



Flow of Funds

June 22nd, 2009

1Q09 Flow of Funds

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

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.

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 aversion 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.

Kristin Lomicka
Kristin.Lomicka@bbvacompass.com

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

U.S. Household Balance Sheet
US\$ trillions

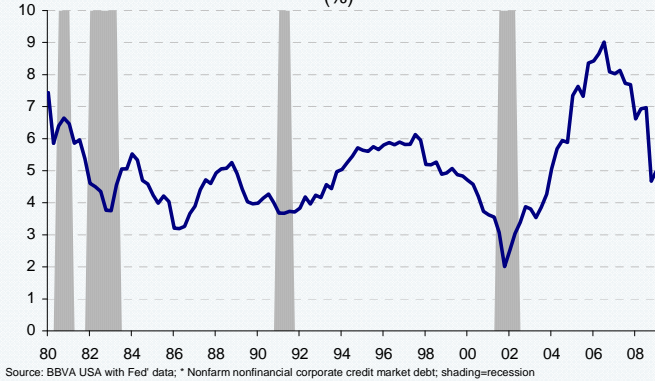
	1Q09	4Q08	1Q08	YoY % change
Total assets	64.5	66.0	74.6	-13.5
Tangible assets	24.2	24.8	26.4	-8.3
Real Estate	19.8	20.4	22.1	-10.3
Other tangible assets	4.4	4.4	4.3	1.7
Financial assets	40.3	41.2	48.2	-16.3
Checkable deposits and money funds	1.8	1.8	1.6	14.7
Time and savings deposits	6.0	6.0	5.9	1.6
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	26.2	26.9	33.7	-22.4
(financial assets minus total liabilities)				

Source: Fed; includes nonprofit organizations

Business Sector

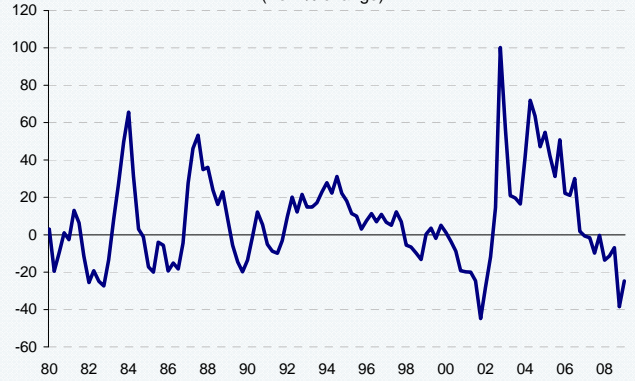
Business profits rose slightly...

Economic Profits as a Share of GDP (%)



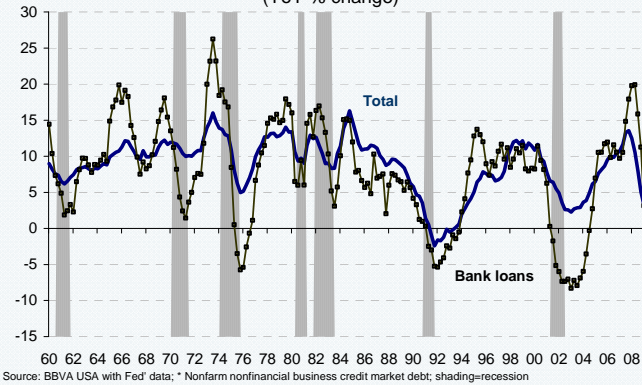
...but remain low due to weak demand in response to the global recession

Business Profits (YoY % change)



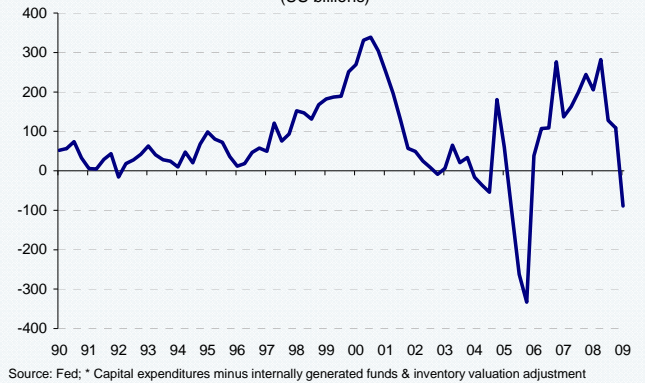
Businesses are lowering capital expenditures...

Business Debt (YoY % change)



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

Financing Gap (US billions)



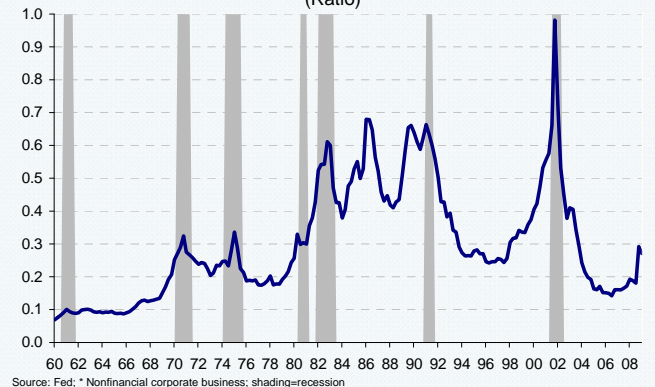
Despite expansionary monetary policy, the debt burden has increased...

Debt to Net Worth Ratio (%)



... raising the risk of insolvencies.

Net Interest Payments to Economic Profits (Ratio)

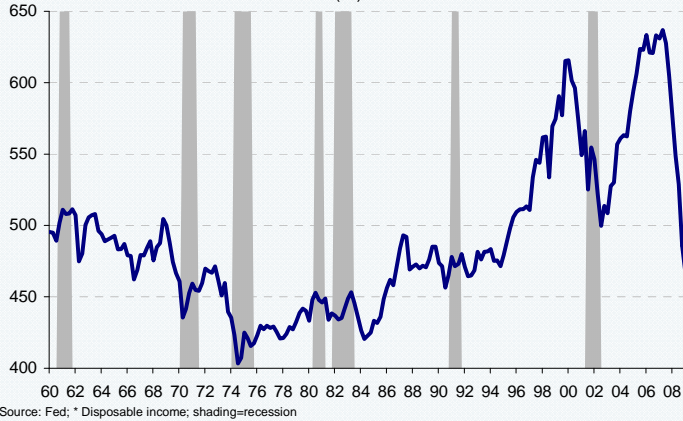


Household Sector

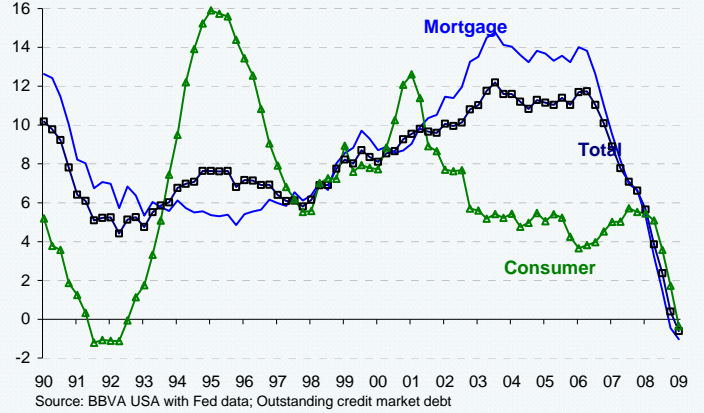
Declining home prices have eroded households' wealth...

...causing them to minimize their debt

Household Net Worth as a Share of Income (%)



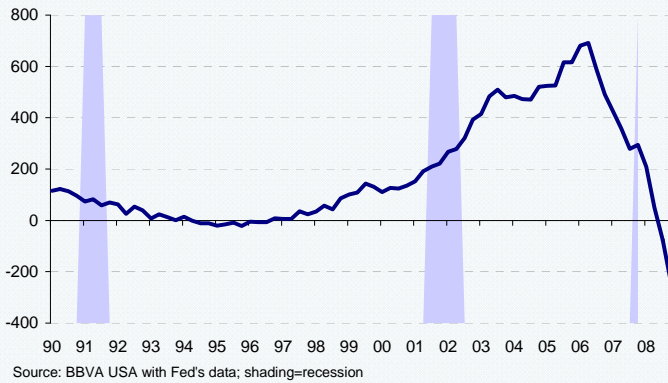
Household Debt (YoY % change)



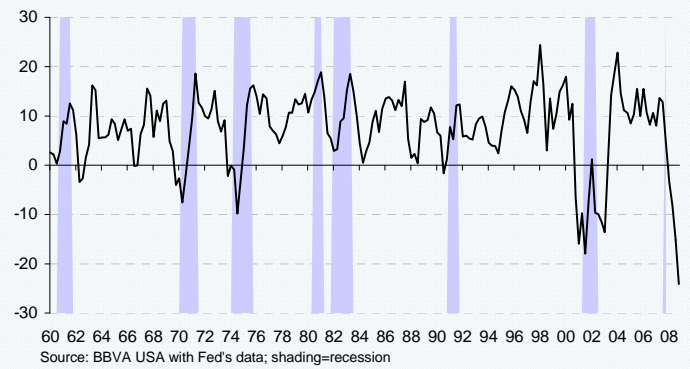
Households are borrowing less on their homes...

... and purchasing fewer financial assets

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



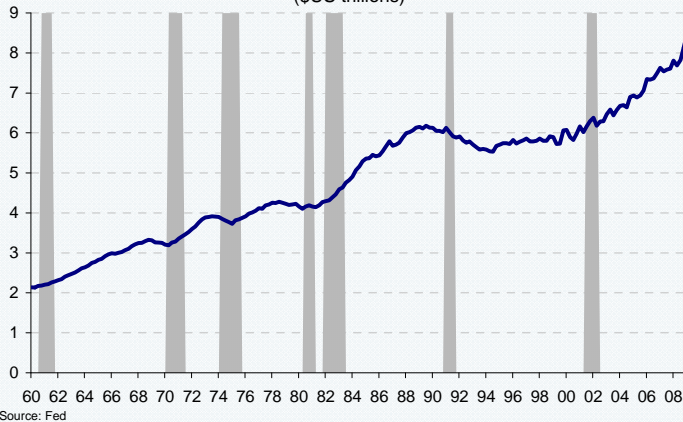
Financial net worth (YoY % change)



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

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

Real Household Liquid Assets (\$US trillions)



Personal Savings Rate (% of disposable income)

