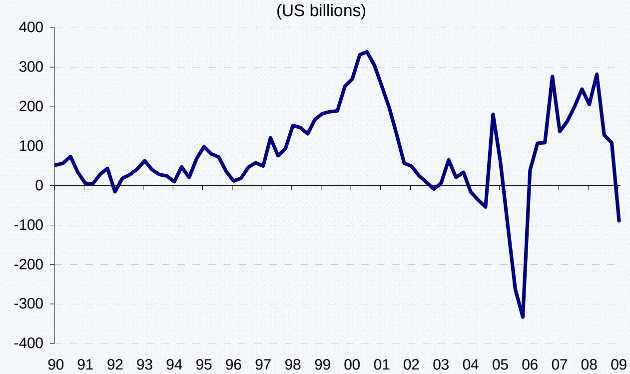



Source: BBVA USA with Fed' data; * Nonfarm nonfinancial business credit market debt; shading=recession

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

**Financing Gap**

(US billions)

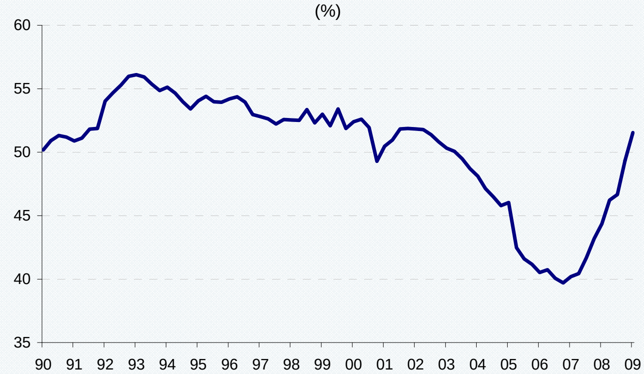



Source: Fed; * Capital expenditures minus internally generated funds & inventory valuation adjustment

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

**Debt to Net Worth Ratio**

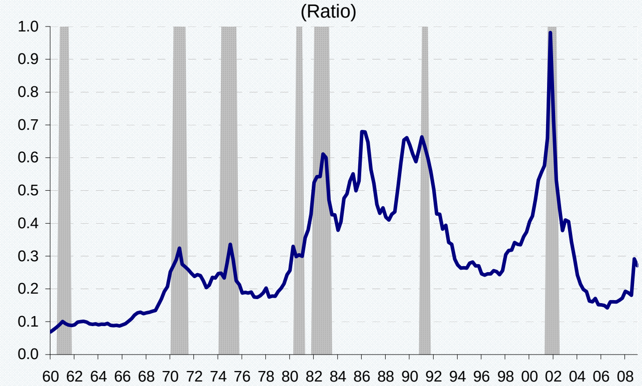
(%)




## ... raising the risk of insolvencies.

**Net Interest Payments to Economic Profits**

(Ratio)

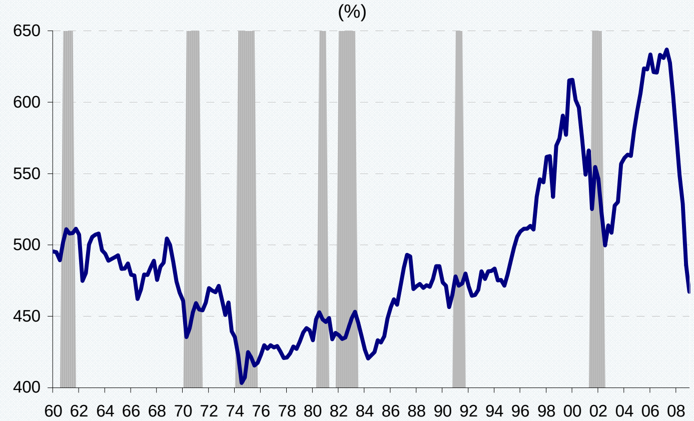



Source: Fed; * Nonfinancial corporate business; shading=recession

# Household Sector

## Declining home prices have eroded households' wealth...

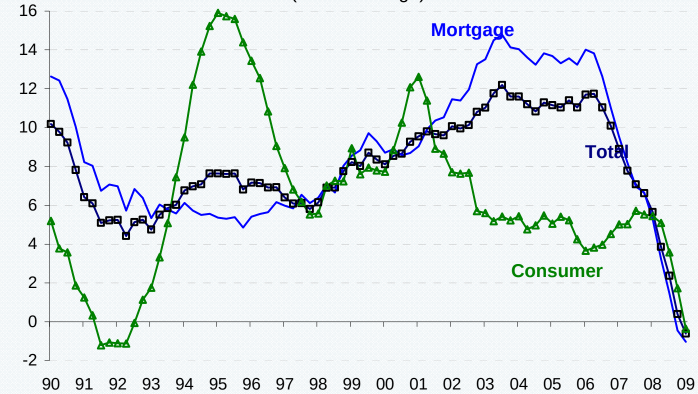
**Household Net Worth as a Share of Income**
(%)




Source: Fed; * Disposable income; shading=recession

## ...causing them to minimize their debt

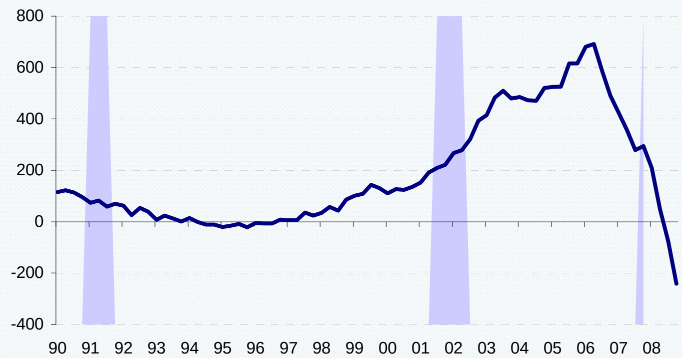
**Household Debt**
(YoY % change)




Source: BBVA USA with Fed data; Outstanding credit market debt

## Households are borrowing less on their homes...

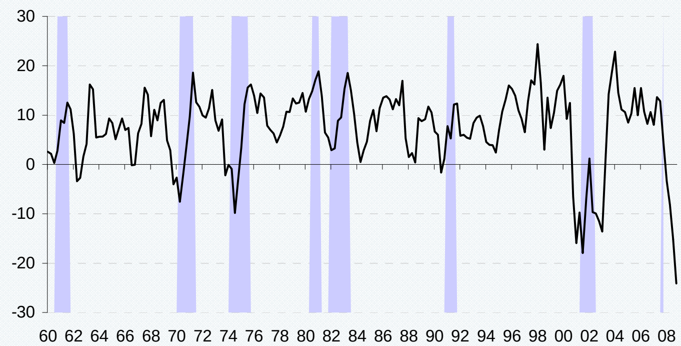
**Mortgage Equity Withdrawal**
(US$bn, 4Q sum)




Source: BBVA USA with Fed's data; shading=recession

## ... and purchasing fewer financial assets

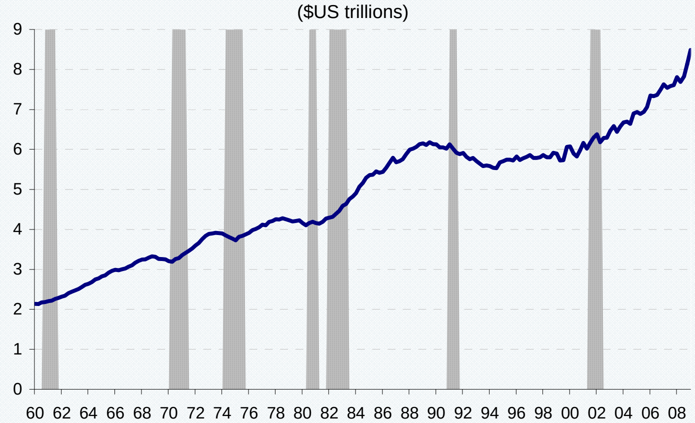
**Financial net worth**
(YoY % change)




Source: BBVA USA with Fed's data; shading=recession

## Risk aversion is pushing households to hold more liquid assets...

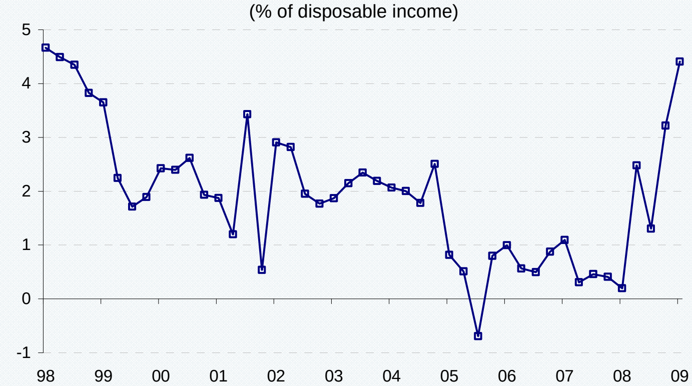
**Real Household Liquid Assets**
($US trillions)




Source: Fed

## ... and to save more of their income, which will slow the growth of consumption

**Personal Savings Rate**
(% of disposable income)




Source: BBVA USA with Fed data