

# The Economic Outlook: Fasten Your Seatbelts

David Wyss  
Chief Economist  
Standard & Poor's

March 25, 2009  
Data as of March 13

**CONFIDENTIAL AND PROPRIETARY.**

Permission to reprint or distribute any content from this presentation requires the written approval of Standard & Poor's.

Copyright (c) 2008 Standard & Poor's, a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.

# The U.S. Is In Recession

---

- **The economy is in recession.**
- **Housing has been in recession for three years, subtracting over a percentage point from GDP growth in both 2007 and 2008.**
- **But that was offset by strength in nonresidential construction and the closing of the trade gap, each of which added back about a half point in 2007.**
- **Weaker overseas growth will mean less benefit from the trade deficit, despite the declining dollar.**
- **Nonresidential construction is plunging.**
- **The fiscal 2008 deficit beat the 2004 record; 2009 may triple 2008.**
- **The Fed has cut rates sharply.**
- **The recession will be long and deep.**
- **And an even deeper recession is possible if the financial markets remain locked up, oil prices rebound, and home prices continue to drop.**

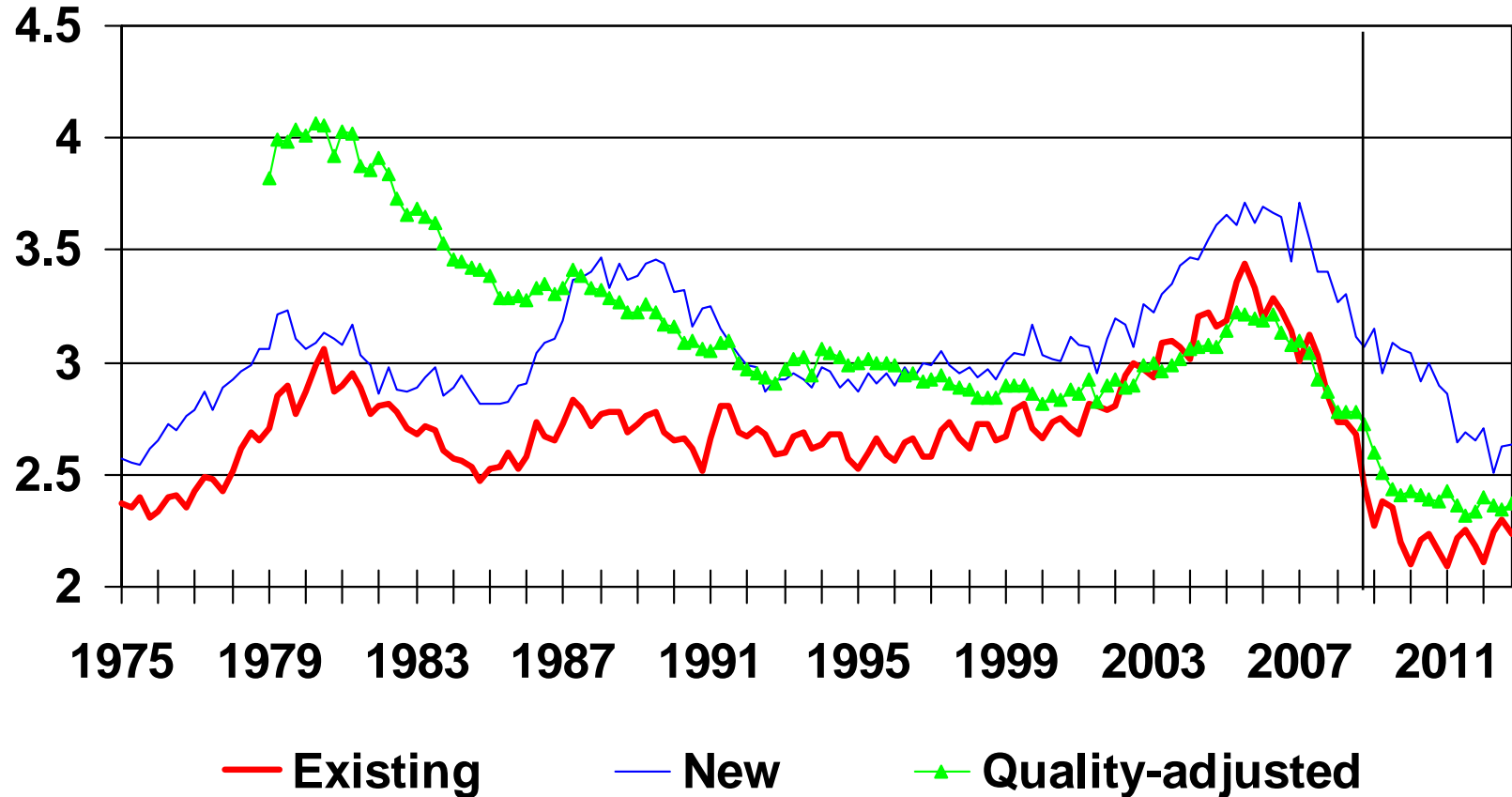
# The Housing Bubble

---

- **Housing was too affordable, thanks to low mortgage rates**
- **But what happened when rates went up?**
- **Ratio of home price to income hit a record high in 2006,**
- **Which could not be maintained at higher interest rates**
- **We built too many houses at too high prices**
- **Starts and sales have dropped sharply**
- **Defaults have soared, cutting back on willingness to lend**
- **Prices are down 25% from their peak**
- **And the ratio of home price to income is below its historical average**
- **We expect to hit bottom on starts this winter**
- **But prices probably won't hit bottom until early 2010.**

# Home Prices Were Too High

(Ratio of average home price to average household disposable income)

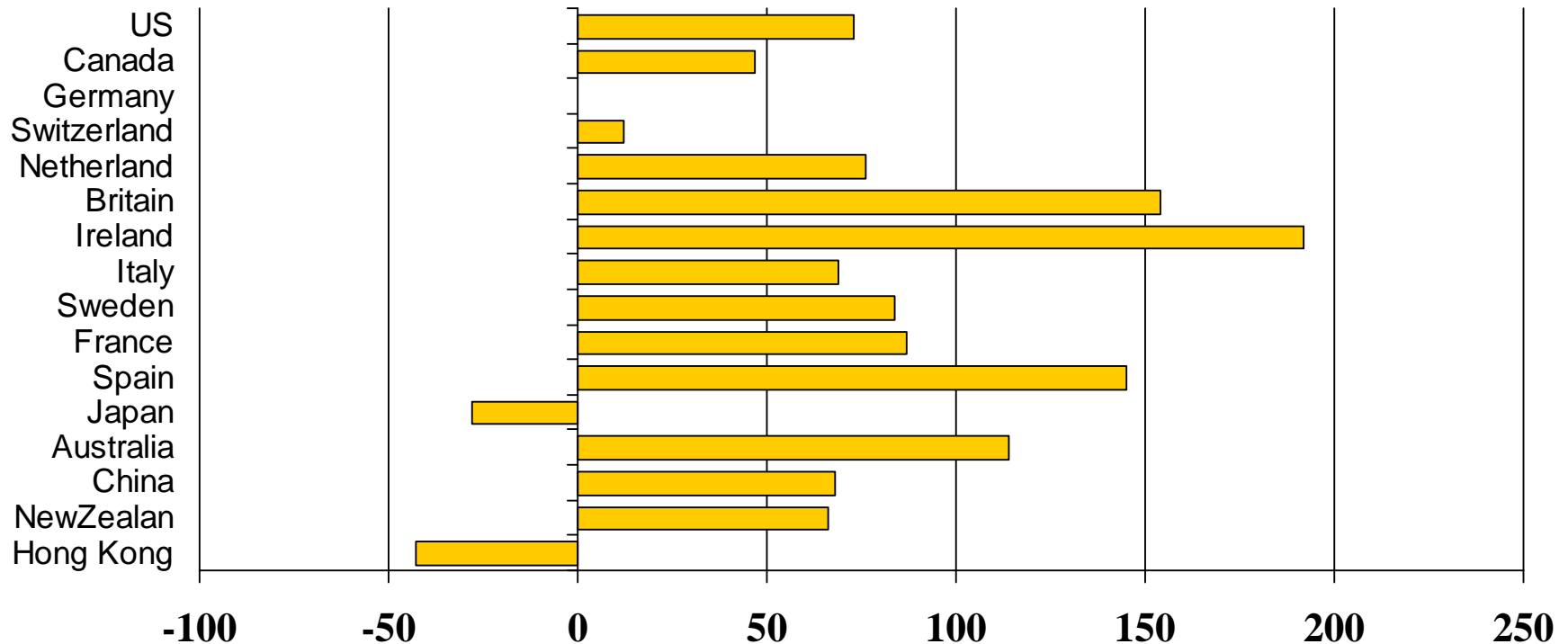


Source: BEA, Census

CONFIDENTIAL AND PROPRIETARY.

# Bubbles Were Almost Everywhere

(Percent increase in home prices, 1997-2005)



Source: Mortgage Bankers' Association and S&P

CONFIDENTIAL AND PROPRIETARY.

**STANDARD  
& POOR'S**

# Most Weakness Is In The Bubble Cities

(S&P/Case-Shiller Home Price Indexes, December)

	Decline from July 2006	2002-2005 average (12-month percent change)	Price/income ratio (2005)
<b>Top 5</b>			
Charlotte	-4.3	4.1	3.8
Dallas	-7.8	2.7	3.0
Denver	-10.3	2.6	4.5
Seattle	-11.0	12.2	7.1
Portland, OR	-11.8	13.1	5.0
20-City Average	-27.0	14.3	6.3
<b>Bottom 5</b>			
Phoenix	-45.5	20.6	5.1
Las Vegas	-43.9	17.5	6.1
Miami	-40.7	19.9	8.6
San Francisco	-40.2	14.7	12.7
San Diego	-38.9	17.2	14.0
Detroit	-34.3	3.1	2.6

Source: Standard & Poor's, Census Bureau

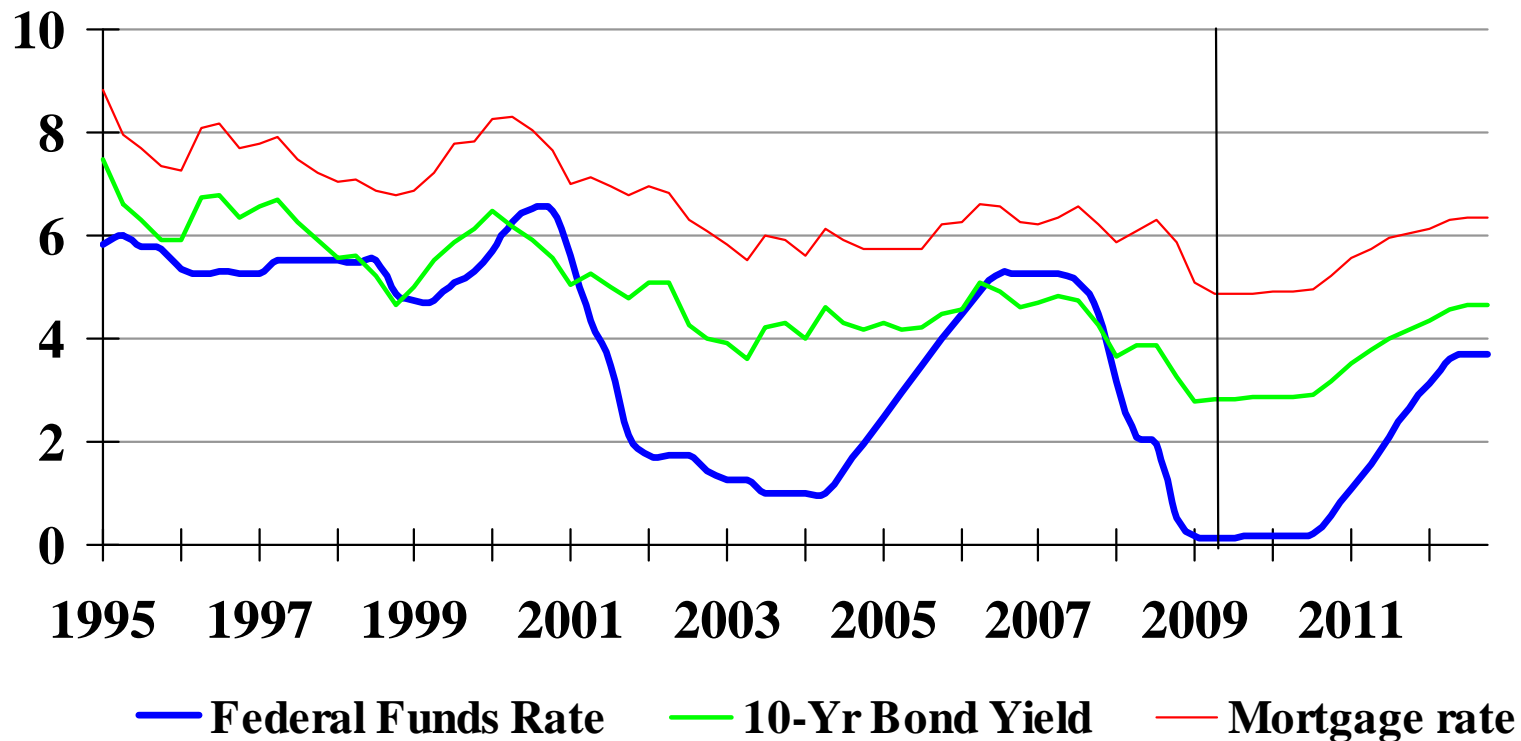
CONFIDENTIAL AND PROPRIETARY.

6. Permission to reprint or distribute any content from this presentation requires the written approval of Standard & Poor's.

**STANDARD**  
**& POOR'S**

# The Fed Is Still Cutting

(Percent)



Source: Federal Reserve

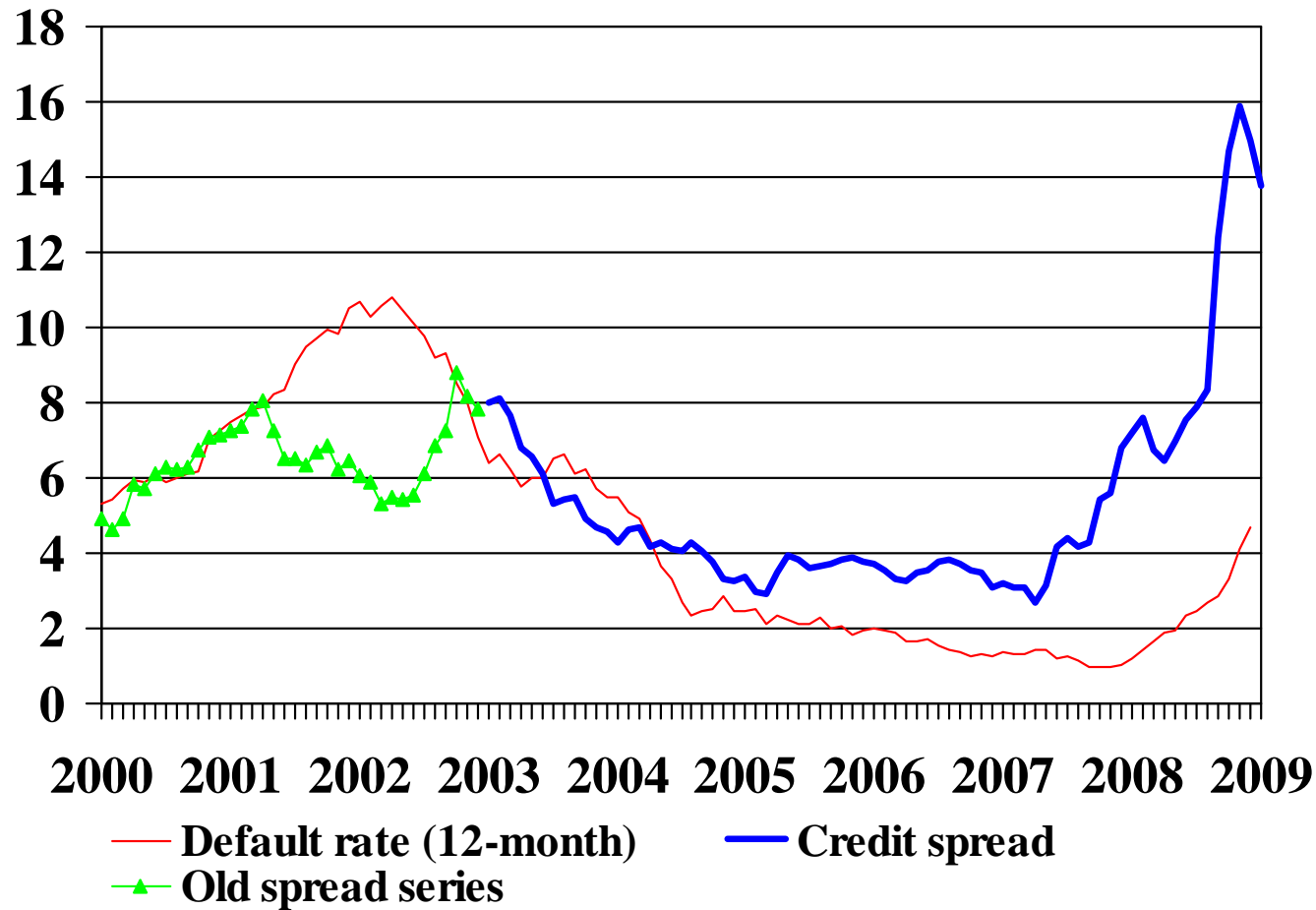
CONFIDENTIAL AND PROPRIETARY.

7. Permission to reprint or distribute any content from this presentation requires the written approval of Standard & Poor's.

**STANDARD  
& POOR'S**

# Quality Spreads Are Widening From Record Lows

(Spread over Treasury yields, percentage points)

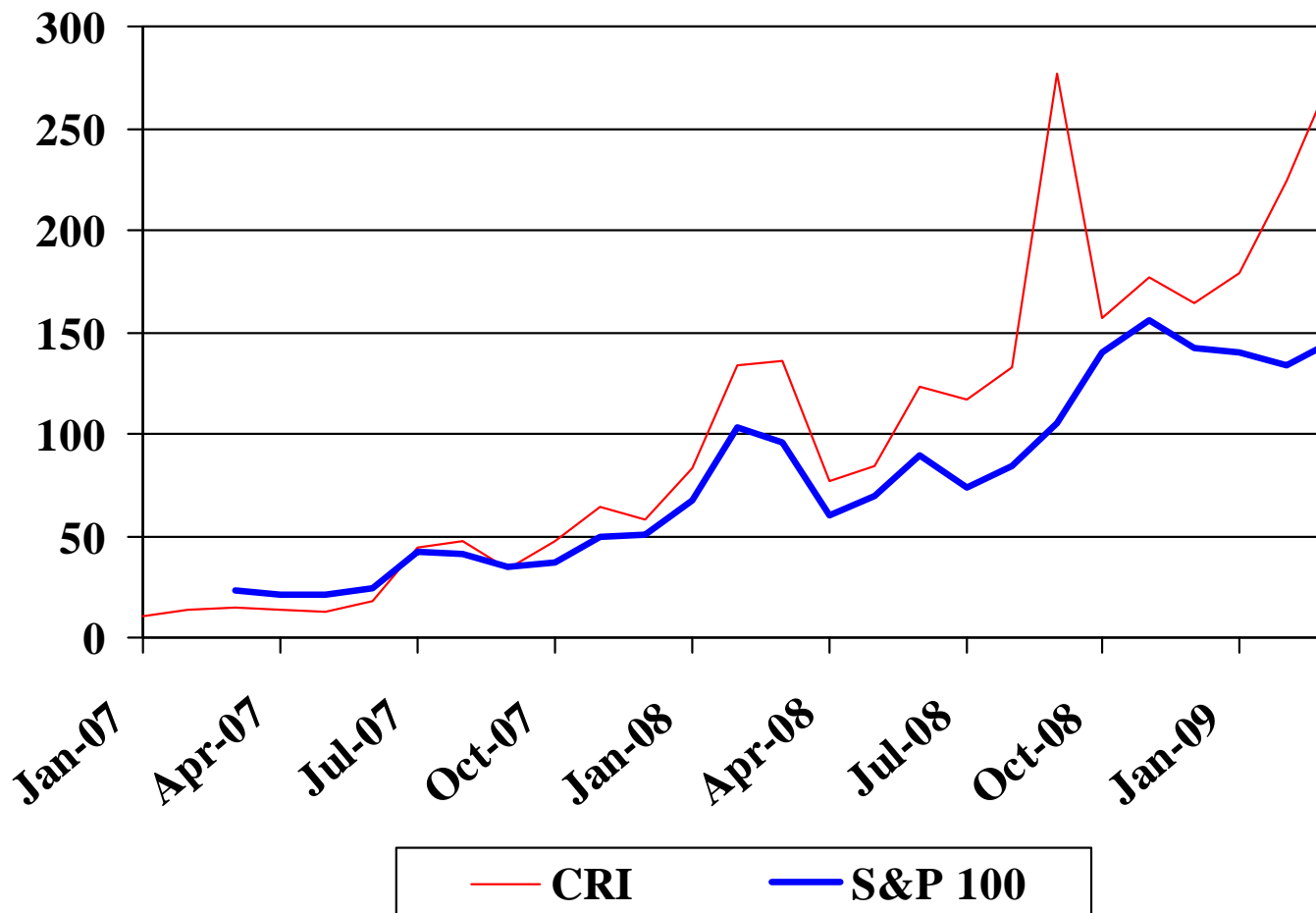


Source: Standard & Poor's Global Fixed Income Research

CONFIDENTIAL AND PROPRIETARY.

# Credit Default Insurance Jumped Sharply

(Counterparty Risk Index, basis points)



Source: Credit Default Research, S&P

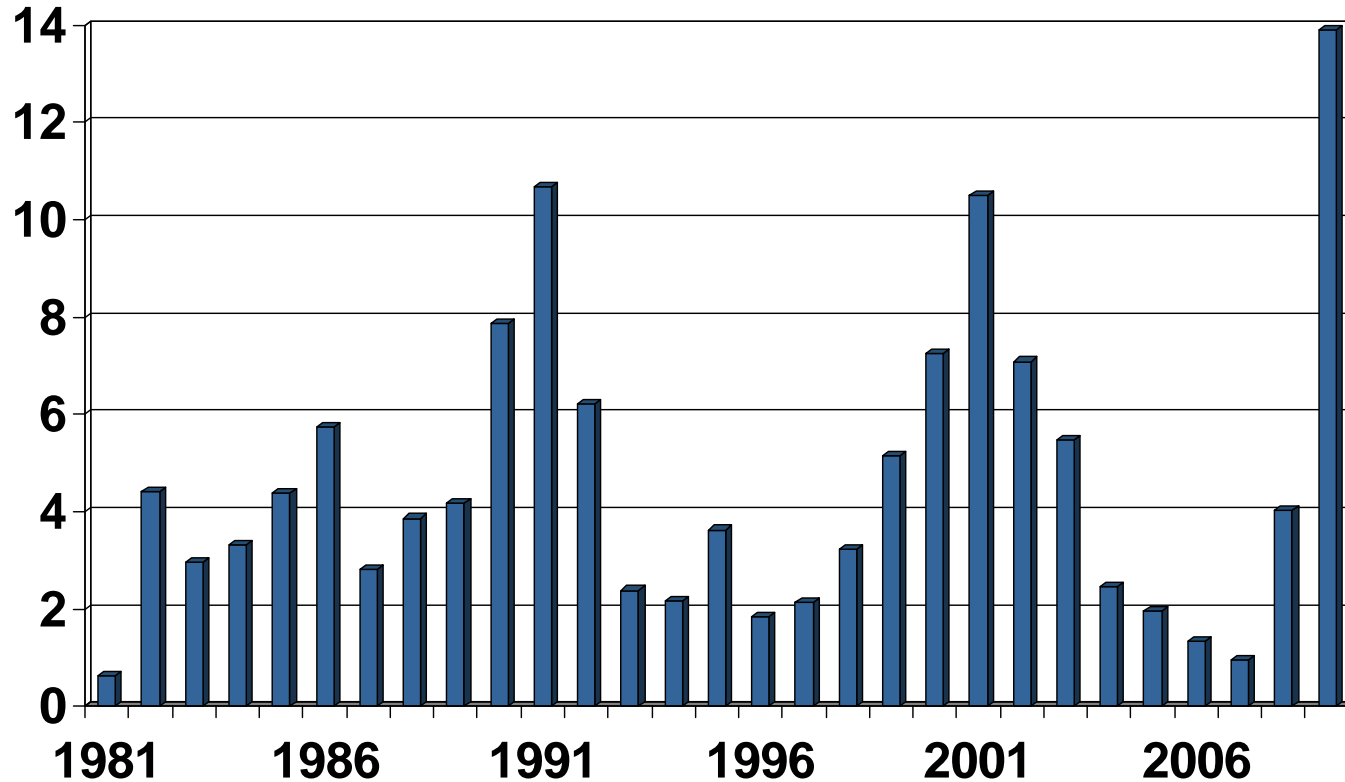
CONFIDENTIAL AND PROPRIETARY.

9. Permission to reprint or distribute any content from this presentation requires the written approval of Standard & Poor's.

**STANDARD  
& POOR'S**

# Corporate Defaults Are Accelerating

Speculative-grade default rate



Source: S&P

CONFIDENTIAL AND PROPRIETARY.

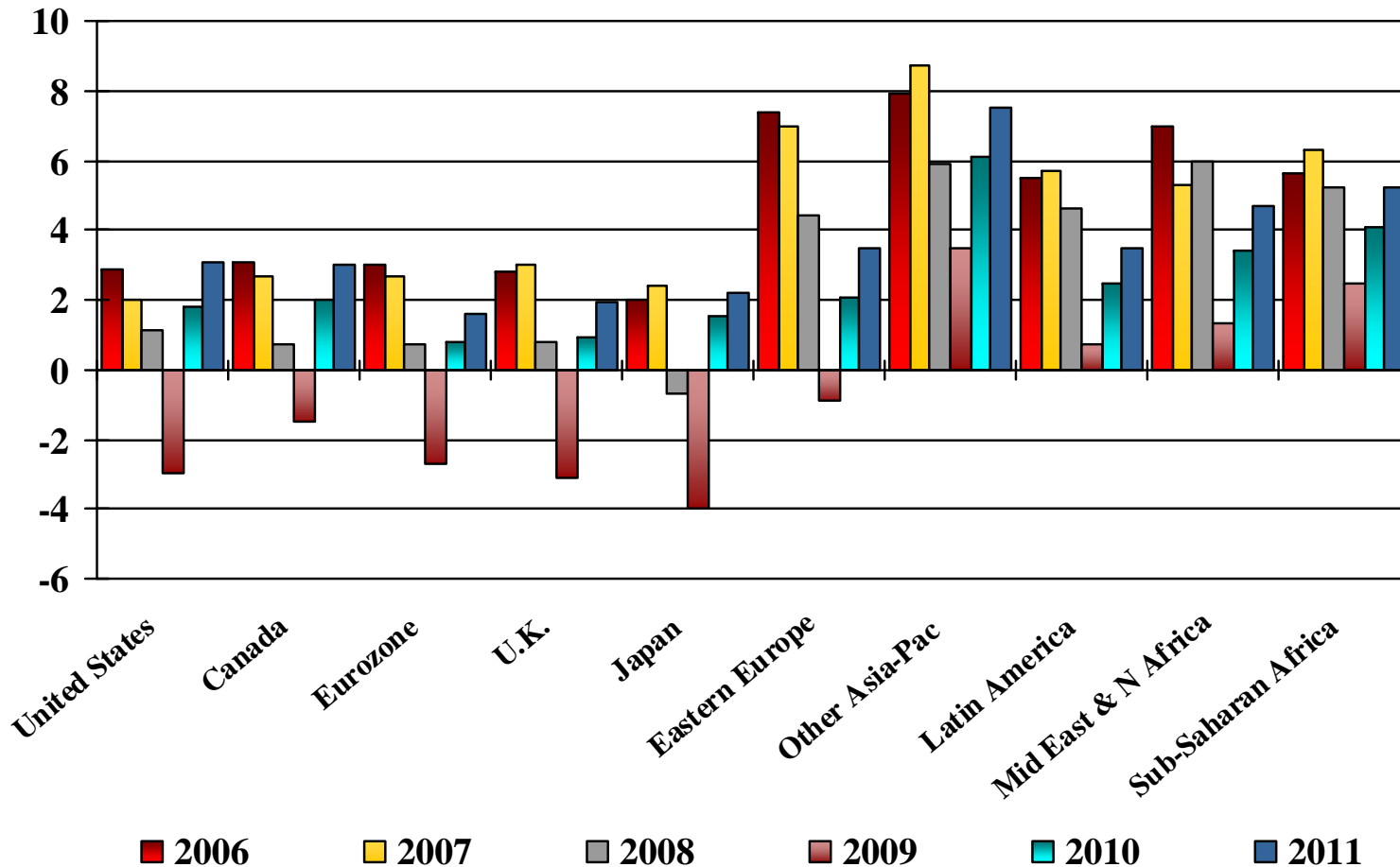
# The World Is In Recession

---

- **Industrial countries are in recession**
- **Declines in the US, Japan, and Europe and weakness in Asia**
- **The train has more engines attached**
- **And the world is thus less dependent on US growth**
- **We expect a slowdown in world growth, to 1.3% in 2009 from 3.8% in 2007**
- **The most synchronized world recession in recent memory**

# World Growth Has Slowed

(Real GDP, % change)

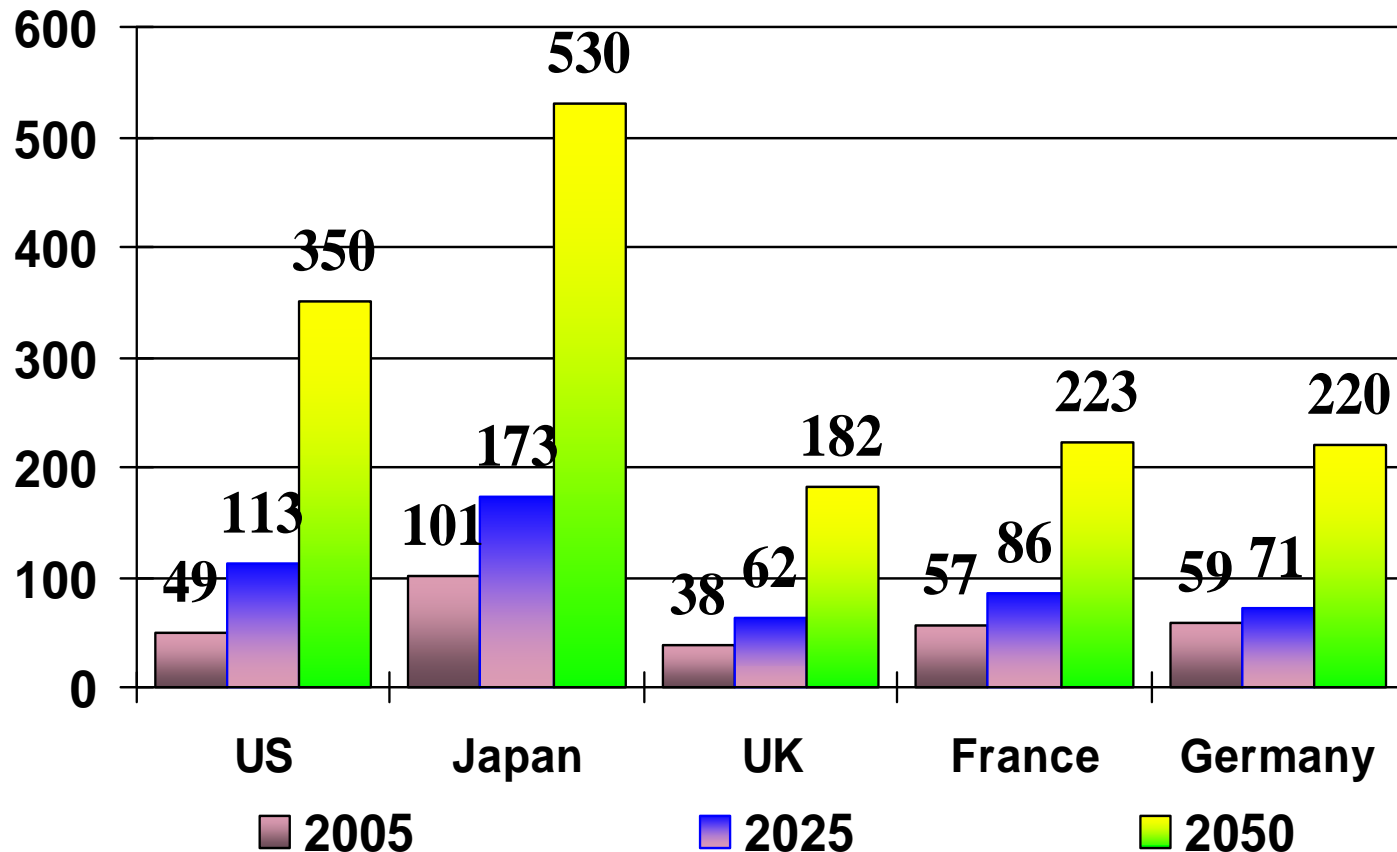


Source: Global Insight and S&P

CONFIDENTIAL AND PROPRIETARY.

# The Future Looks Bleak

(Government debt as % of GDP)

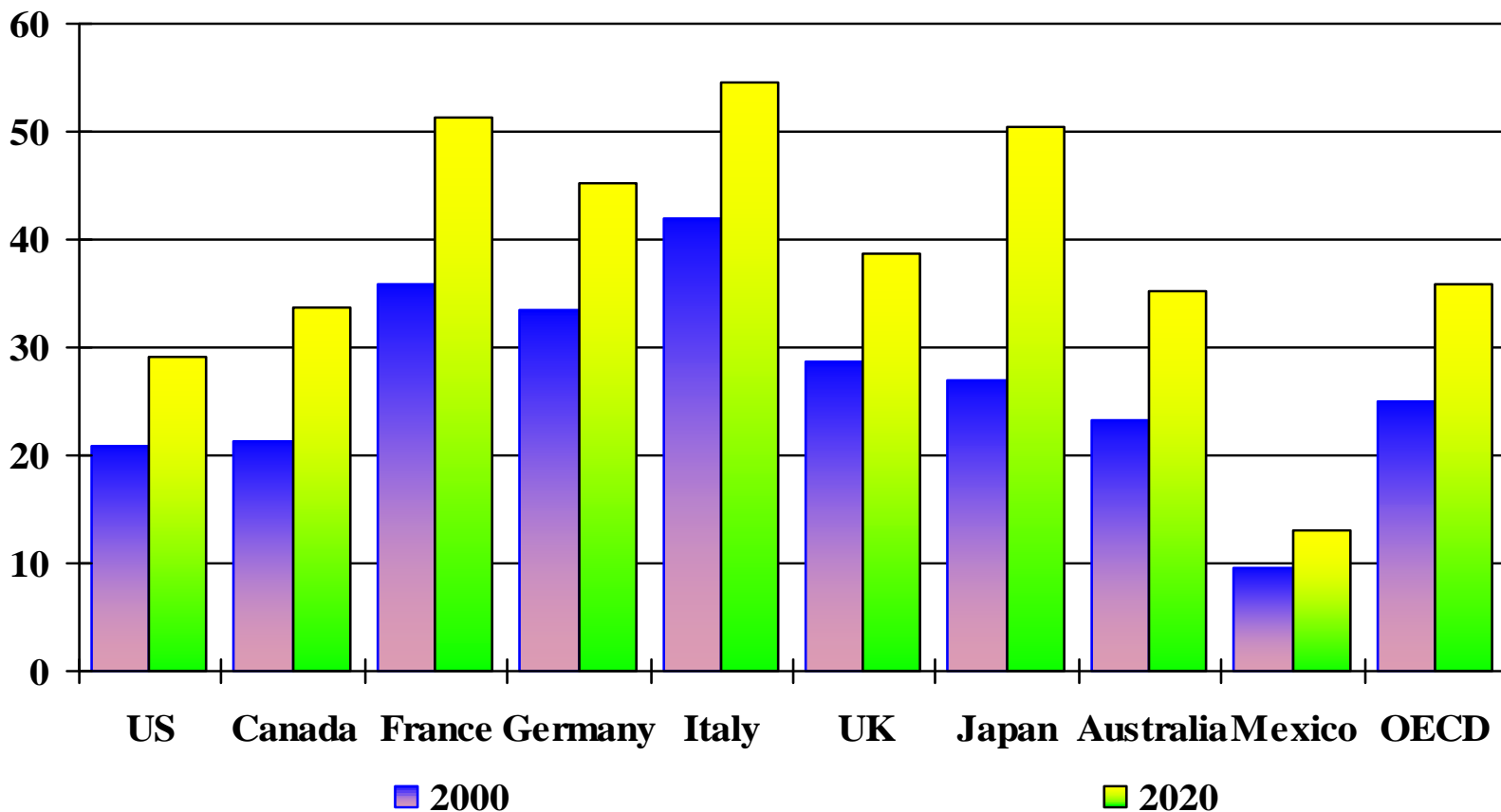


Source: S&P, 2007

CONFIDENTIAL AND PROPRIETARY.

# Aging Populations Will Boost Government Spending

(Ratio of over 65 population to labor force)

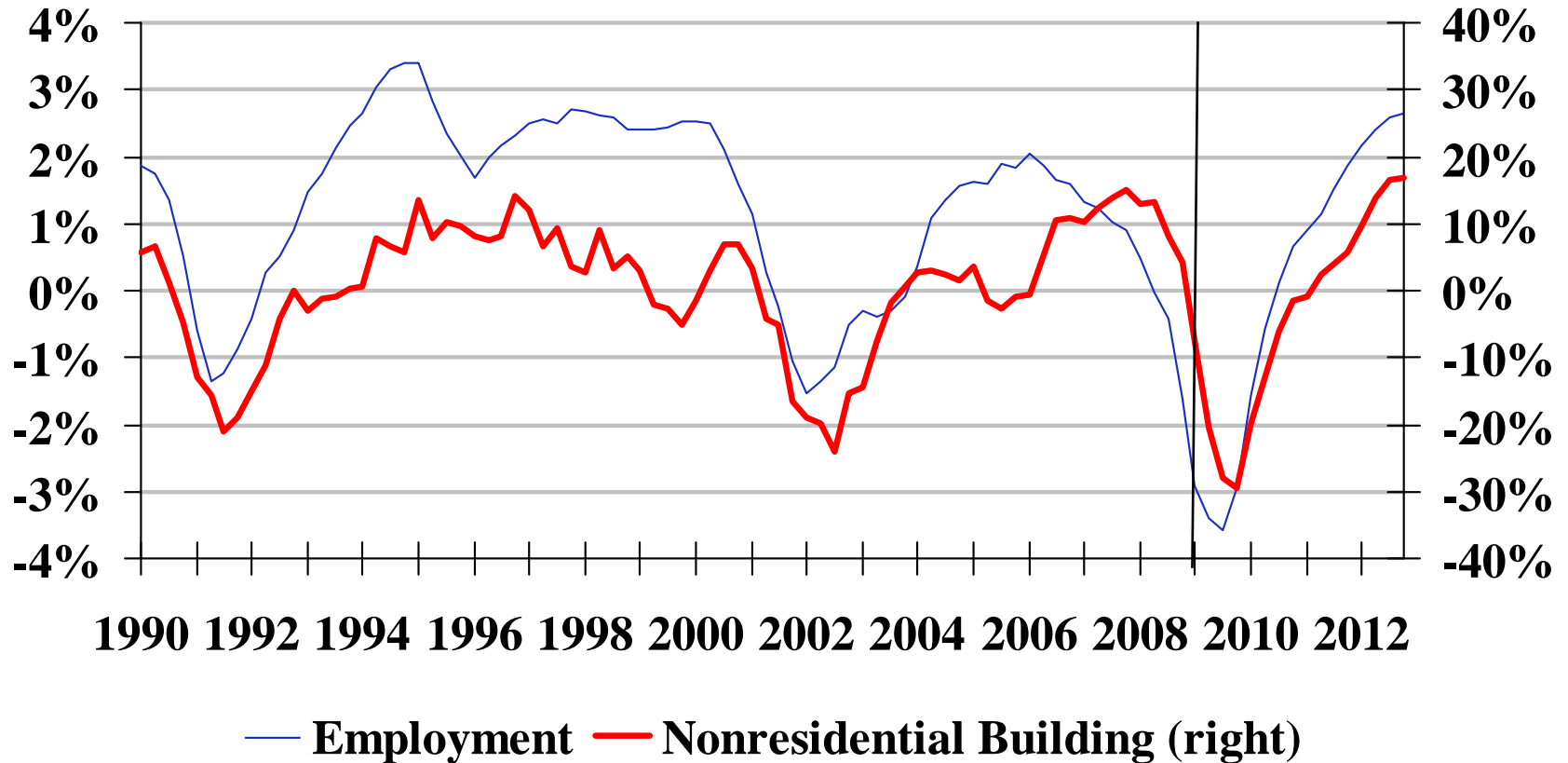


Source: OECD

CONFIDENTIAL AND PROPRIETARY.

# Weaker Employment Is Hurting Construction

(4-quarter percent change)

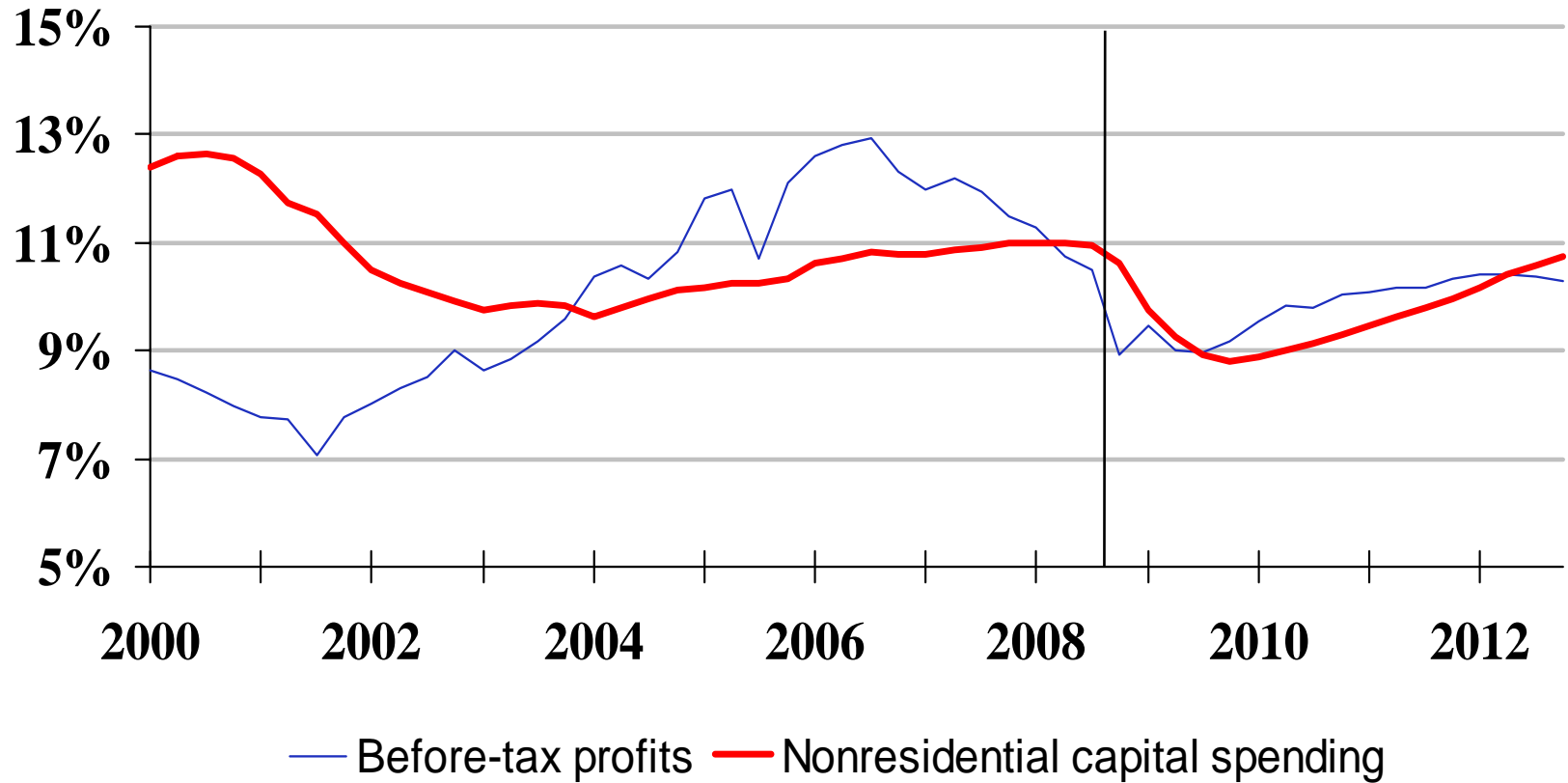


Source: BLS, BEA

CONFIDENTIAL AND PROPRIETARY.

# Nonfinancial Profits Remain High

(Percent of GDP)



Source: BEA

CONFIDENTIAL AND PROPRIETARY.

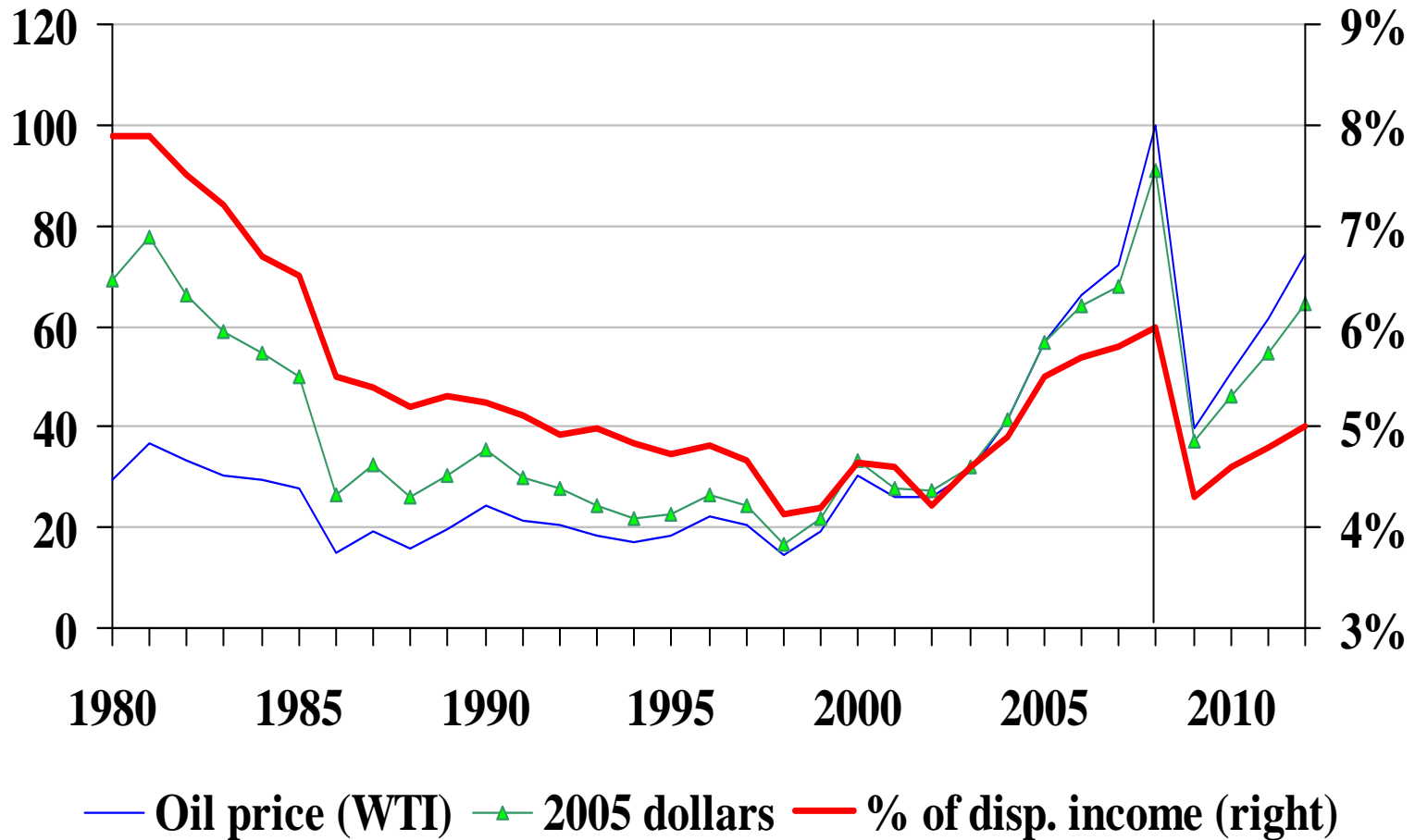
# Can the Consumer Keep Spending?

---

- **Consumer spending has led the expansion**
- **But wealth is down because home prices are dropping and**
- **Stocks are weak**
- **Borrowing is more difficult, and home equity loans much less available**
- **Confidence has dropped and unemployment risen**
- **Consumers are likely to save more**
- **Rebates will provided some quick cash**
- **Most of which has been spent**
- **And falling oil prices give back some purchasing power**

# Oil Prices Hit New Records

(\$/barrel, WTI and deflated by CPI;  
household energy purchases as percent of disposable income)

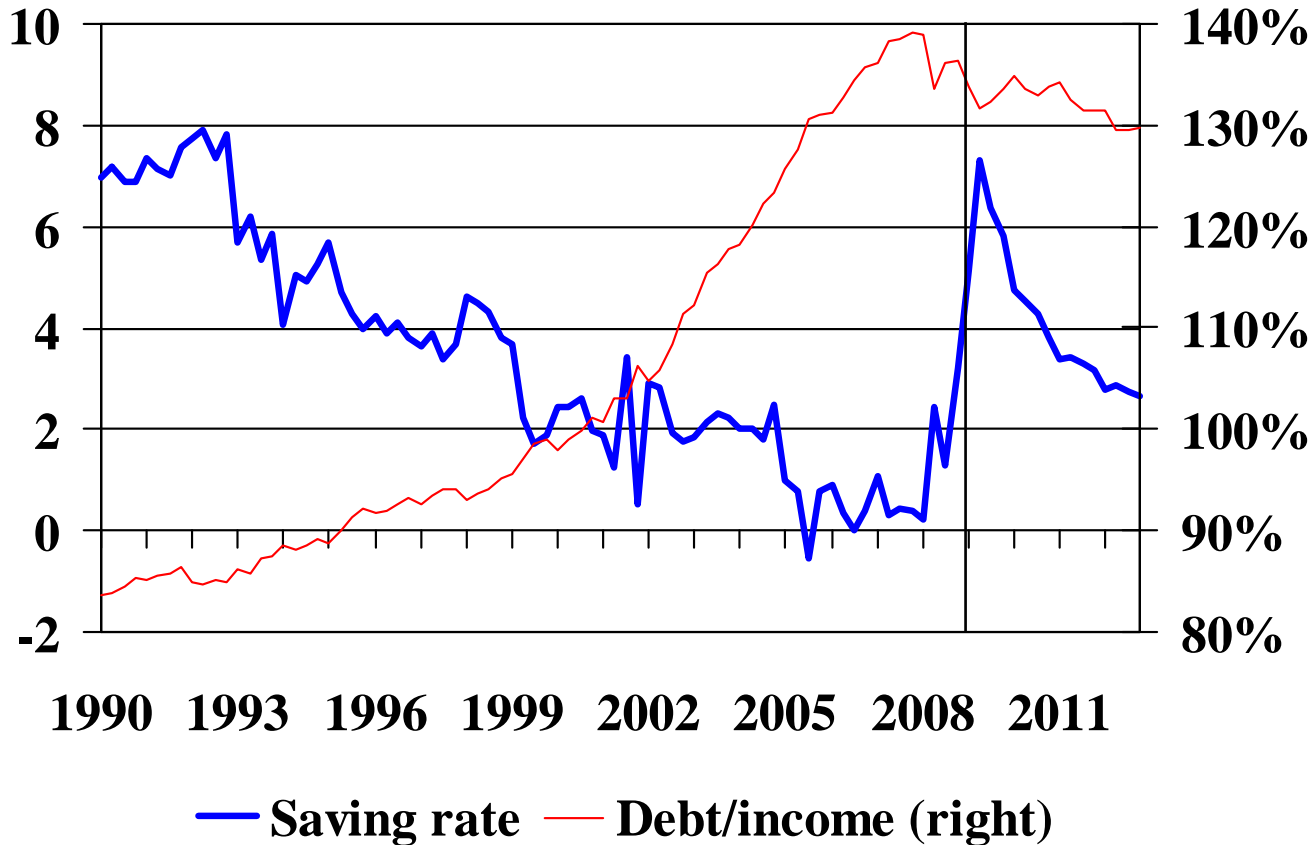


Source: BEA

CONFIDENTIAL AND PROPRIETARY.

# No Savings, But Lots of Debt

(Percent of after-tax income)

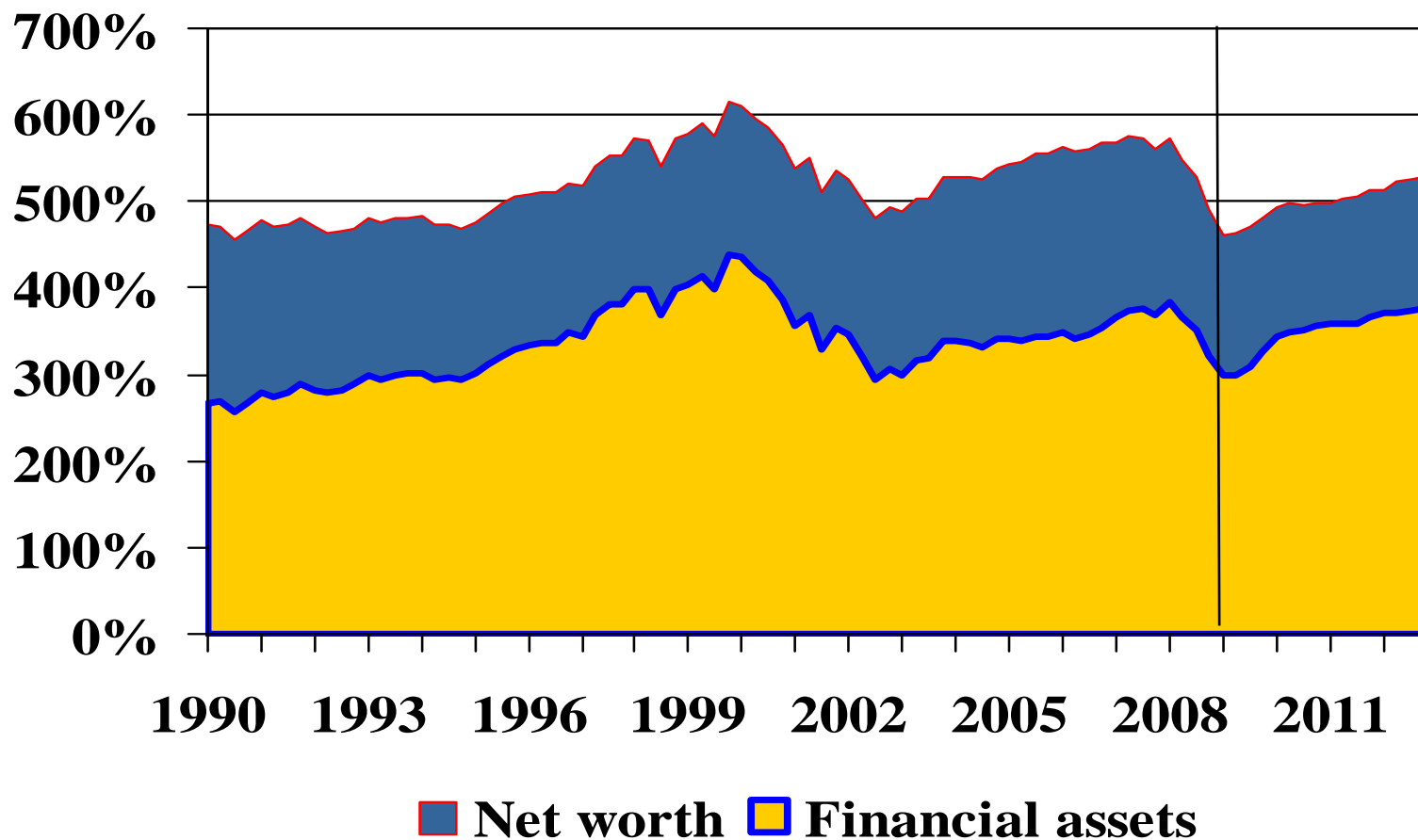


Source: BEA and Federal Reserve

CONFIDENTIAL AND PROPRIETARY.

# Wealth Slides With Home Prices

(Percent of after-tax income)

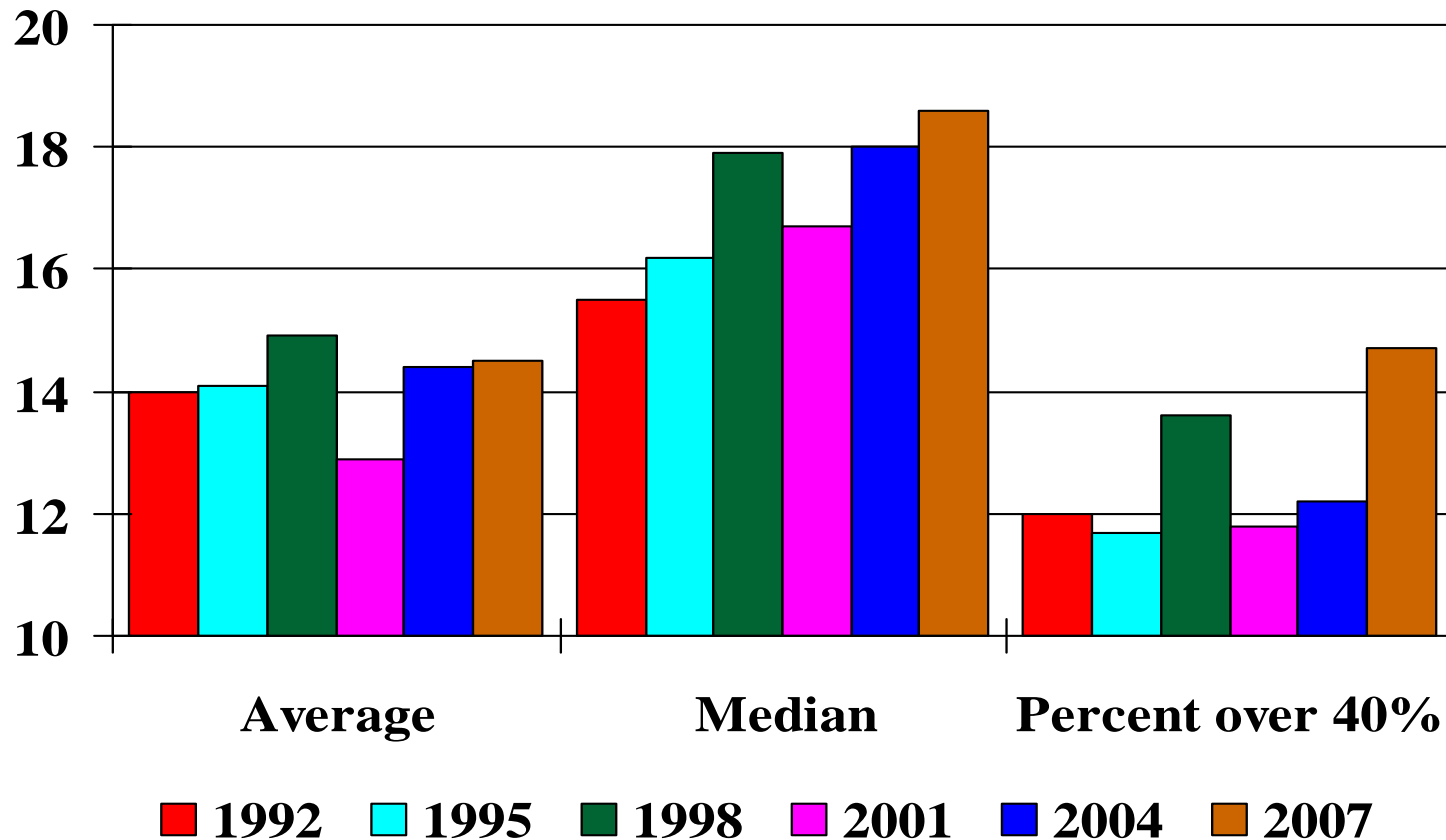


Source; Federal Reserve

CONFIDENTIAL AND PROPRIETARY.

# Debt Burdens Have Risen

(Debt repayment as percent of disposable income and percent of households with debt service over 40% of income)



Source: SCF

CONFIDENTIAL AND PROPRIETARY.

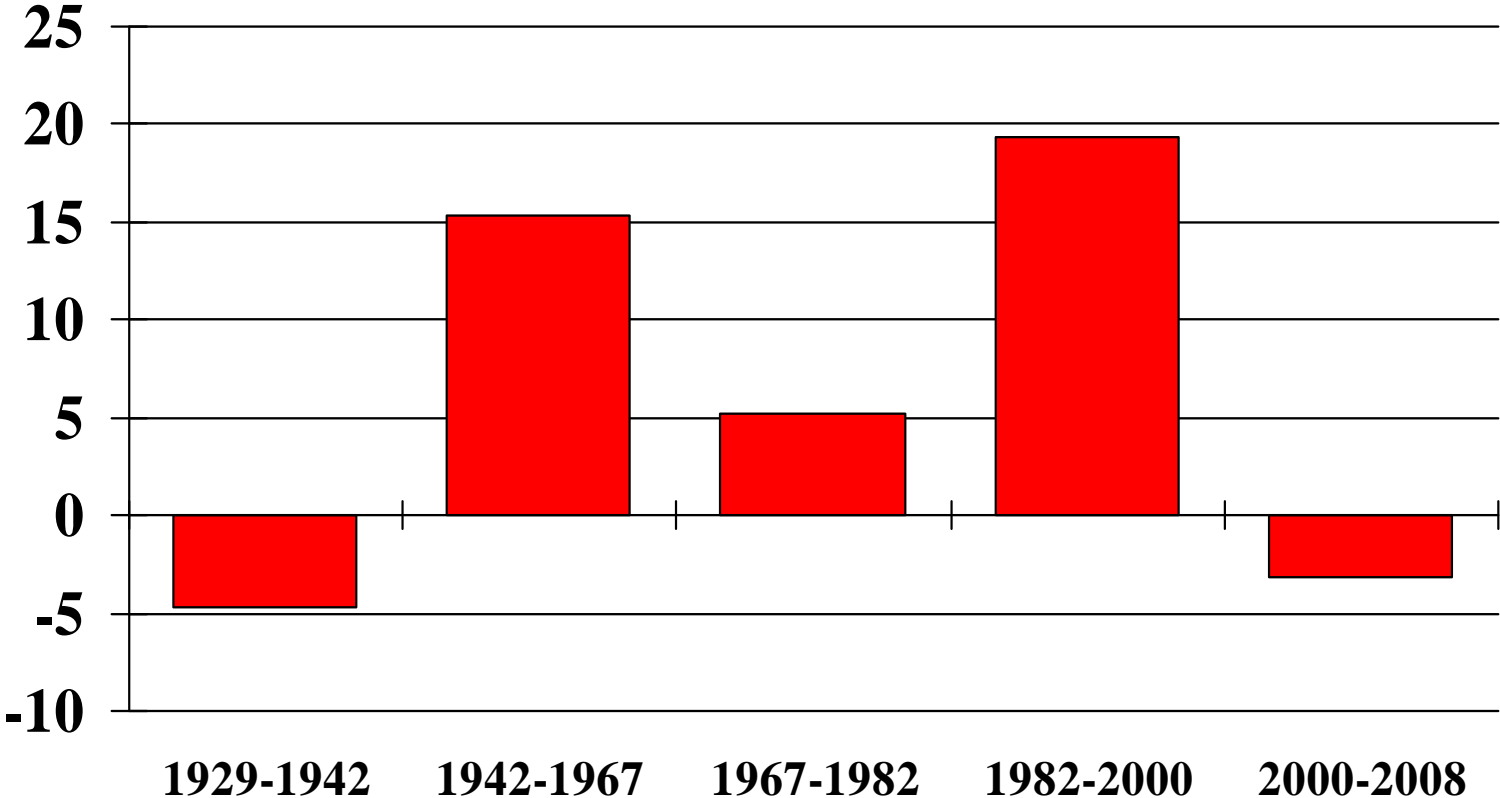
# Bigger Than The Average Bear

---

- **A great run from 1982 to 2000**
- **But the secular bear began in 2000**
- **Two largest bear markets since the depression**
- **Earnings were negative in Q4 for first time in history**
- **Stocks were overdue for a correction**
- **We think the market will improve, but slowly.**
- **The current long-term cycle may have another bear in it, however.**

# Stocks Cycle

(Annualized total return, S&P 500)



Source: S&P

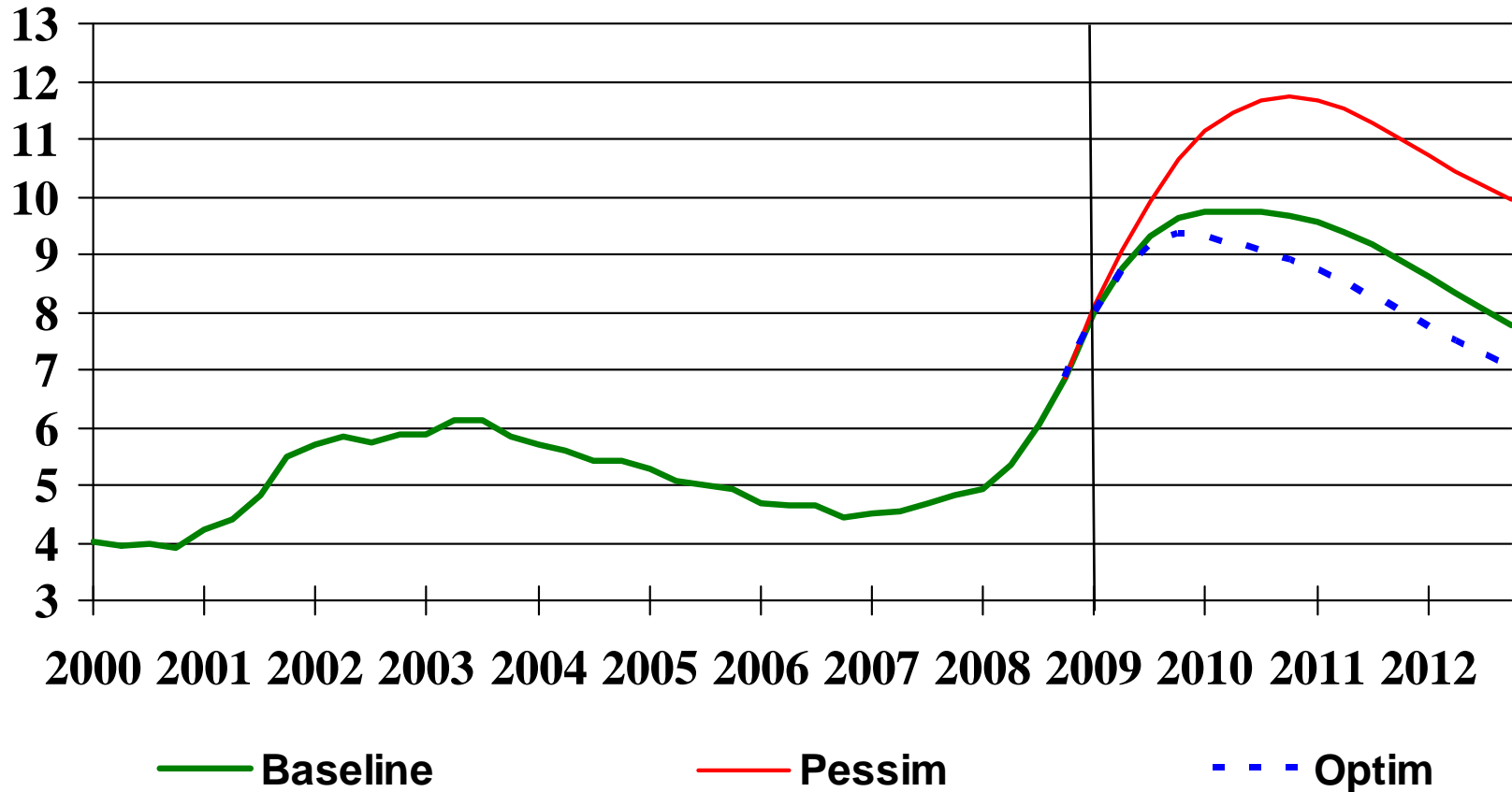
CONFIDENTIAL AND PROPRIETARY.

# **Bottom Line: The Economy Will Recover Slowly**

- **The recession is expected to be the longest and deepest since the 1930s**
- **Fiscal stimulus support the recovery**
- **But it is likely to be slow because of financial markets and switch top higher savings**
- **If financial markets remain locked up**
- **Home prices continue to fall**
- **And oil prices continue to rise**
- **The recession could be longer and deeper**
- **With the risk of a “lost decade” similar to Japan in the 1990s**

# Risks to the Economy

(Unemployment rate)



Source: BLS, S&P projections

CONFIDENTIAL AND PROPRIETARY.

# STANDARD & POOR'S

---

Analytic services and products provided by Standard & Poor's are the result of separate activities designed to preserve the independence and objectivity of each analytic process. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during each analytic process.