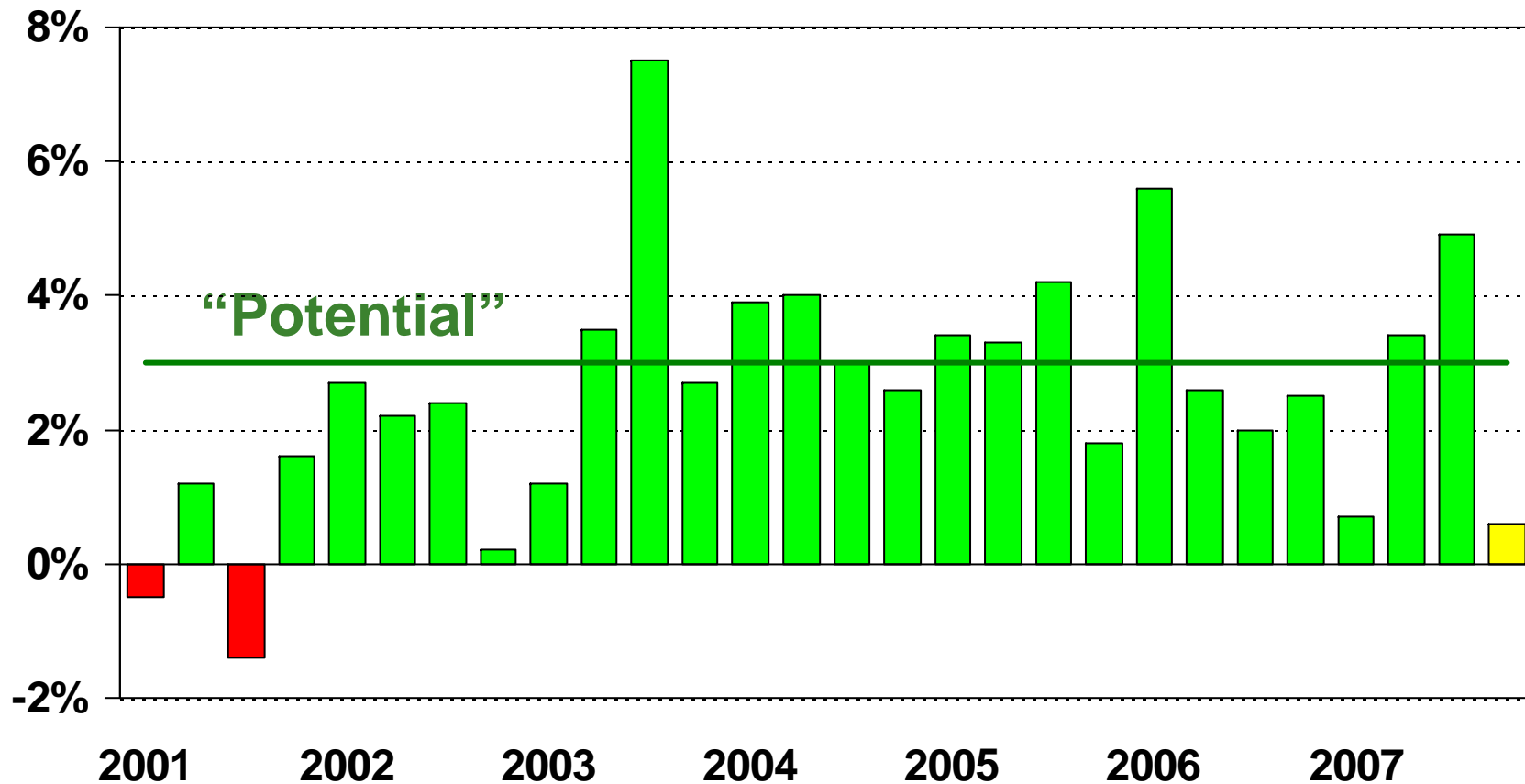

A Pregnant Pause

Economic Prospects for the Remainder of 2008

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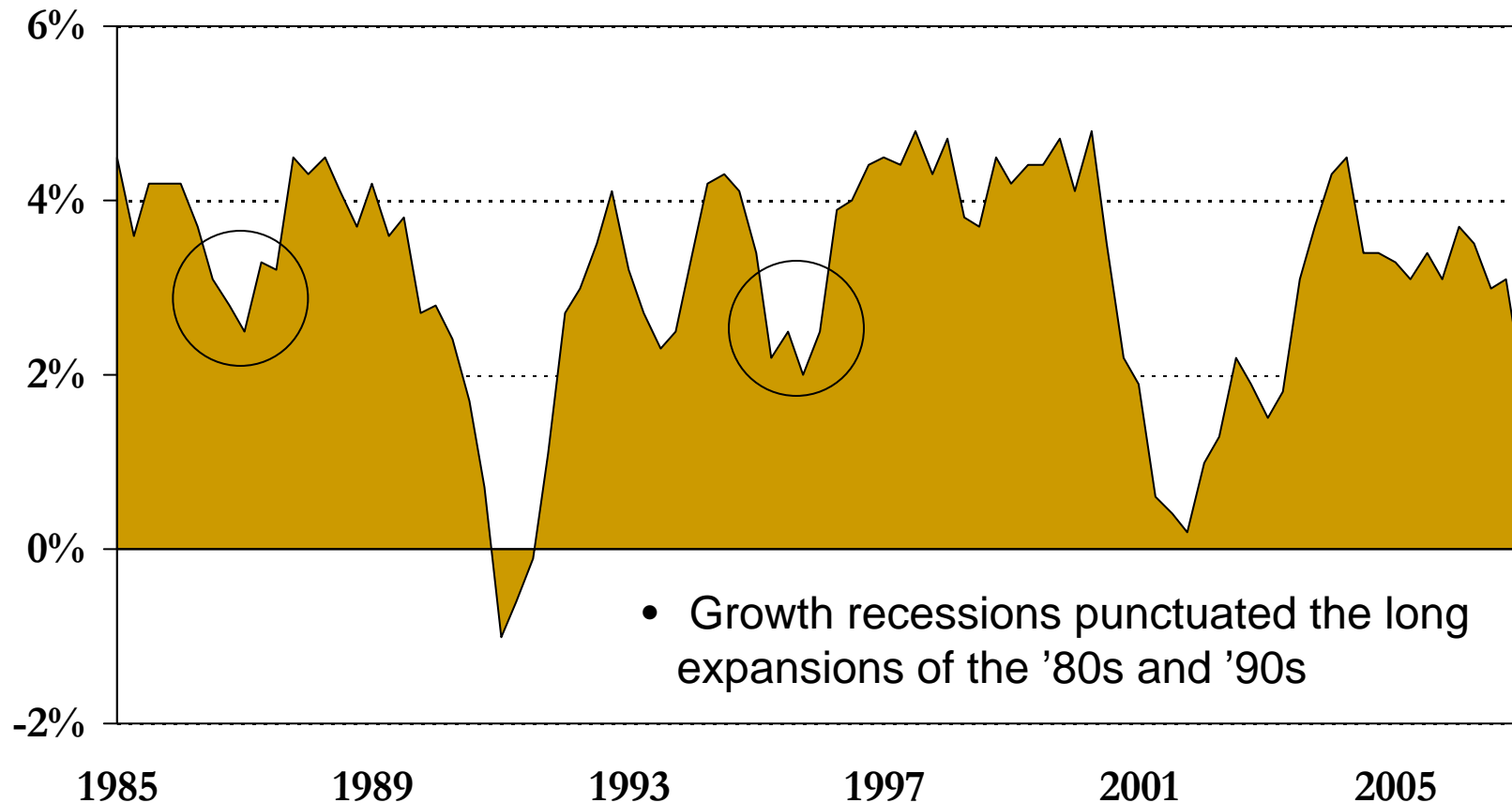
Let's Not Forget: Things Haven't Been That Bad!

Quarterly Change in US GDP, Annualized



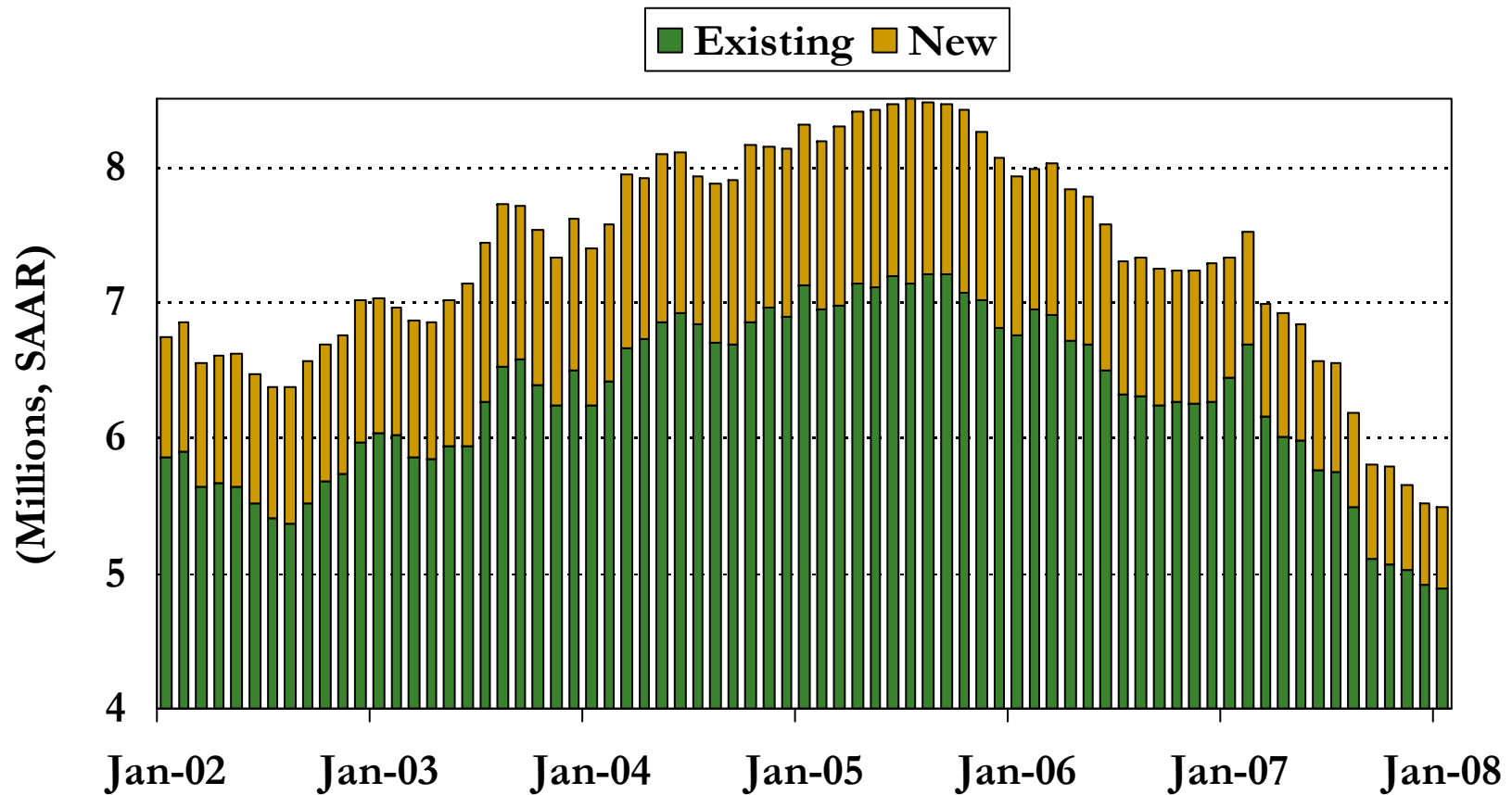
Expansions: Not Always Smooth Sailing

Year over Year Growth in Real GDP



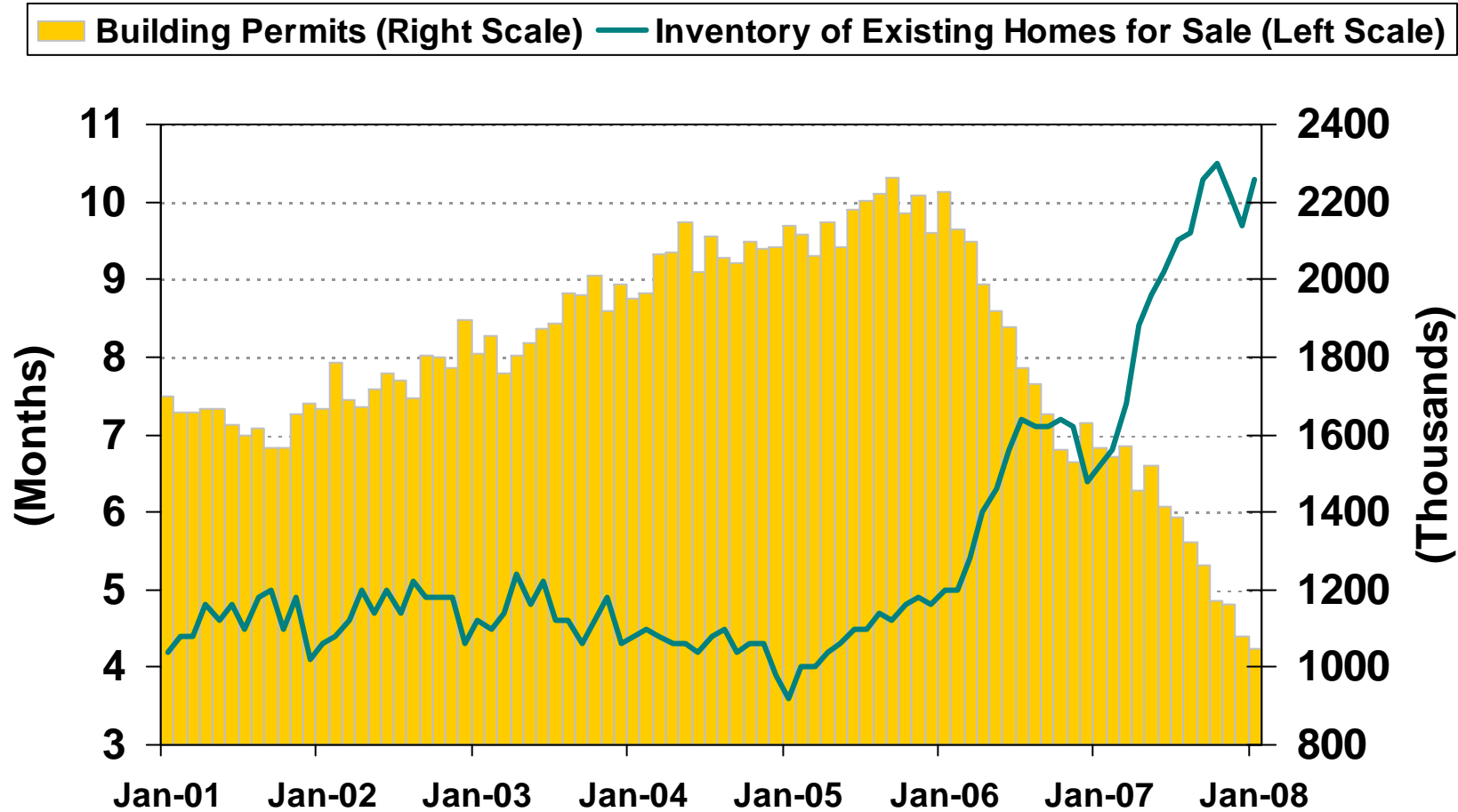
The Housing Correction

Trends in Home Sales



Sources: National Association of Realtors, National Association of Home Builders

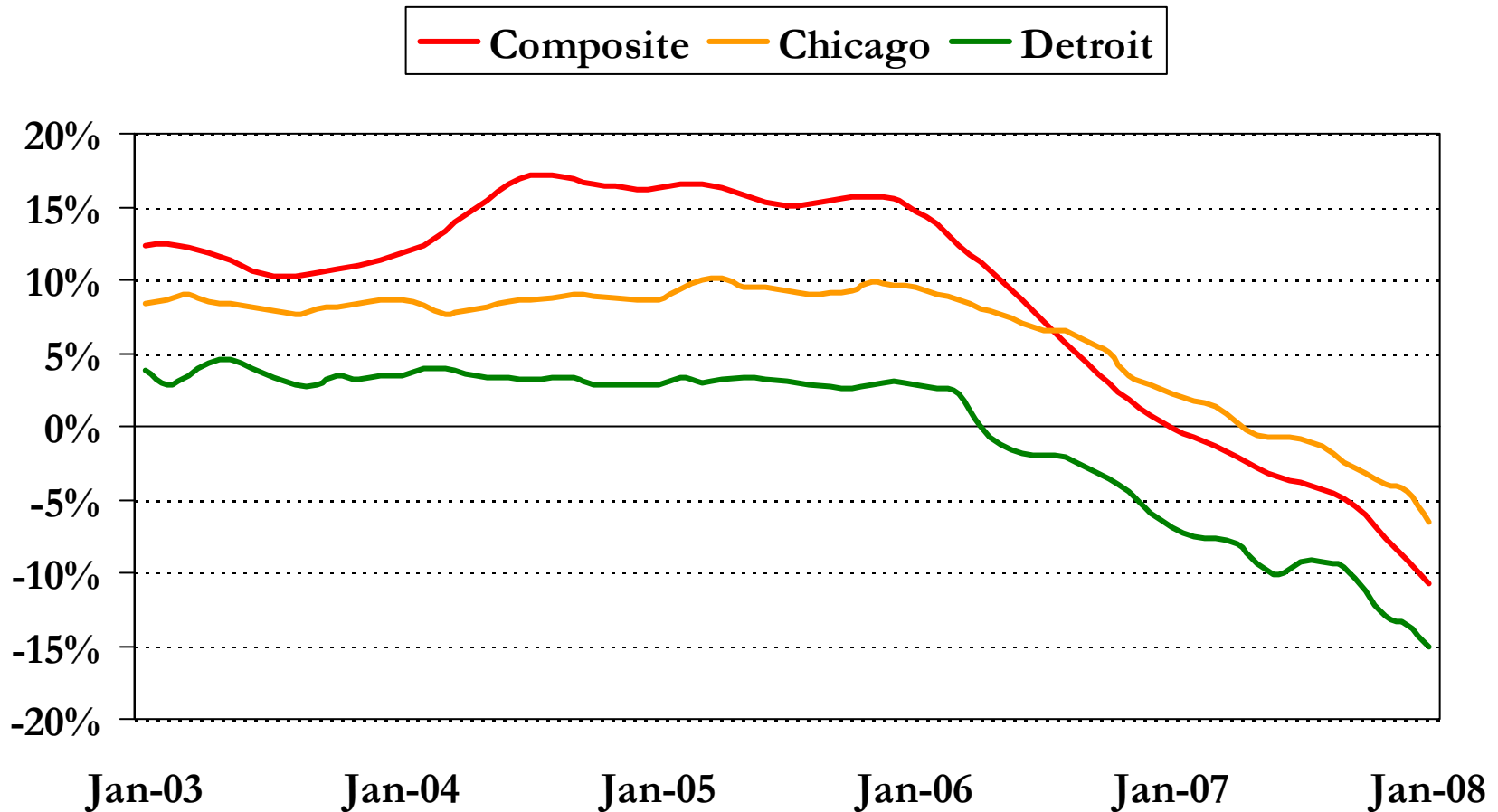
Putting the Hammer Down



Sources: National Association of Realtors, National Association of Home Builders

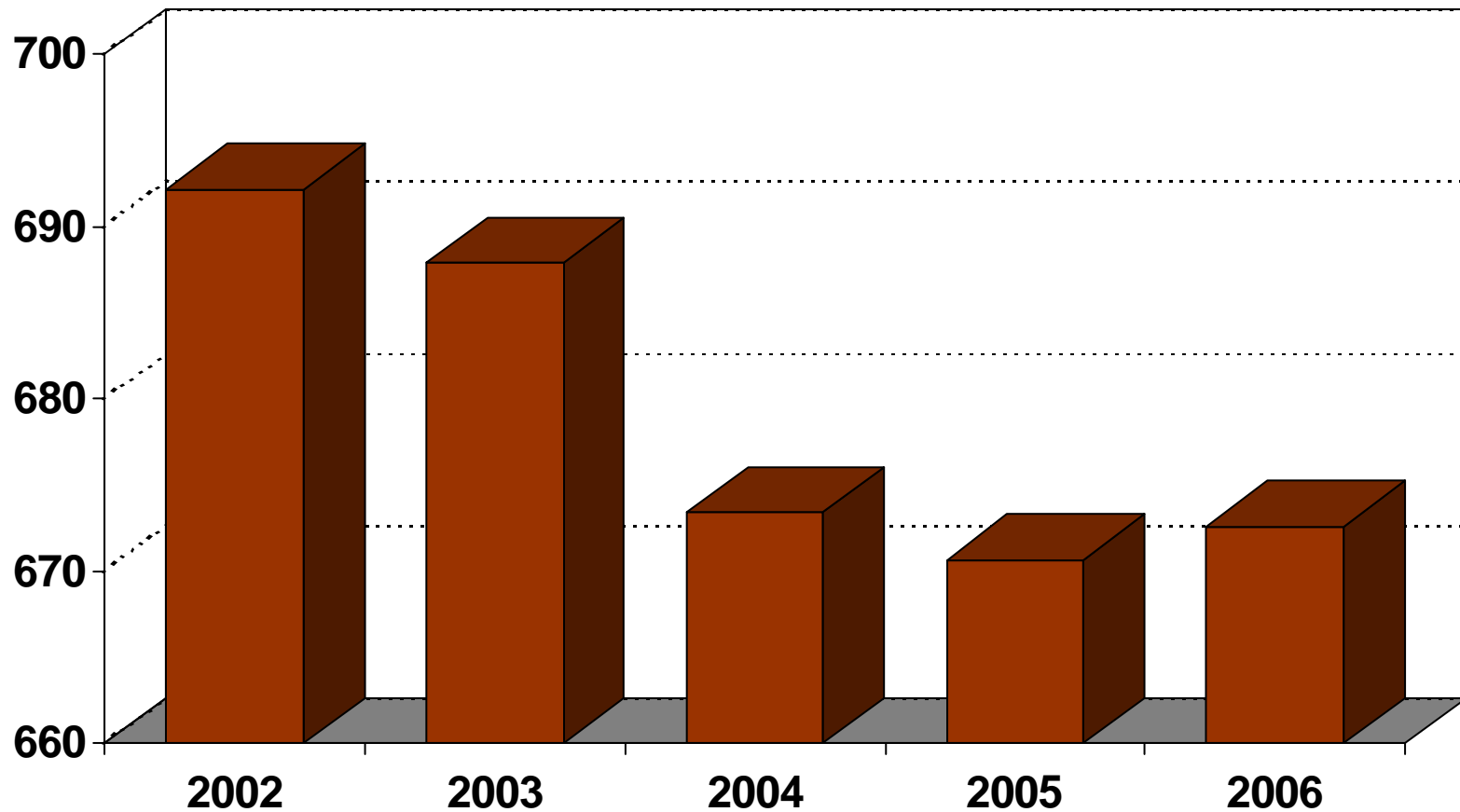
Home Prices

Year over Year Change, Case-Shiller Index

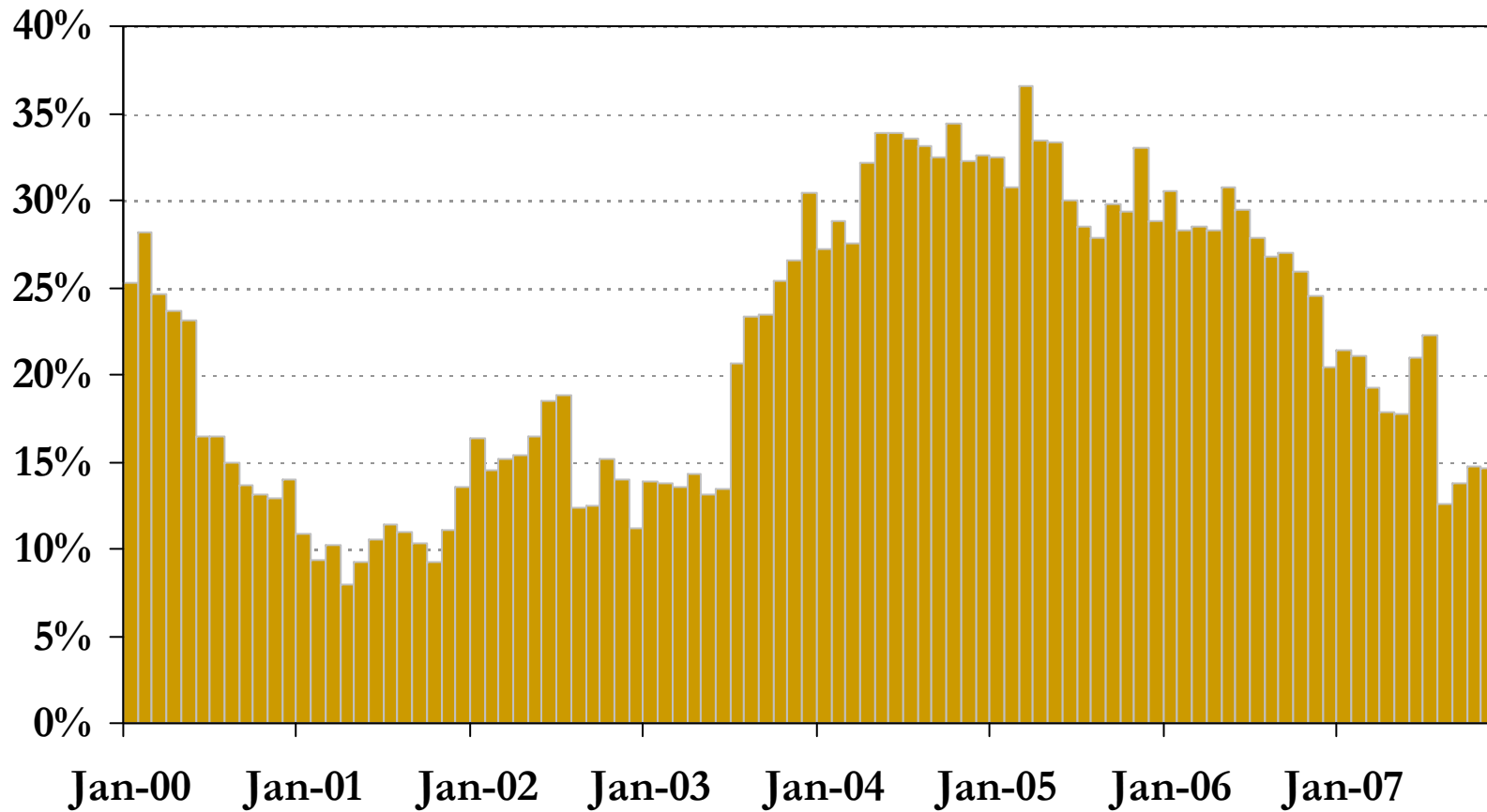


FICO Scores

Weighted Average of FICO Scores for Total Originations



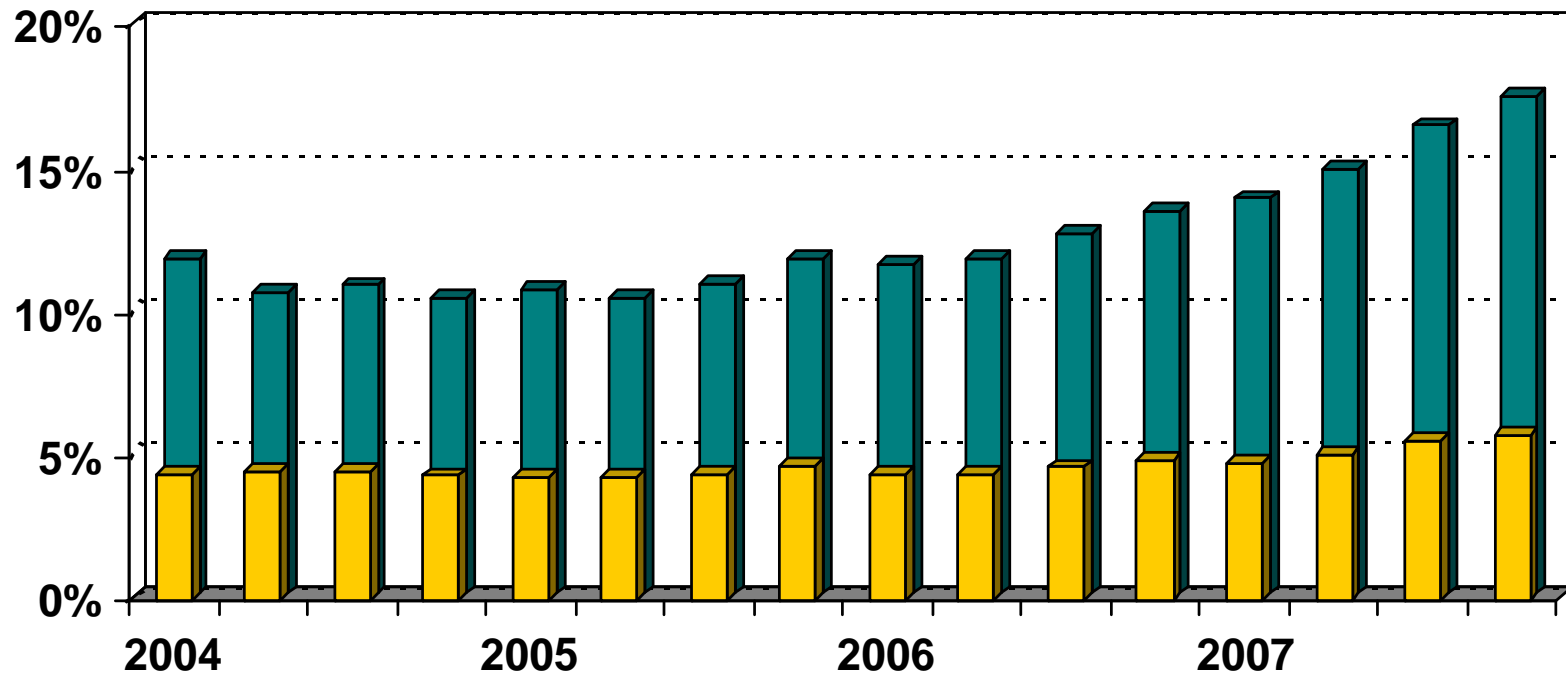
ARM Share of new originations



Past Their Prime

Home mortgages 30 or more days past due

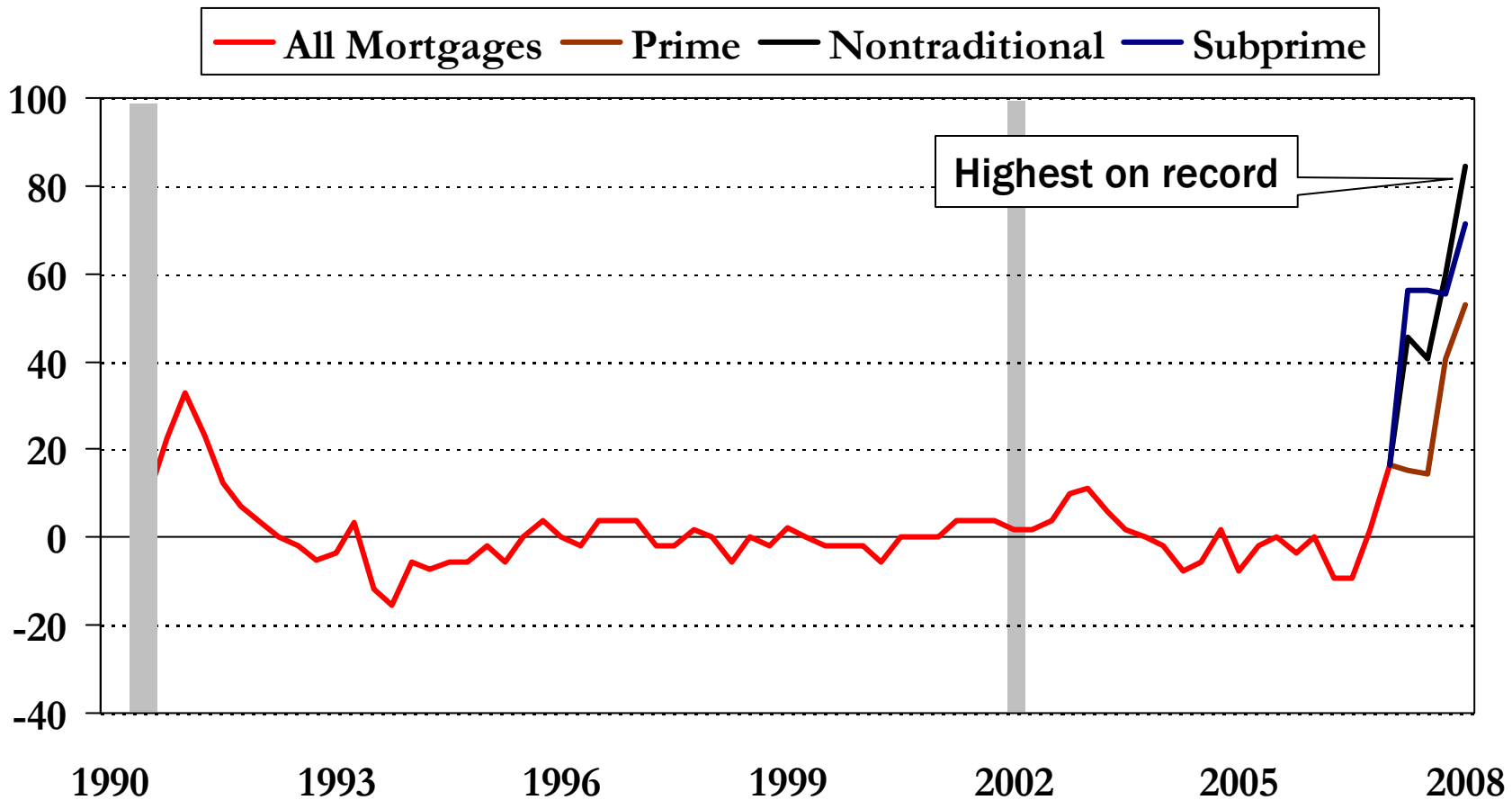
■ All Loans ■ Subprime Loans



Source: Mortgage Bankers Association

Senior Loan Officer Survey: Home Mortgages

Net Percentage of Respondents Tightening Credit

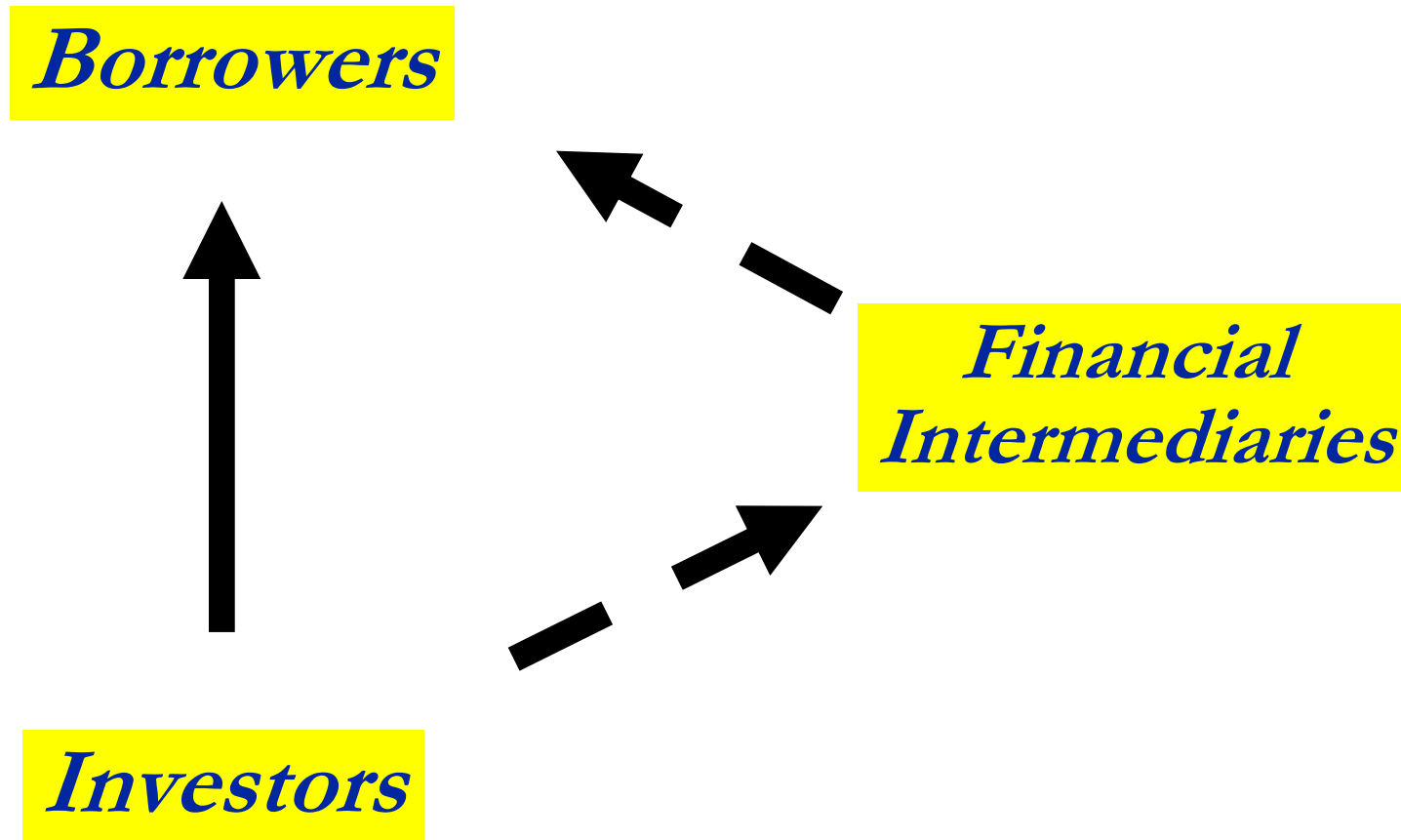


Source: Federal Reserve

Views on Sub-Prime

- ***Not a complete disaster, but some very questionable practices***
- ***Break in housing prices causes contagion to other mortgage segments***
- ***A wake-up call for borrowers and lenders***
- ***Losses: \$200 billion; widely dispersed***

The Modern Financial Reality

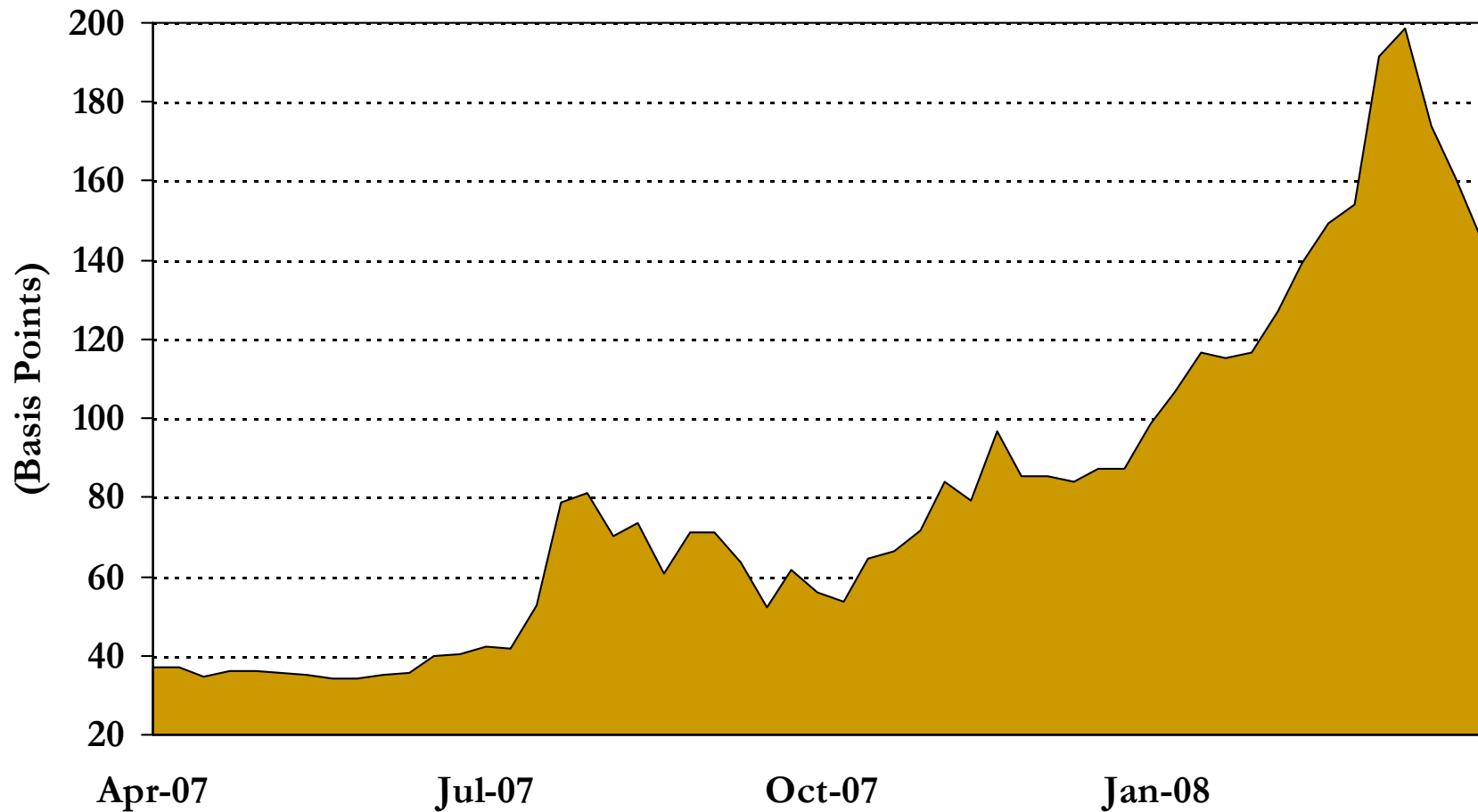


Spiraling Downward

- Subprime losses prompt investor and lender flight
- Rating agencies wade in with downgrades
- CDO/ABCP: acronyms to be avoided
- Selling to raise cash/capital
- Rumor travels faster than fact
- Poor information + shifting risk appetites freeze some markets

Corporate Creditworthiness

Composite of Credit Default Swaps

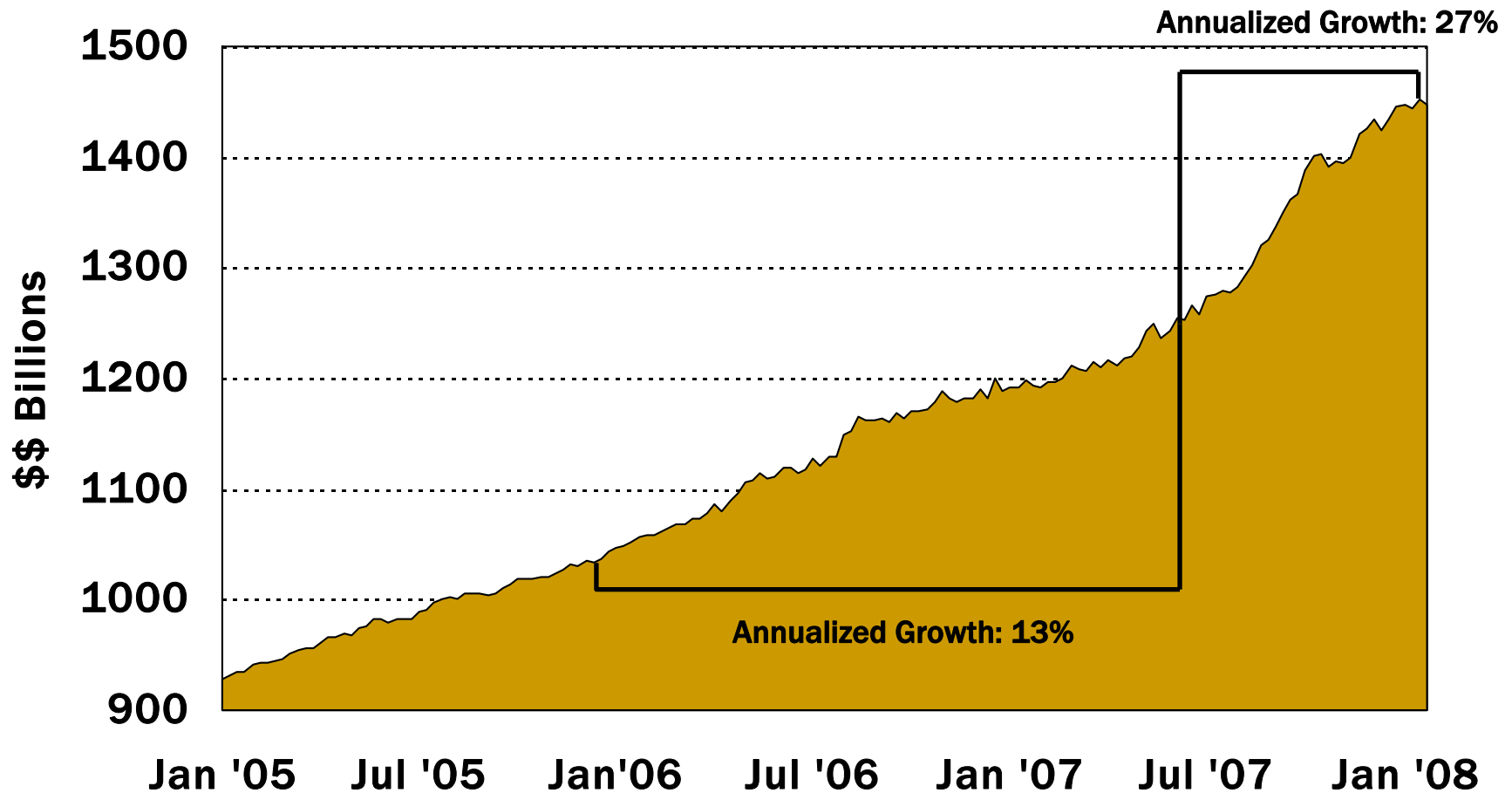


Source: Bloomberg

Pregnant Pause, April 2008

Commercial and Industrial Loans

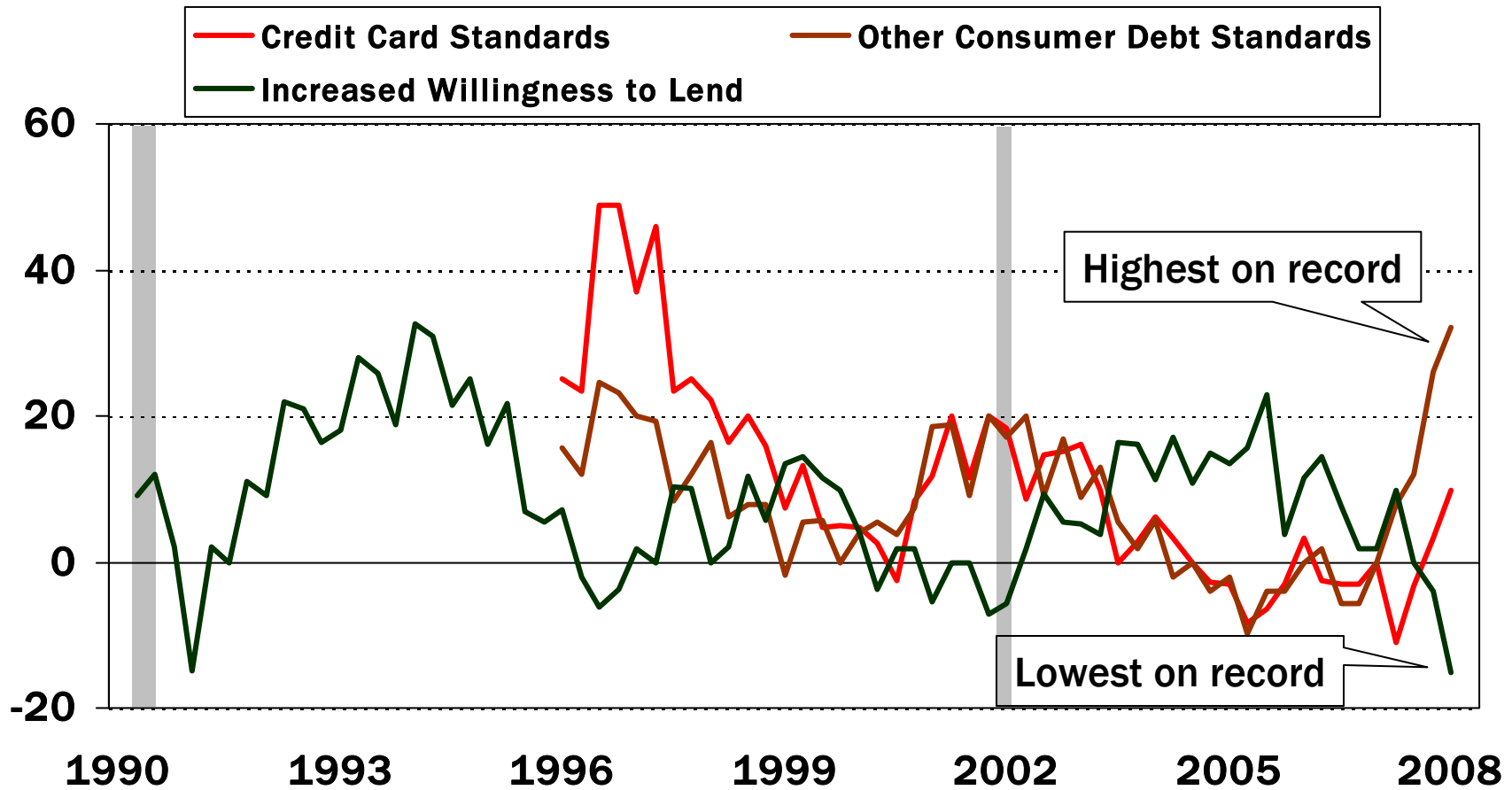
All Commercial Banks



Source: Federal Reserve

Senior Loan Officer Survey: Consumer Debt

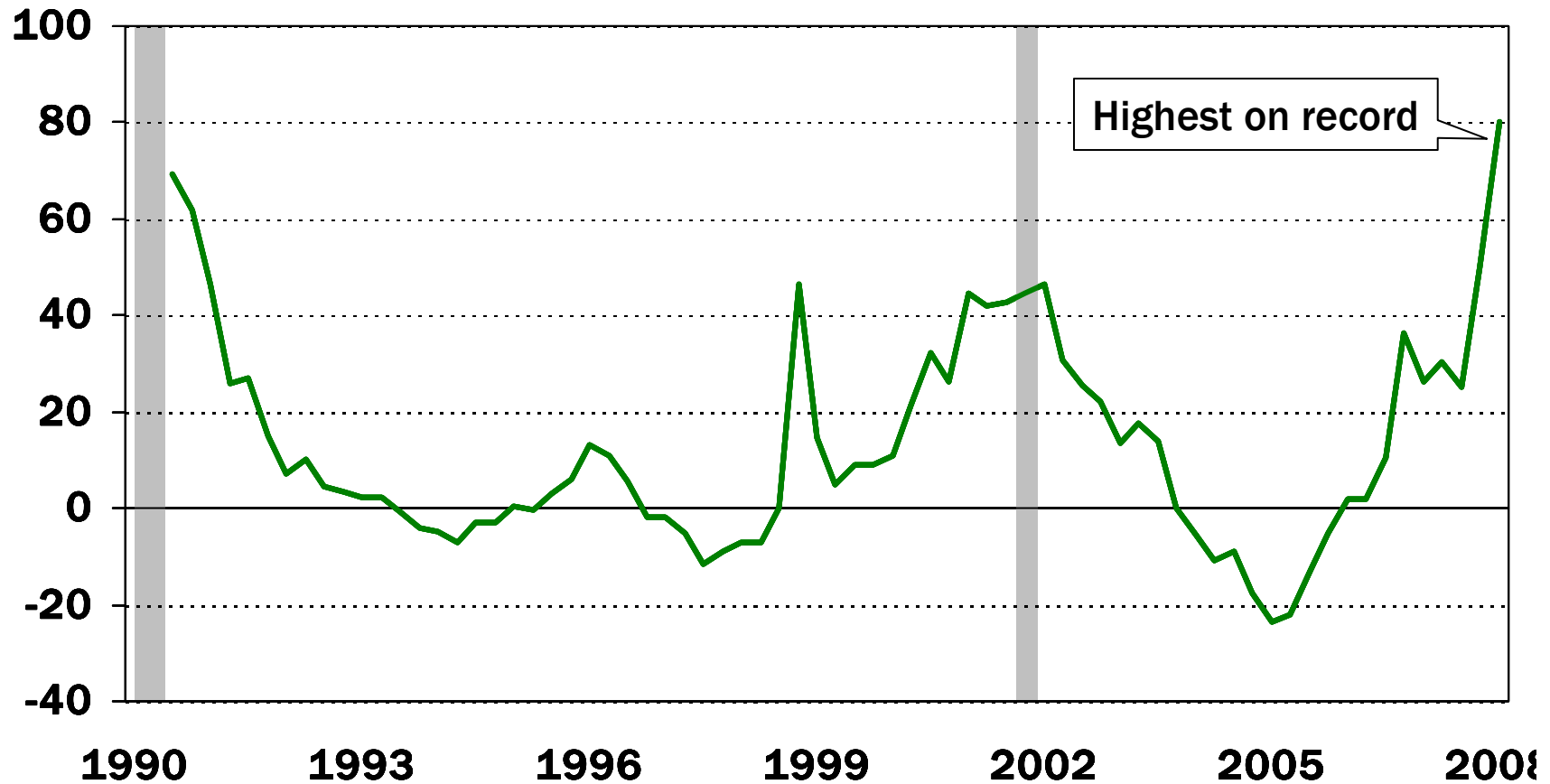
Net Percentage of Respondents Tightening Credit



Source: Federal Reserve

Senior Loan Officer Survey: Commercial Real Estate

Net Percentage of Respondents Tightening Credit



Source: Federal Reserve

Pregnant Pause, April 2008

Tightening the Vise?

Rating Agencies

Congress

Bond Insurers

Regulators?

Conclusions: Credit

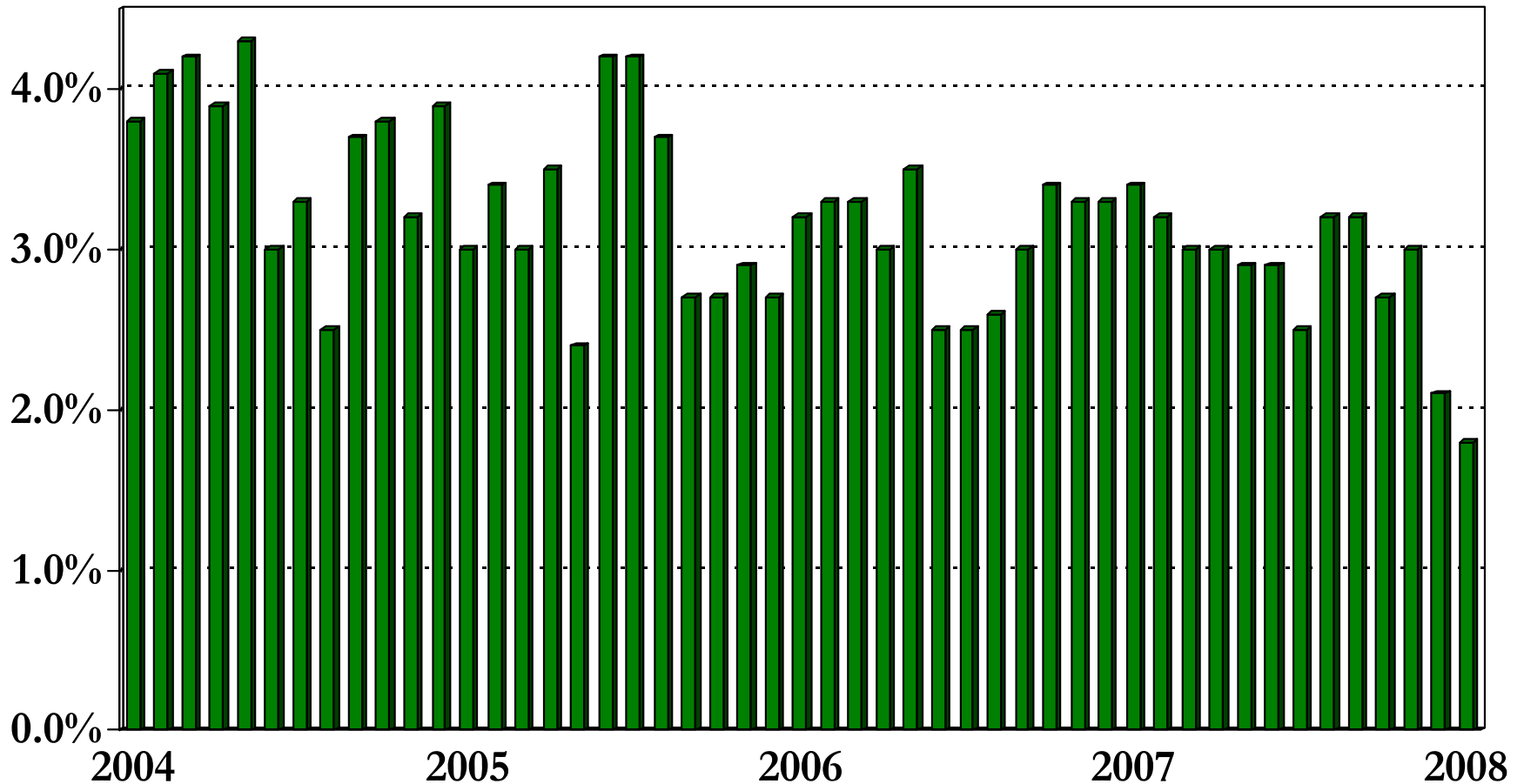
- We're working to avoid a credit crunch
- Wall Street firms remain under stress; high vulnerability to event risk
- Effect on community banks has been limited, but translation from Wall Street down to Main Street is possible
- We're seeing the downside of the modern financial markets

Fallout from Housing

- **Significant drop in construction**
 - Affects building materials, trades
- **Broad pressure on home values**
 - Negative “wealth effect”
- **Shivers roll through financial markets**
 - Potential for a credit crunch
- **Risk of ill-advised regulation**
 - A potent political issue

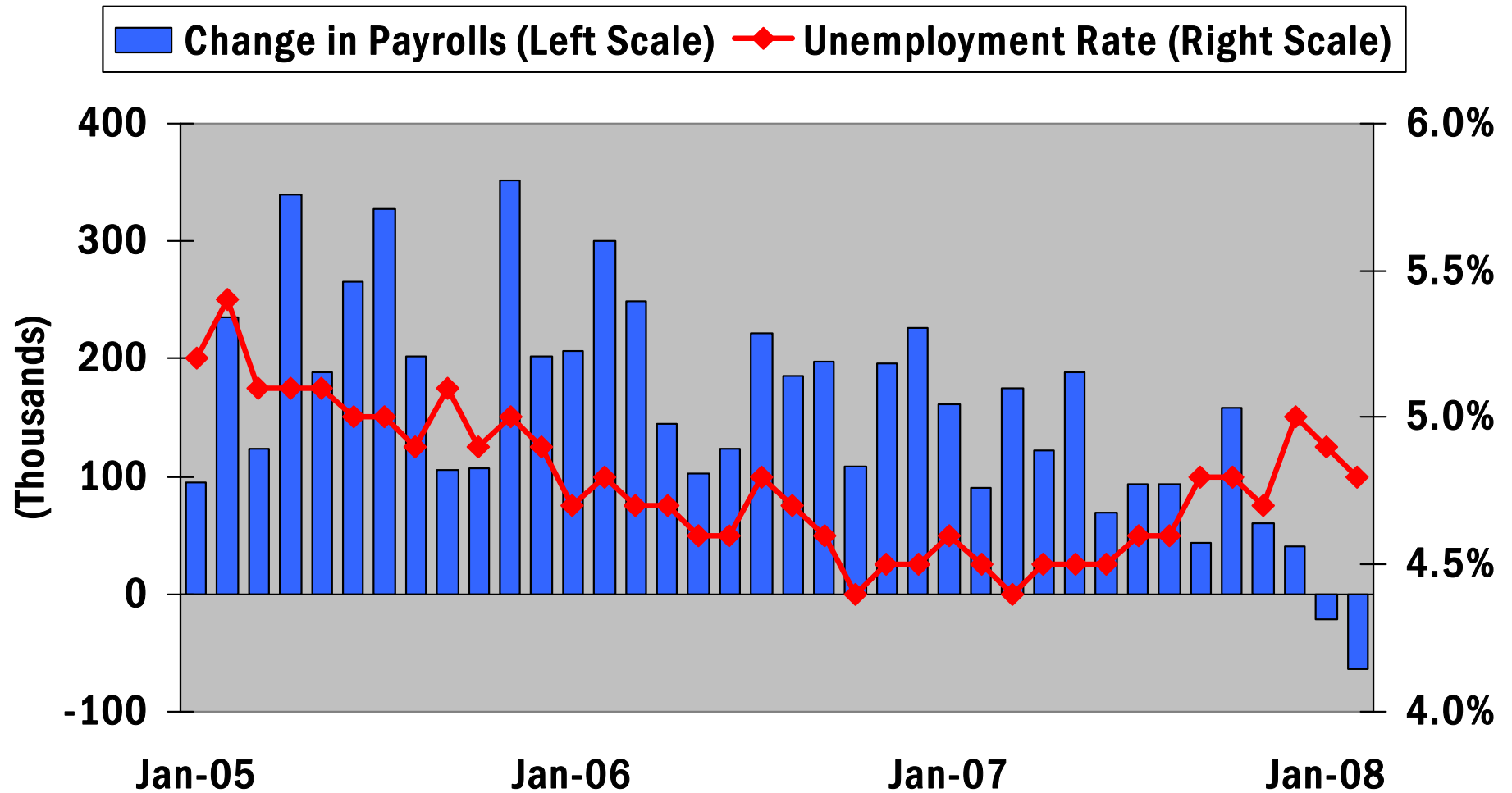
Real Personal Consumption

Year over Year Change



Pregnant Pause, April 2008

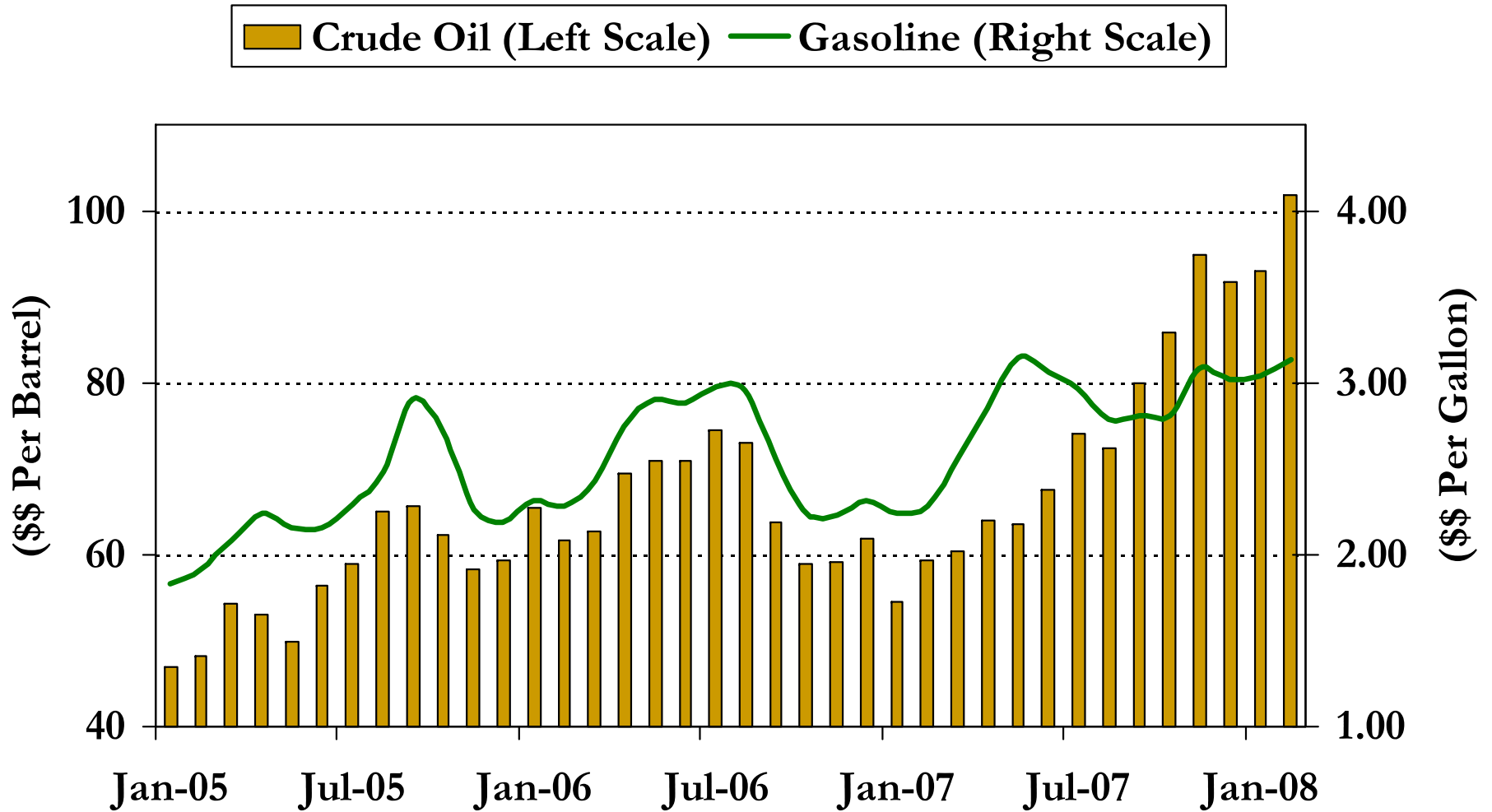
Employment Trends



Source: Bureau of Labor Statistics

Pregnant Pause, April 2008

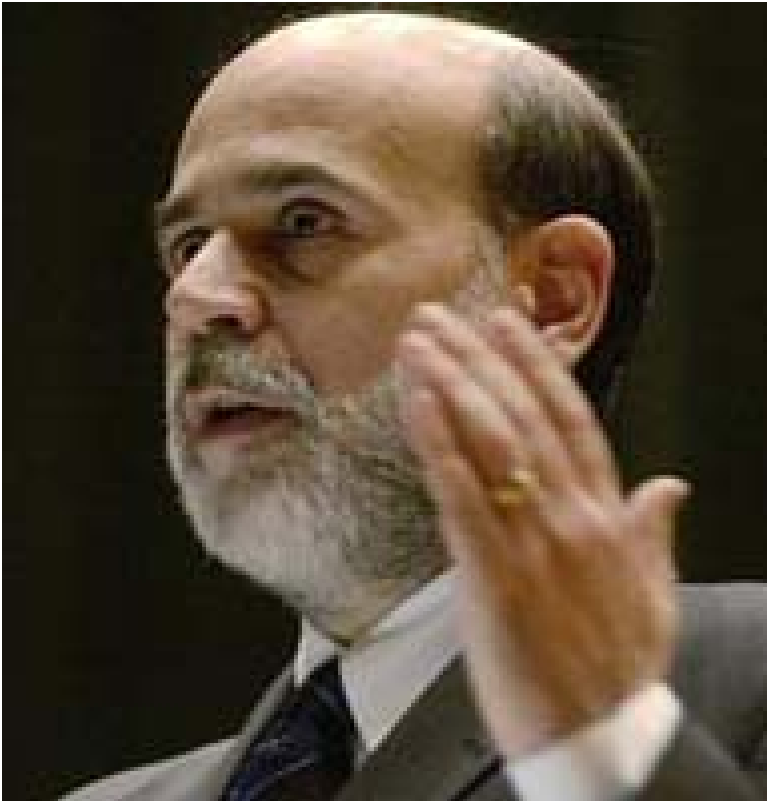
Sapping Energy?



Source: Energy Information Administration

Pregnant Pause, April 2008

Mr. Bernanke's Big Test



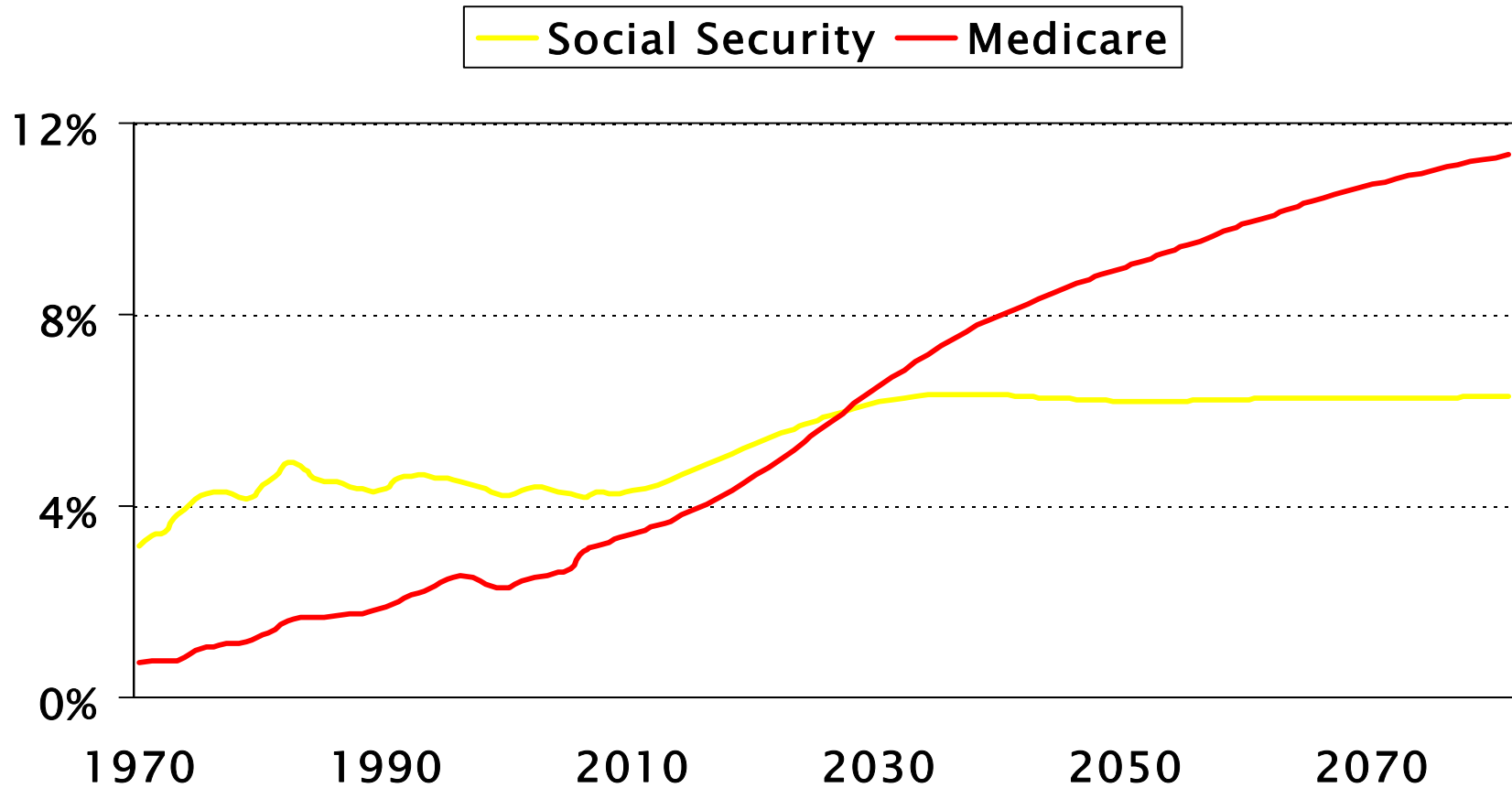
- **Doesn't want to reward reckless behavior**
- **Expansion is less secure**
- **Inflation above comfort zone**
- **The financial system came close to melting down**
- **Tough choices, but pulling out all stops**

Issues on the Other Side of Washington

- **Short-term stimulus: too much, too late?**
- **What will become of the tax cuts?
AMT?**
- **Is the tide turning against free trade?**
- **What to do about social security and health care?**

Projected Program Costs

As a Percent of GDP



The Scorecard

	<u>2006</u>	<u>2007</u>	<u>2008E</u>
Real GDP Growth	2.9%	2.2%	1.5%
Core Inflation (CPI)	2.6%	2.4%	2.3%
Unemployment	4.6%	4.9%	5.5%
Year-End Fed Rate	5.25%	4.25%	3.00%

Conclusions

- **The housing slump is deeper and longer lasting than most expected**
- **After-shocks are still being sorted out**
- **Some forward momentum has been lost**
- **We've traditionally underestimated the resilience of the US economy**
- **After this “pregnant pause,” the expansion should continue**

A Pregnant Pause

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