



# Flow of Funds

September 23, 2009

## 2Q09 Flow of Funds

- Corporate profits rose 11.5% but remain low due to feeble demand
- Non-residential investment will decline further in 3Q09
- Household net worth increased due to rising owners' equity in household real estate and financial net worth
- Consumer spending will increase in 3Q09, but recovery will be weak

## Profits rise, but business investment will remain subdued

Non-farm, non-financial corporate profits rose 11.5% in 2Q09 for the second quarter in a row, reflecting the success of companies' cost cutting measures in response to the decline in demand. While profits remain low at 15.8% below those of 2Q08, the pace of decline has eased from the high of -43.4% yoy in 4Q08. Although profits rose on a quarterly basis, their low levels and the tight credit markets have slowed the pace of business indebtedness in 2Q09. Non-farm, non-financial business liabilities rose 0.5% qoq, but the year-over-year change eased to 2.5%, the lowest since 2Q04. More than half the net increase in liabilities was due to financing sourced from financial markets. While net equity issues rose for the first time since 2Q02, the use of credit market instruments was the lowest since 2Q04, reflecting a shift in financing preferences due to the high cost of borrowing in the credit markets. Within the credit markets, the issuance of corporate bonds and municipal securities rose, while that of commercial paper and bank loans declined. Furthermore, mortgage borrowing dropped (0.7%qoq) for the second consecutive quarter, reflecting the decline in commercial real estate investment. Although corporate profits are beginning to recover, businesses are still facing restricted access to credit, which will cause non-residential investment to decline further in 3Q09, albeit at a slower pace.

## Household net worth rises, but risk aversion remains high

After declining for six straight quarters, households' net worth rose 3.9% in 2Q09. Rising home prices prompted owners' equity in household real estate to increase 4.7%, while rallying equity prices supported a 4.4% rise in financial assets that resulted in a 6.8% increase in financial net worth. While the positive results support our forecast of an increase in consumption in 3Q09, households' net worth remains 12.3% below that of 2Q08, which supports our expectation that consumer spending will recover slowly. Furthermore, household risk aversion remains high. Even though the ratio of liquid assets to total assets dropped to 13.6% from 14.1%, it remains well above the ten year average of 11.1%. Moreover, credit market debt declined for the third consecutive quarter by 0.3% and mortgage equity withdrawal dropped for the fifth quarter in a row. These trends indicate that consumers are deleveraging and their financing options are declining, which further supports the scenario of a slow recovery in the consumption component of GDP.

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### U.S. Nonfarm Nonfinancial Business Balance Sheet

US\$ trillions

	2Q09	1Q09	2Q08	YoY % change
<b>Total assets</b>	26.6	27.1	28.4	-6.4
Tangible assets	12.5	13.2	14.5	-13.7
Real Estate	6.6	7.2	8.5	-22.4
Equipment and Software	4.3	4.3	4.2	3.5
Inventories	1.7	1.7	1.9	-12.5
Financial assets	14.0	13.9	13.9	1.1
<b>Total Liabilities</b>	13.4	13.3	13.0	2.5
Credit market instruments	7.3	7.2	7.1	2.9
Trade payables	1.6	1.7	1.9	-12.2
Taxes payable	0.1	0.1	0.1	0.6
Other	4.3	4.3	4.0	8.8
<b>Net worth</b> (market value)	13.2	13.8	15.4	-14.0

Source: Fed; Nonfarm Nonfinancial Corporate Business

### U.S. Household Balance Sheet

US\$ trillions

	2Q09	1Q09	2Q08	YoY % change
<b>Total assets</b>	67.2	65.2	74.9	-10.3
Tangible assets	24.8	24.7	26.5	-6.4
Real Estate	20.0	19.9	21.8	-8.1
Other tangible assets	4.8	4.8	4.8	1.4
Financial assets	42.4	40.6	48.4	-12.5
Checkable deposits and money funds	1.8	1.8	1.5	20.3
Time and savings deposits	5.9	6.0	5.9	0.9
Credit market instruments	4.3	4.5	4.1	4.5
Equities (direct)	6.3	5.2	8.4	-25.8
Mutual funds	3.7	3.3	4.7	-19.8
Life insurance and pension reserves	11.9	11.1	13.7	-13.3
Equity in unincorporated business	7.0	7.3	8.3	-16.1
Other financial assets	1.4	1.4	1.7	-17.8
<b>Total Liabilities</b>	14.1	14.1	14.4	-2.1
Mortgages	10.4	10.4	10.5	-1.4
Consumer credit	2.5	2.5	2.6	-3.1
Other	1.2	1.2	1.3	-6.1
<b>Net worth</b>	53.1	51.1	60.6	-12.3
<b>Financial net worth</b> (financial assets minus total liabilities)	28.3	26.5	34.0	-16.9

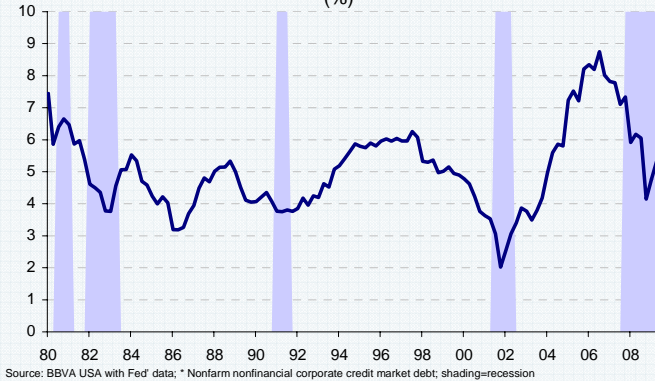
Source: Fed; includes nonprofit organizations

# Business Sector

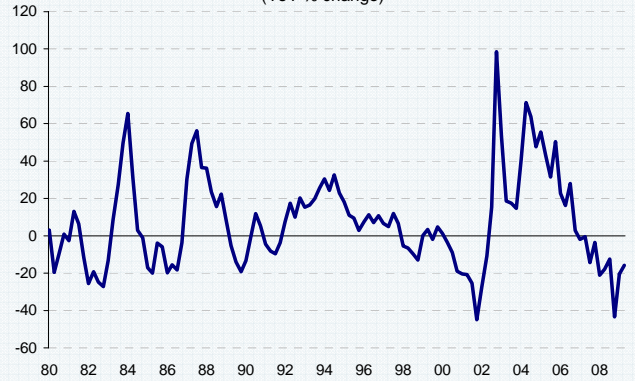
Corporate profits are recovering...

...but remain low due to feeble demand

**Economic Profits as a Share of GDP**  
(%)



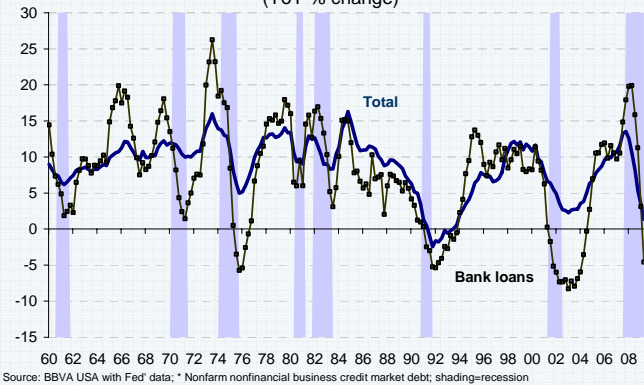
**Business Profits**  
(YoY % change)



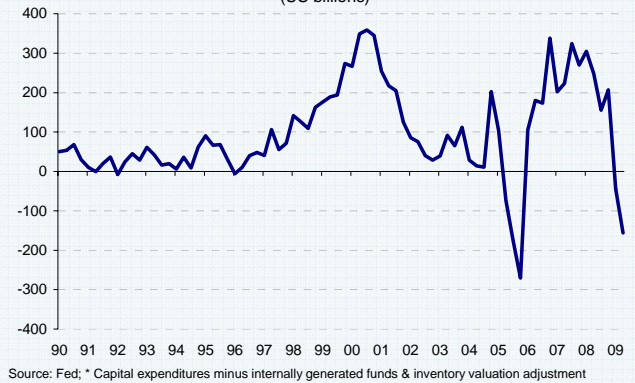
Furthermore, businesses will continue to limit capital expenditures...

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

**Business Debt**  
(YoY % change)



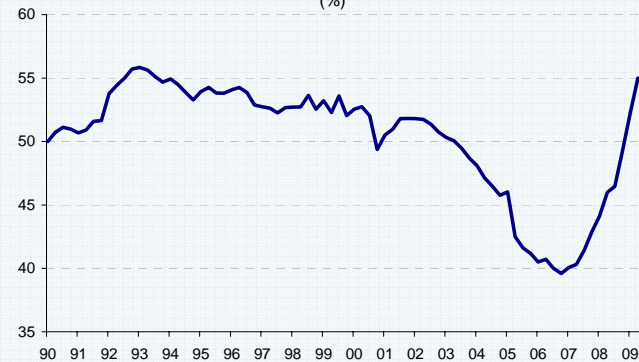
**Financing Gap**  
(US billions)



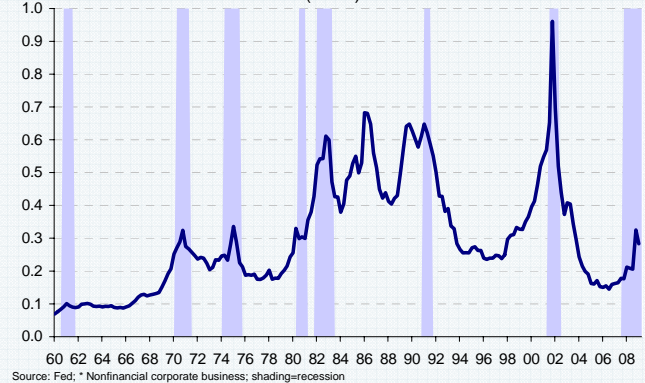
Nevertheless, corporations remain highly leveraged...

...and the risk of insolvencies is still elevated

**Debt to Net Worth Ratio**  
(%)

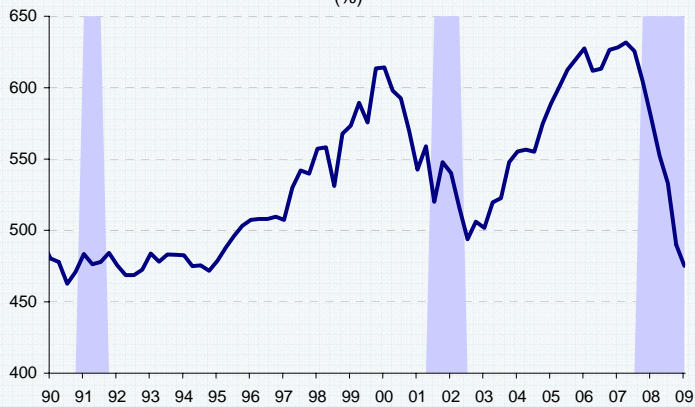


**Net Interest Payments to Economic Profits**  
(Ratio)



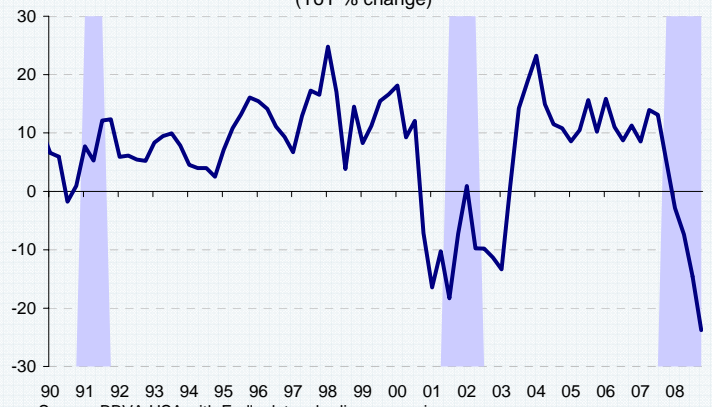
# Household Sector

Households' wealth is beginning to recover  
**Household Net Worth as a Share of Income**  
 (%)



Source: Fed; \* Disposable income; shading=recession

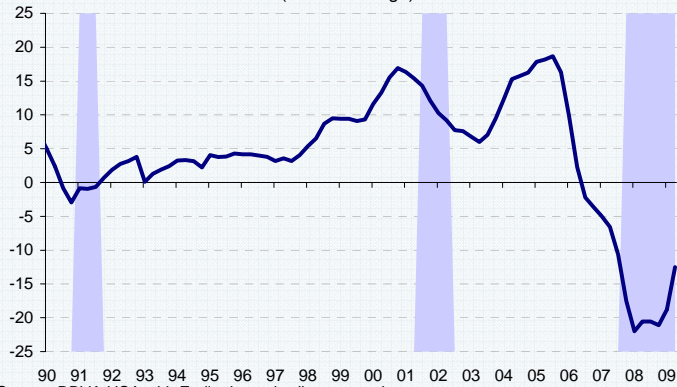
Rising equity prices are supporting financial net worth  
**Financial net worth**  
 (YoY % change)



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

Stabilizing home prices boosted owners' equity

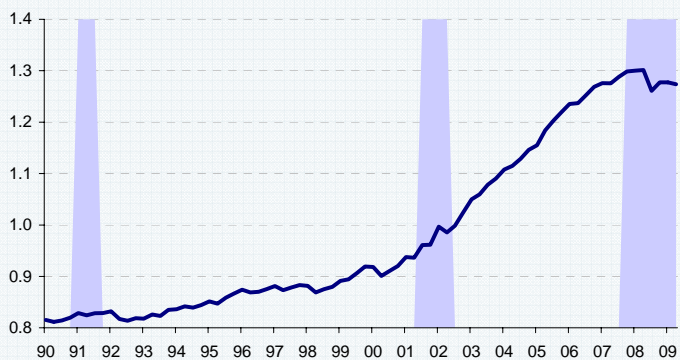
**Owners' equity in household real estate**  
 (YoY % change)



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

Furthermore consumers are deleveraging...

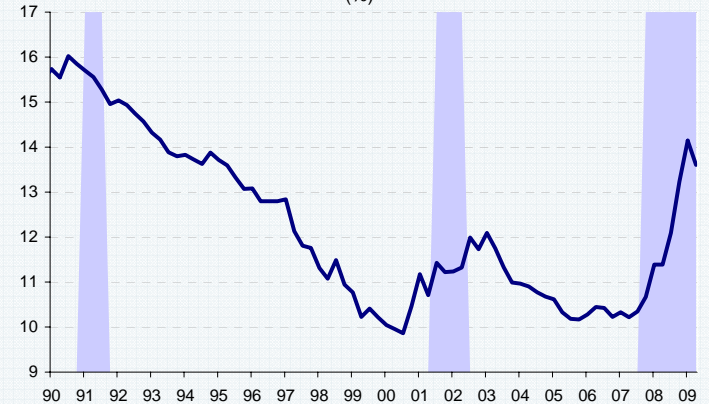
**Ratio of Credit Market Debt to Disposable Income**  
 (%)



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

Risk aversion remains high as households hold more liquid assets

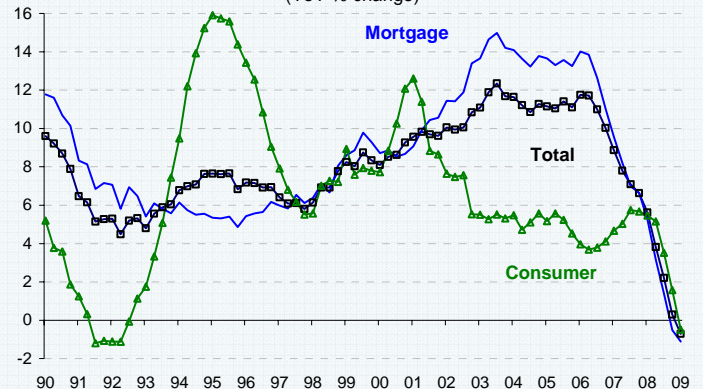
**Ratio of Household Liquid Assets to Net Worth**  
 (%)



Source: Fed

...by reducing their debt levels

**Household Debt**  
 (YoY % change)



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