

***The U.S. Outlook:  
Credit Crunched***

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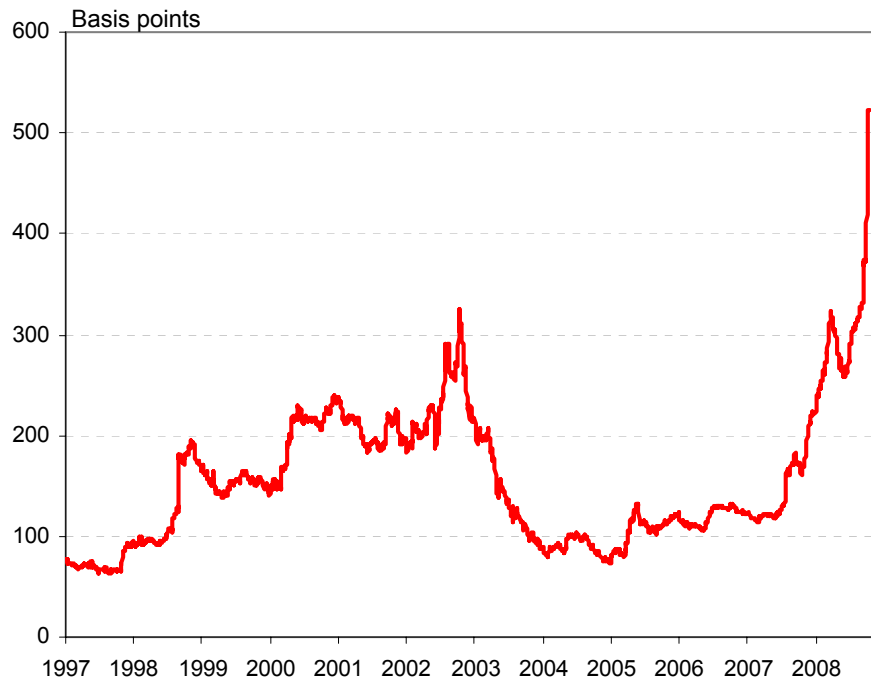
October 2008

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# Credit Conditions: The Dominant Forecast Factor

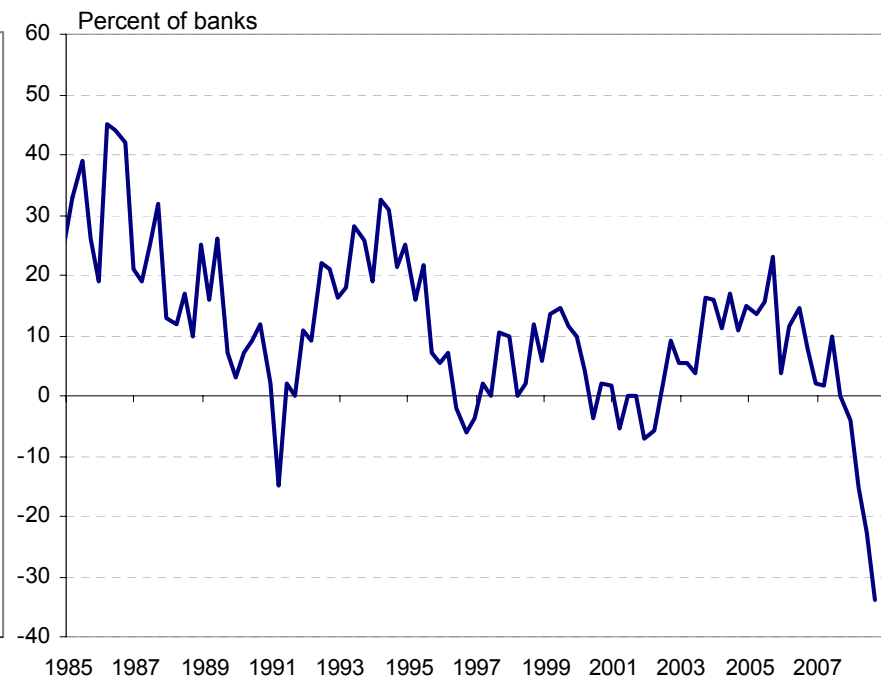
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Corporate Yield Spread  
(BBB\* less Treasury)



\* Merrill Lynch index.

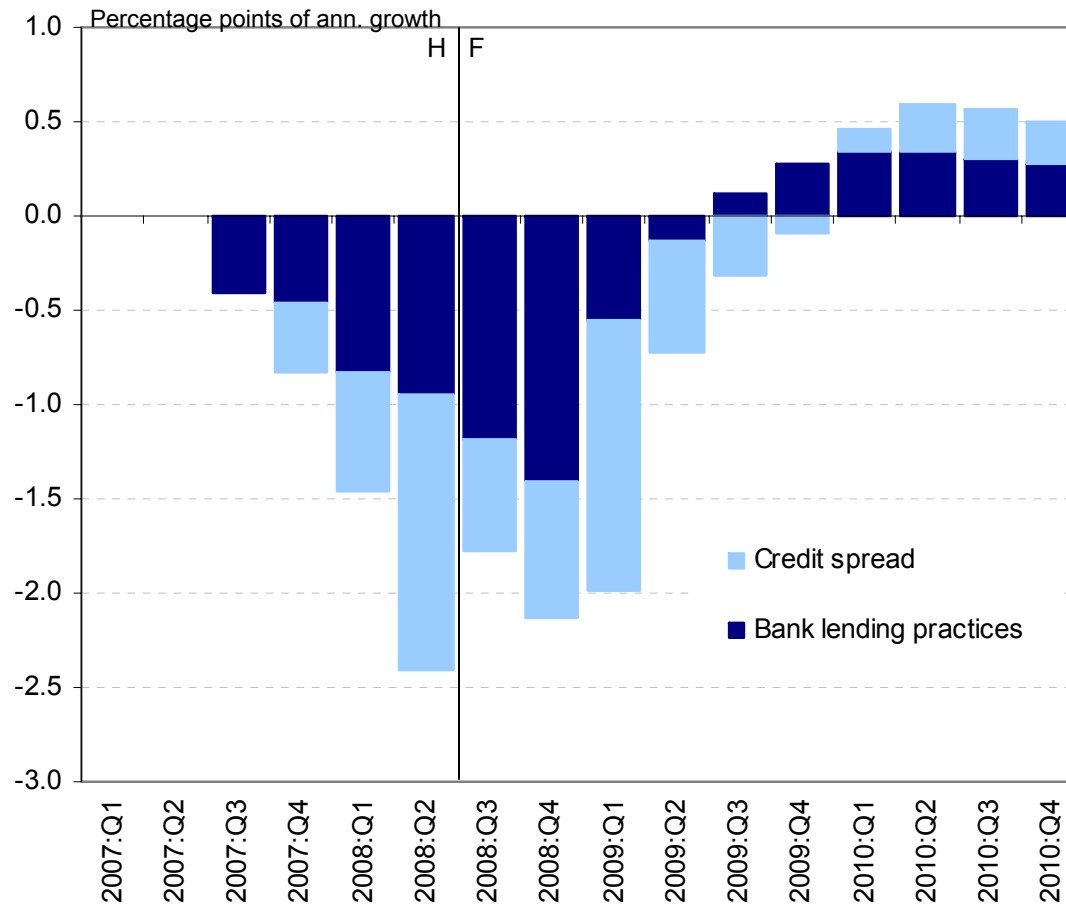
Banks' Willingness to Lend\*  
(Senior Loan Officer Survey)



\* Share of institutions more (positive) or less (negative) willing to make consumer installment loans.

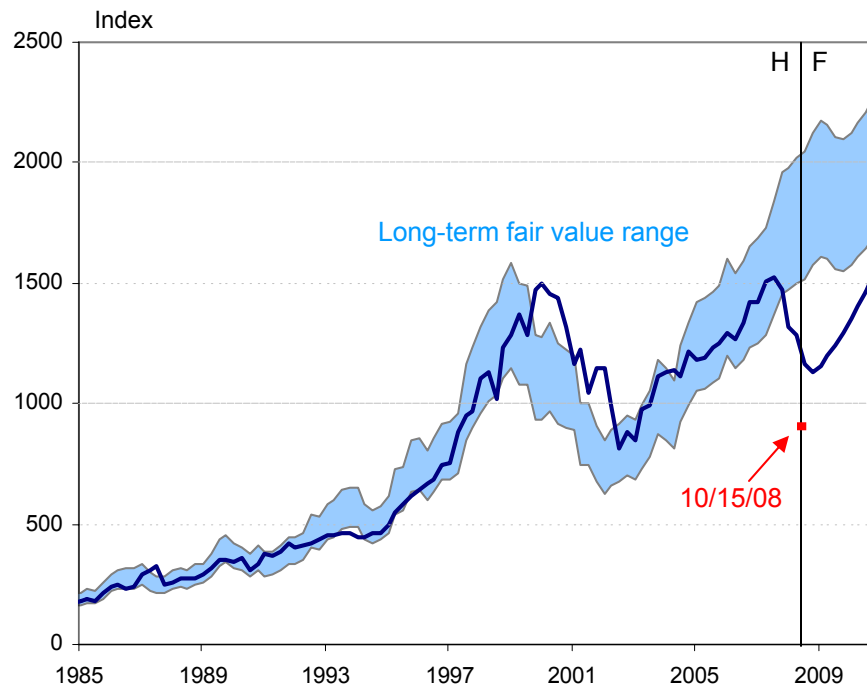
# Credit Conditions: Substantial Restraint on GDP

## Effects of Credit on Consumption Growth

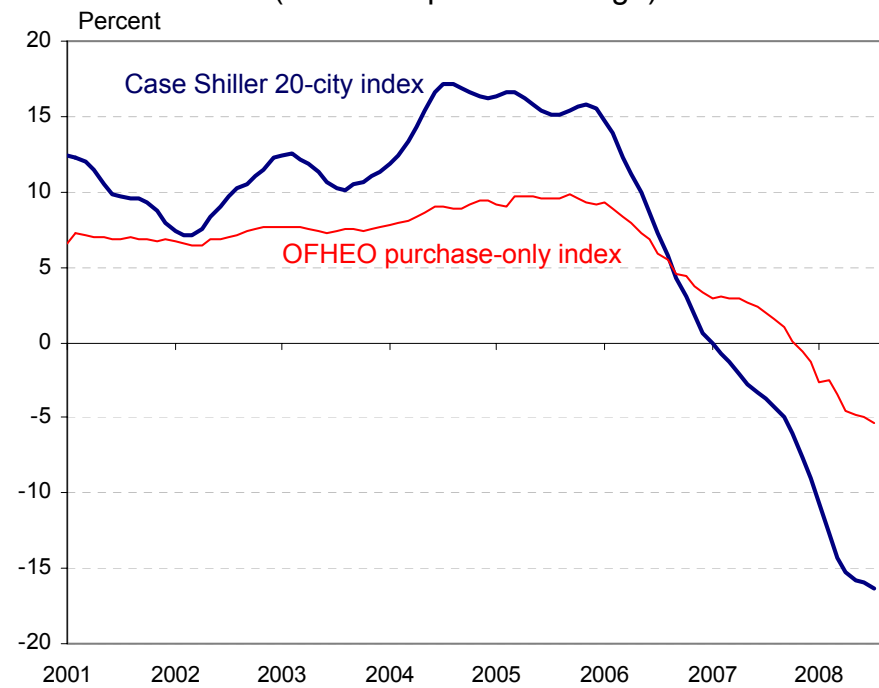


# Asset Prices: Significant Deflation

## S&P 500 Index

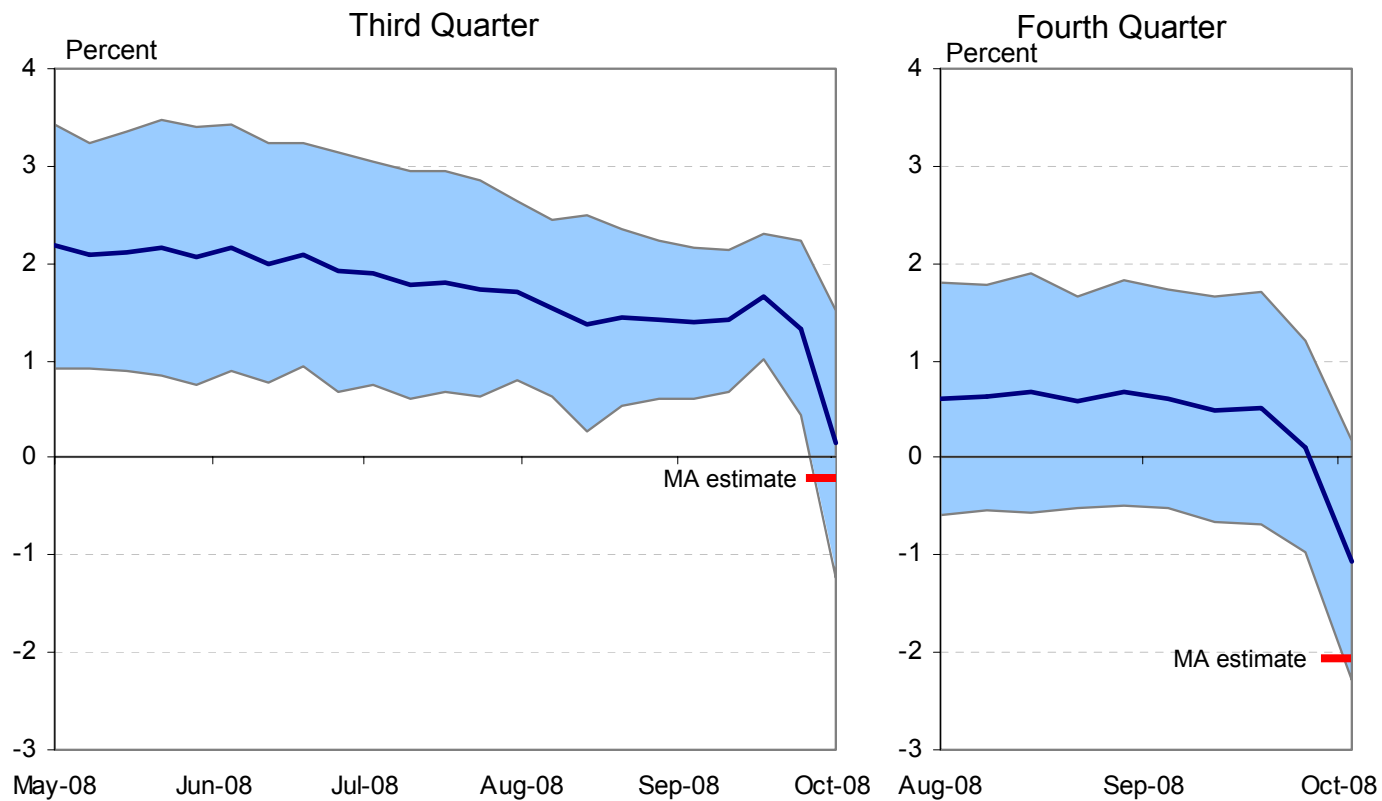


## House Price Indexes (12-month percent change)



# Near-term Outlook: Discrete Shift

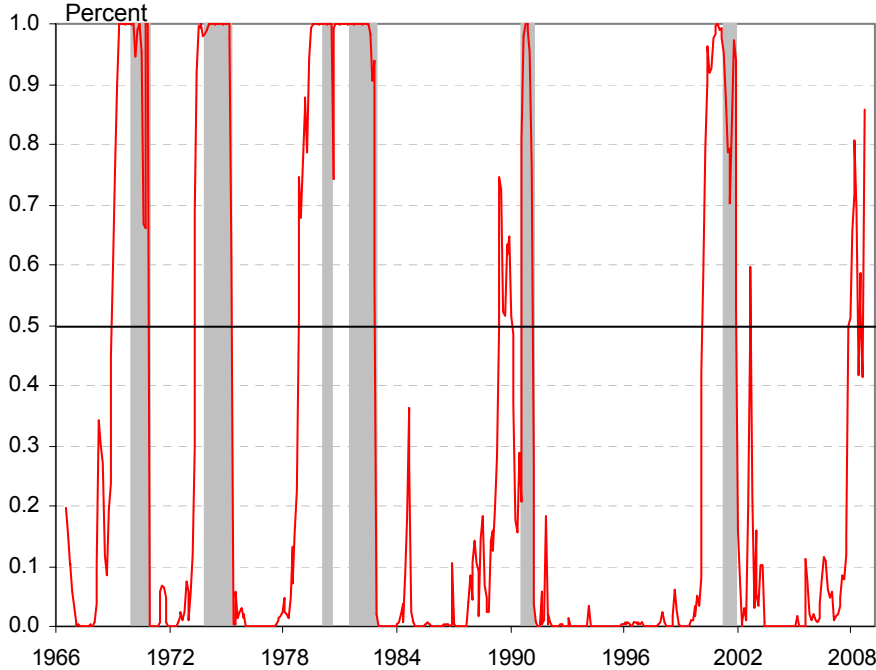
## Projections of Real GDP Growth\*



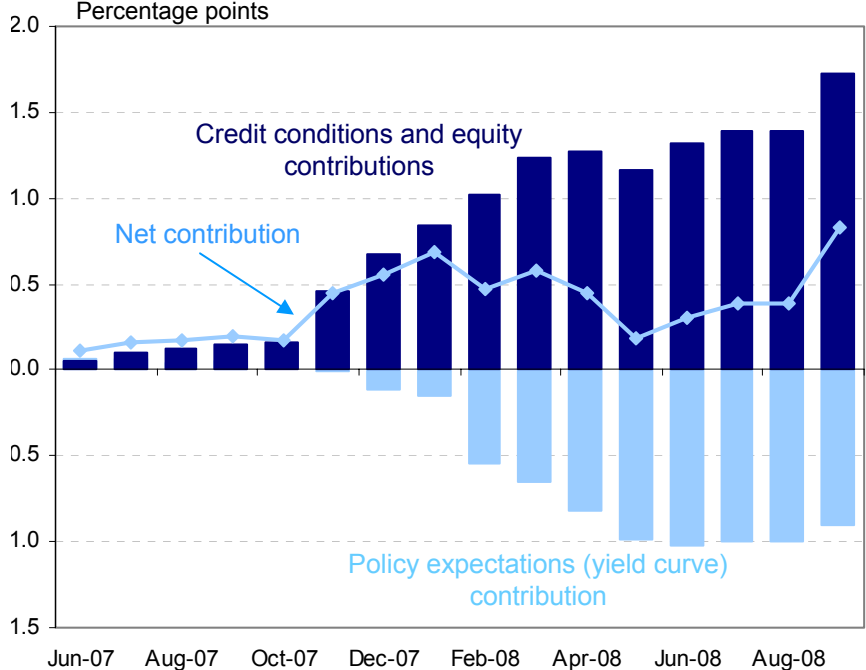
\*Projections are from MA's Consensus Panel, October 6, 2008, as reported in the Weekly Economic Commentary.

# Recession Probability: High

Probability of a Recession in the Next 12 Months

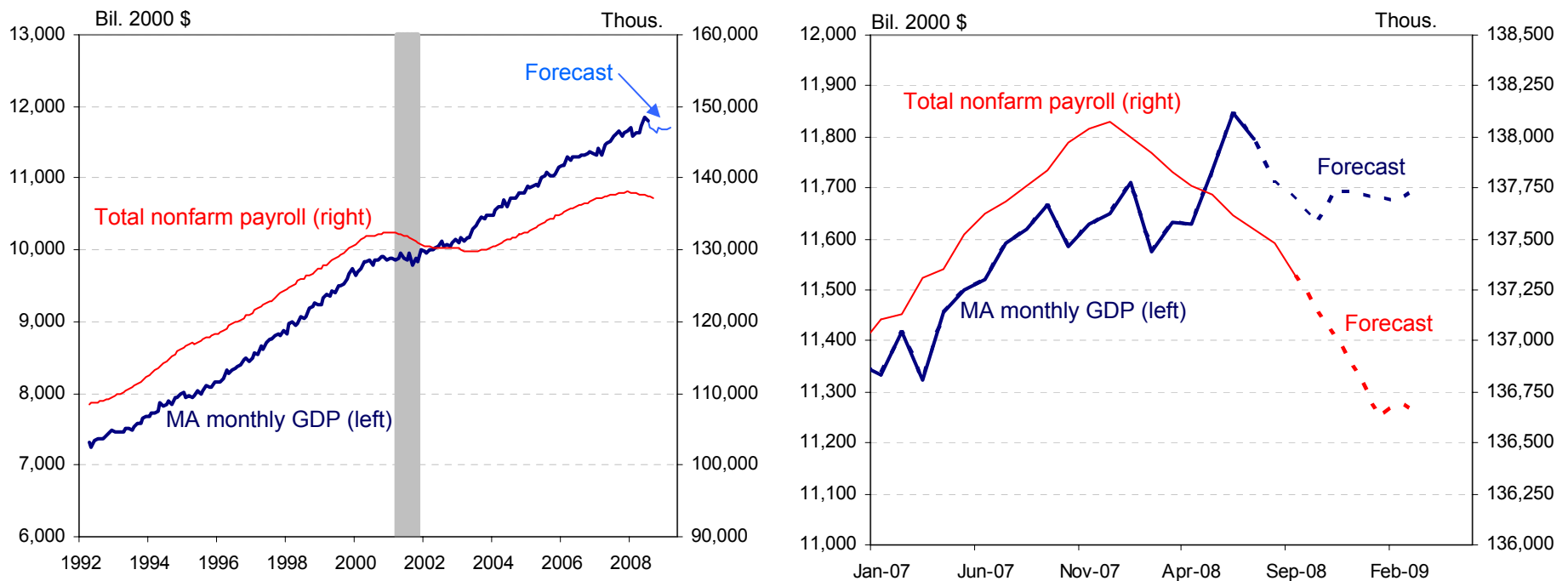


Marginal Contribution to Recession Probability



# Recession Dating: December or June Peak?

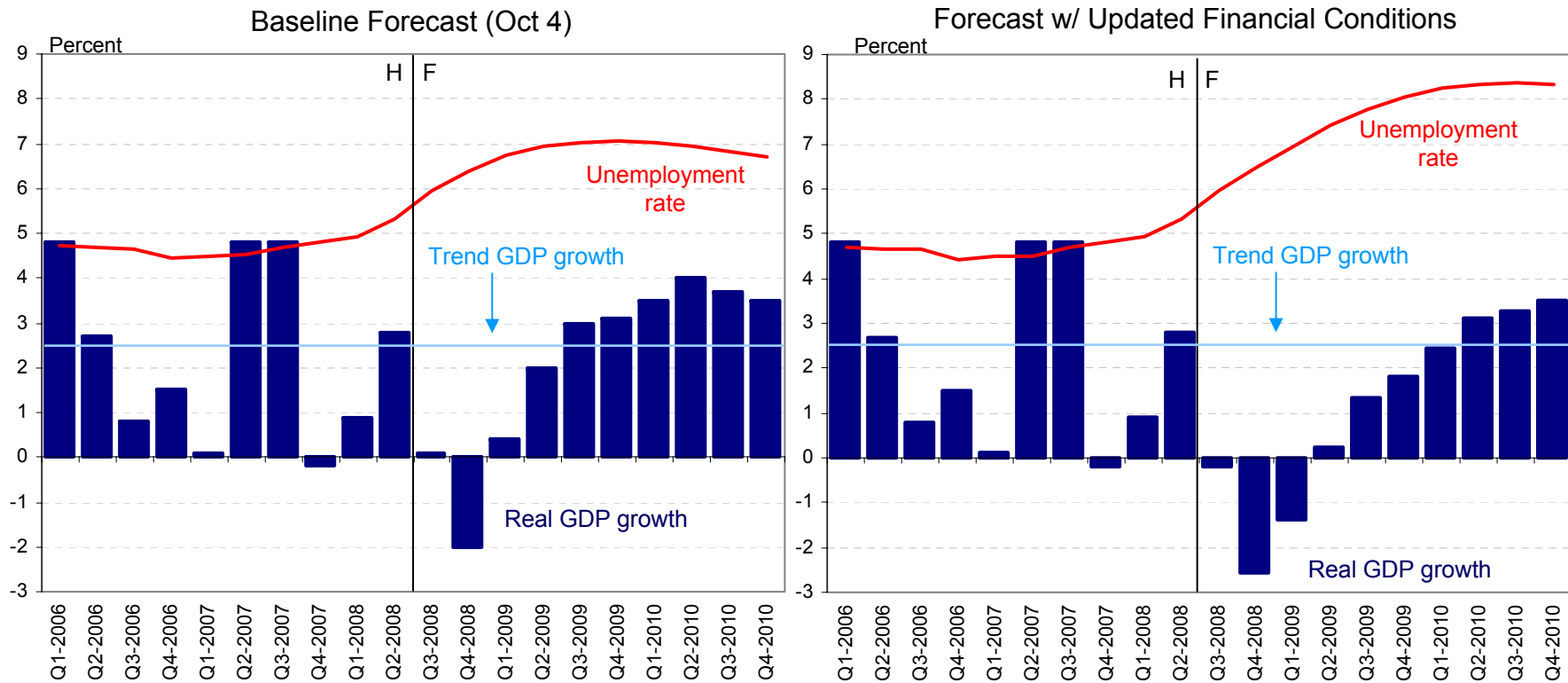
## Monthly GDP and Payroll Employment



Macroeconomic Advisers forecast prepared October 4, 2008

# MA Forecast: Recession Now, Recovery Later

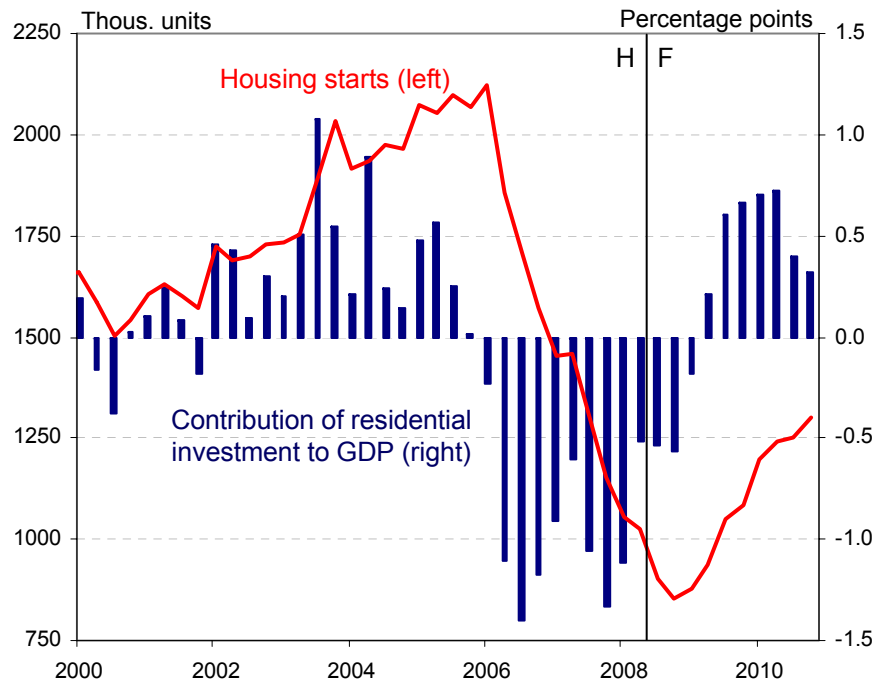
## Real GDP Growth and the Unemployment Rate



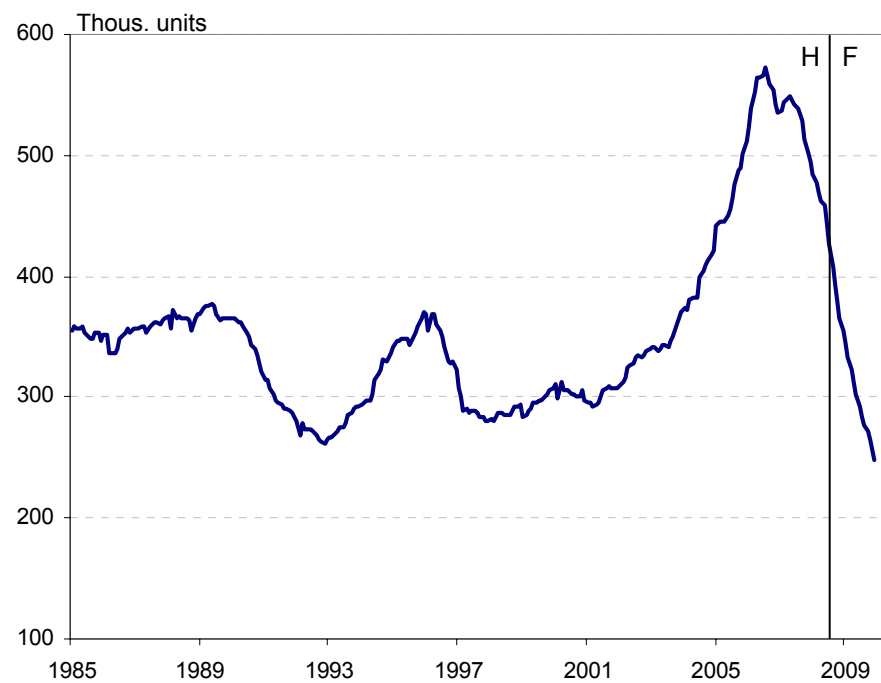


# Housing Construction: In Search of a Bottom

## Housing Activity

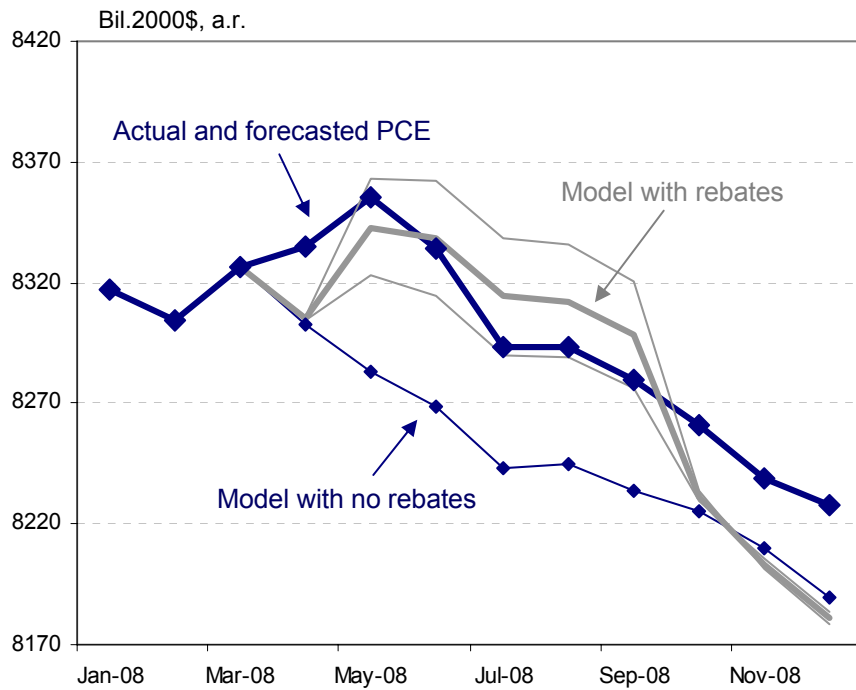


## Inventory of Homes For Sale (New Single Family)

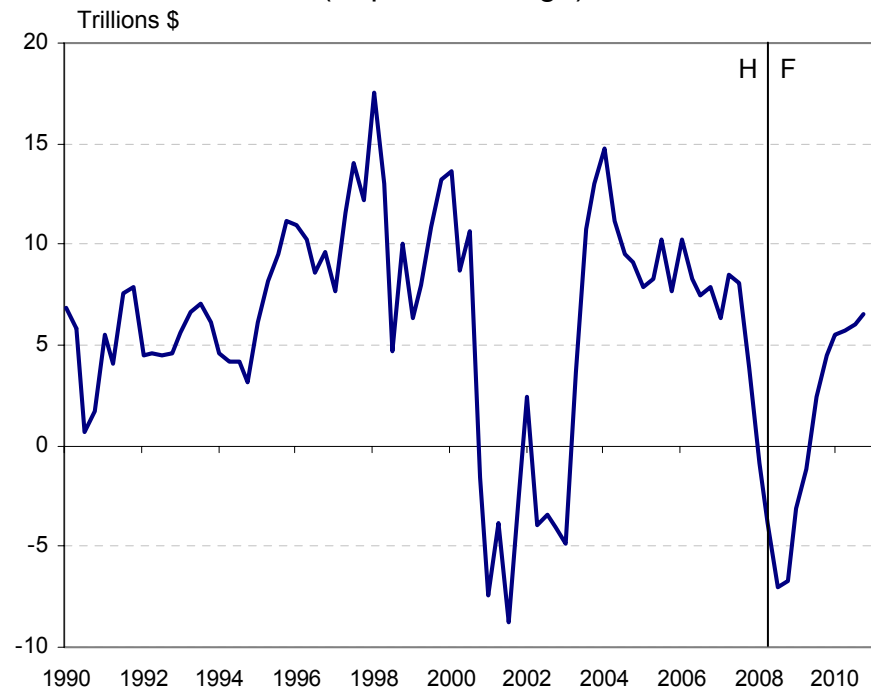


# Consumer Spending: Substantial Drags

## Projections for Consumer Spending

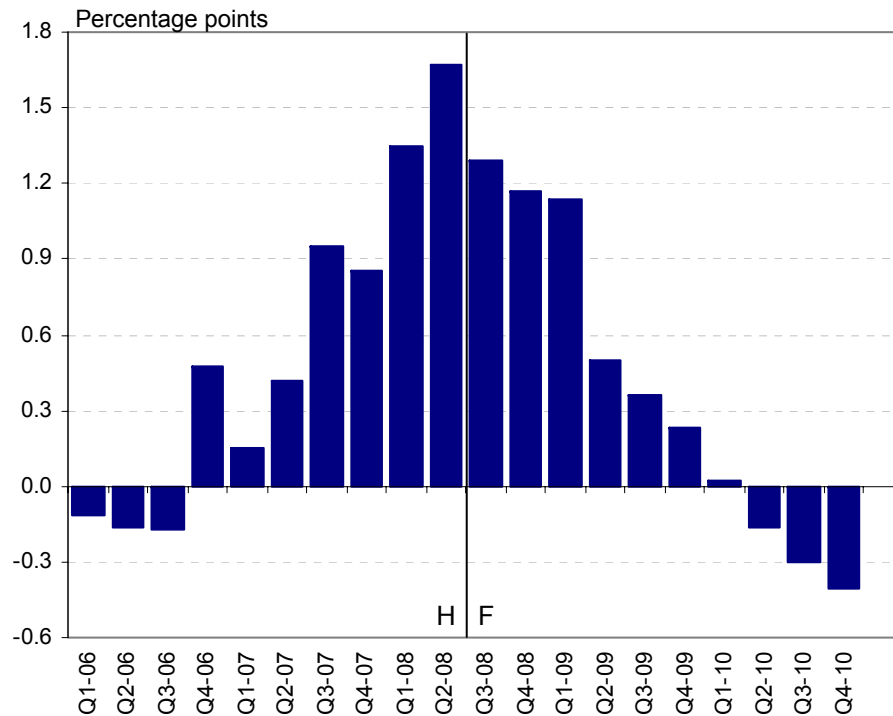


## Household Net Worth (4-quarter change)



# Net Exports: Diminishing Boost to GDP

Net Export Contribution to GDP Growth  
(4-quarter moving average)



Global GDP Growth  
(Year-over-year measures)

	2008	2009
	<b>MA/IMF</b>	
US	1.5/1.6	0.8/0.1
	<b>OE*/IMF</b>	
Euro	1.3/1.3	0.8/0.2
Japan	1.0/0.7	1.0/0.5
China	10.2/9.7	8.8/9.3
Brazil	4.8/5.2	4.0/3.5
World**	4.0/3.9	3.5/3.0

\*Oxford Economics.

\*\*On a PPP basis.

# MA Forecast Details

Q4/Q4 %Δ or annual avg.

	2008				2009				2010				2007	2008	2009	2010
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	4/4	4/4	4/4	4/4
<b>Real gross domestic product</b>	0.9	2.8	0.1	-2.0	0.4	2.0	3.0	3.1	3.5	4.0	3.7	3.5	2.3	0.4	2.1	3.7
Final sales to dom. purchasers *	0.1	1.4	-2.0	-2.0	0.2	1.3	2.1	2.9	3.5	4.0	3.7	3.6	1.6	-0.6	1.6	3.6
Net exports of goods & services*	0.8	2.8	0.6	0.4	0.6	0.4	0.1	0.0	-0.1	-0.3	-0.4	-0.4	0.9	1.1	0.3	-0.3
Change in private inventories*	-0.1	-1.4	1.5	-0.5	-0.4	0.3	0.7	0.2	0.1	0.4	0.4	0.3	-0.2	-0.1	0.2	0.3
<b>Major components of real GDP</b>																
Consumption	0.9	1.2	-2.5	-2.2	0.4	1.3	1.5	2.3	2.8	3.2	3.2	3.3	2.2	-0.7	1.4	3.1
Nonresidential fixed investment	2.4	2.5	-3.1	-3.1	-3.6	-1.8	1.0	3.2	5.4	7.4	7.8	8.0	6.4	-0.4	-0.3	7.1
Residential investment	-25.1	-13.3	-14.4	-16.1	-5.6	6.8	20.3	21.6	22.2	21.6	11.1	8.6	-19.0	-17.4	10.2	15.7
Gov't C&GI	1.9	3.9	2.9	2.4	2.4	1.9	1.8	1.7	1.6	1.6	1.5	1.5	2.4	2.8	1.9	1.6
<b>Civilian unemployment rate (%)**</b>	4.9	5.3	6.0	6.4	6.7	7.0	7.0	7.0	7.0	6.9	6.8	6.7	4.6	5.7	6.9	6.9

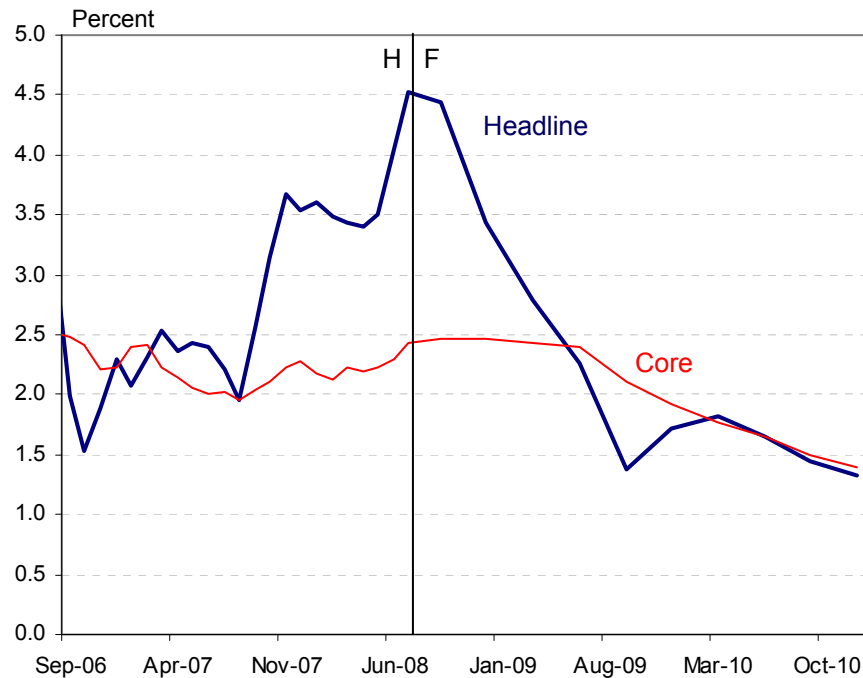
\*Contribution to real GDP growth, in percentage points

\*\*Average level over period, except in 4/4 column, which is the 4th-quarter level

Macroeconomic Advisers forecast prepared October 4, 2008

# Inflation: A Substantial Decline

PCE Inflation Rates  
(4-quarter measures)



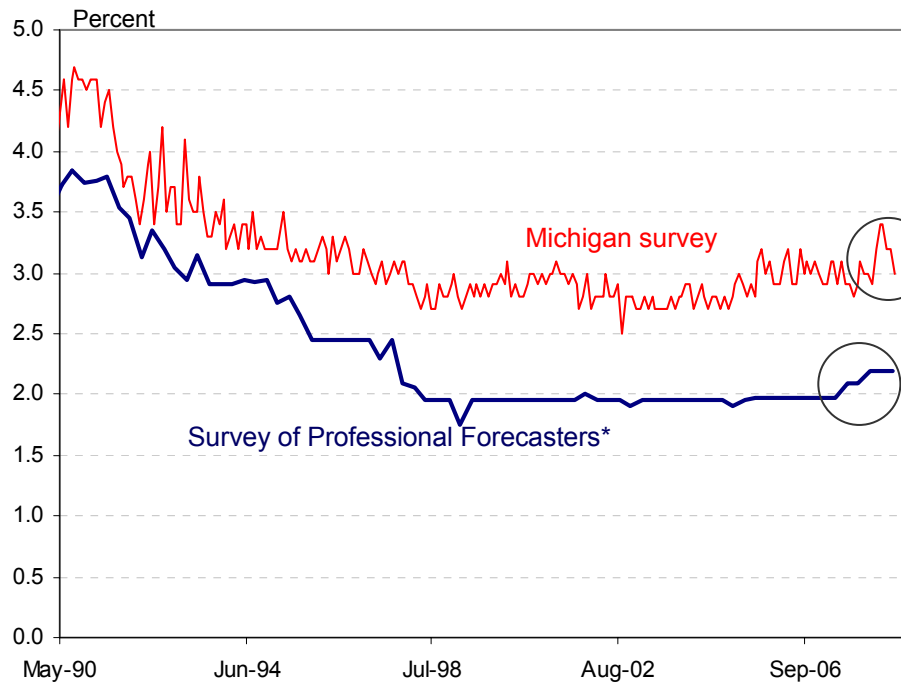
## Factors Affecting Inflation Outlook

	2008	2009	2010
Forecast for Core PCE	2.5	1.9	1.4
Effects from:			
Unemployment	-0.16	-0.58	-0.84
Import prices	+0.12	+0.05	-0.04
Energy prices	+0.15	+0.06	+0.04
Inflation Expectations	+0.07	+0.10	+0.07

Note: Effects measured from alternative simulation beginning in 2007

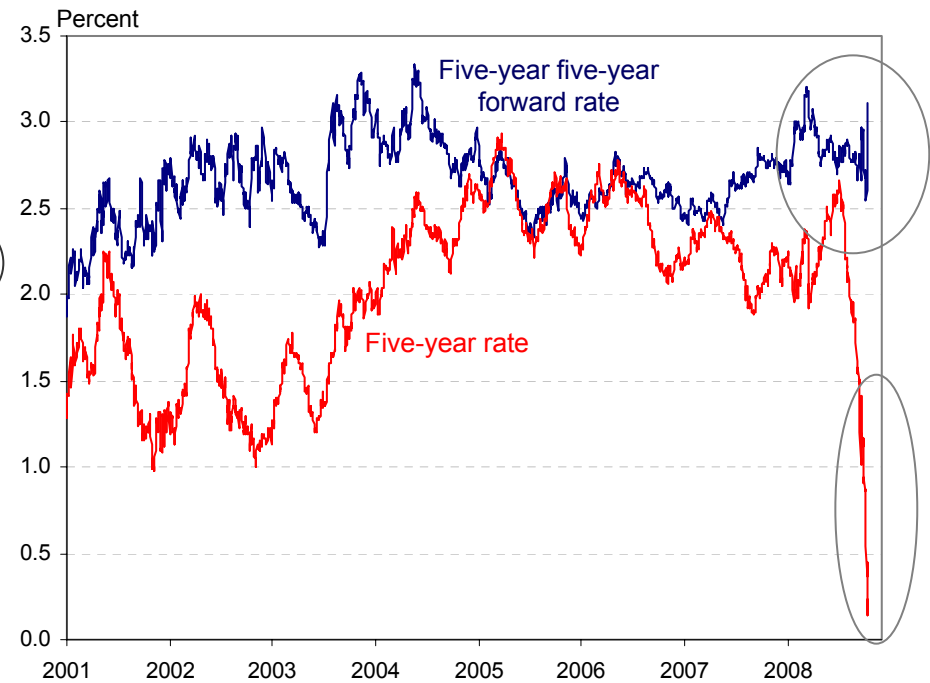
# Inflation Expectations: Fragile in Which Direction?

## Long-term Inflation Expectations (Survey Measures)



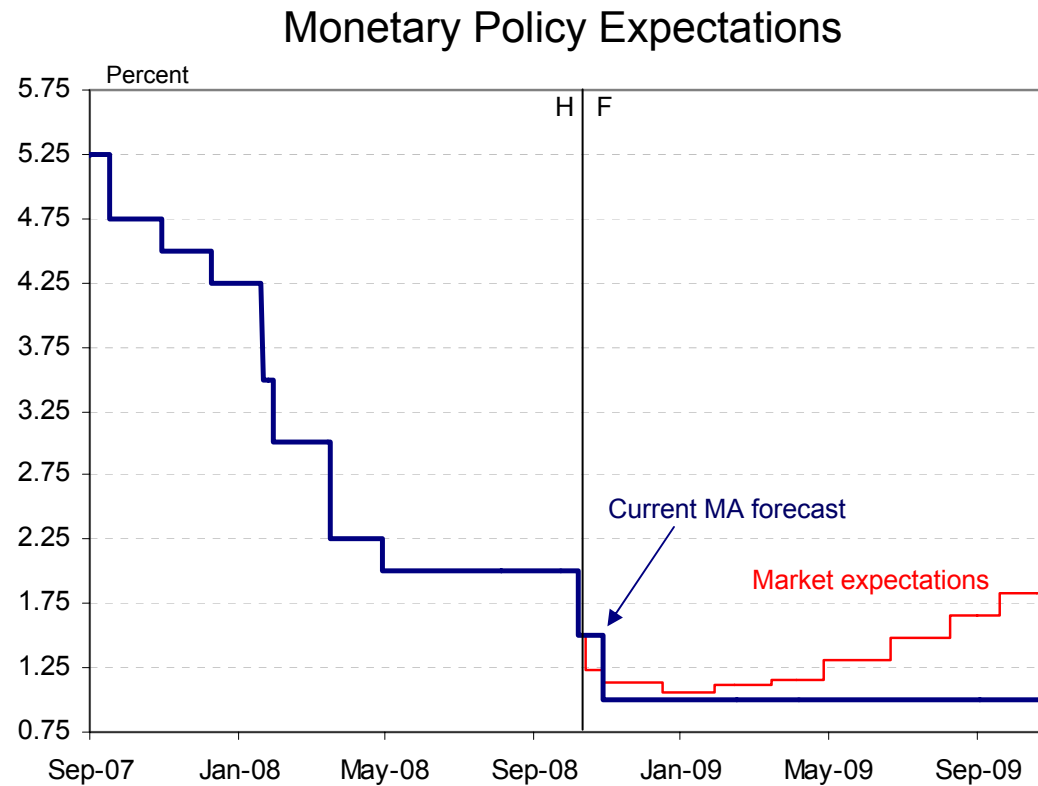
\*Constructed by MA based on SPF responses for period before February 2007.

## Breakeven Inflation Rates



# Monetary Policy Prospects: More Easing Ahead

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# Monetary Policy Easing: Overdue

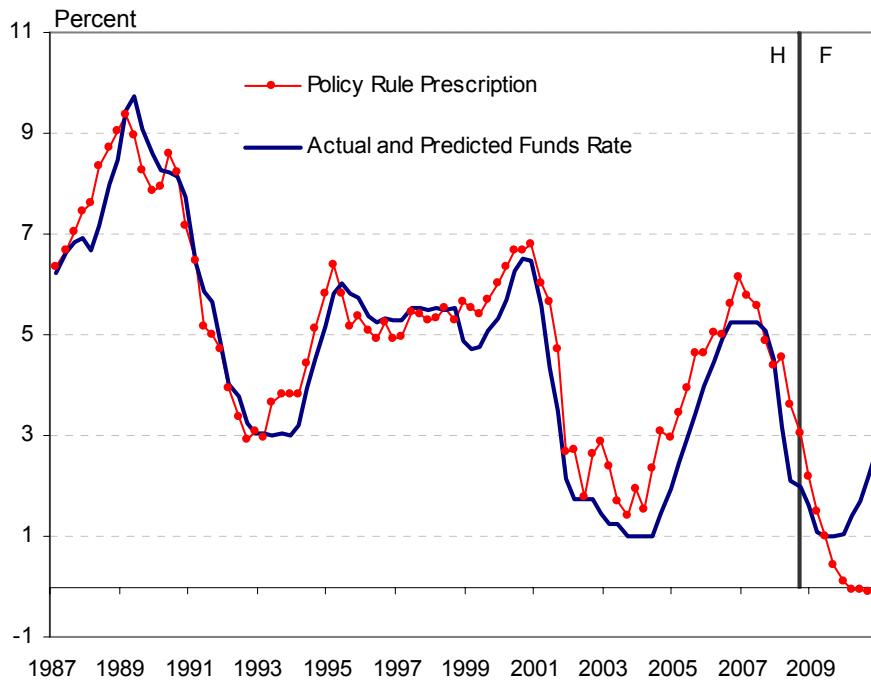
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	Fed Easing: 8/10/2007 to 4/30/2008	Fed Hold: 4/30/08 to 10/7/2008
<b>Equities (%)</b>		
Wilshire	-4.6%	-28.0%
<b>Currencies (%)</b>		
Broad Nominal Index	-7.0%	9.0%
<b>Yields (bp)</b>		
10-year Treasury Yield	-104	-27
<b>Spreads (bp)</b>		
BAA Corporate	80	152
High Yield Corporate	251	607
Libor	39	235
Conforming Mortgages	48	40
EMBI	65	248
<b>Bank Lending (index)</b>		
Willingness to Make Consumer Loans	-15.1	-34.0
<b>Inflation Factors</b>		
WTI Spot (\$)	42	-23
Commodity Index (%)	47.2%	-23.2%
5-year Breakeven Inflation (bp)	15	-165

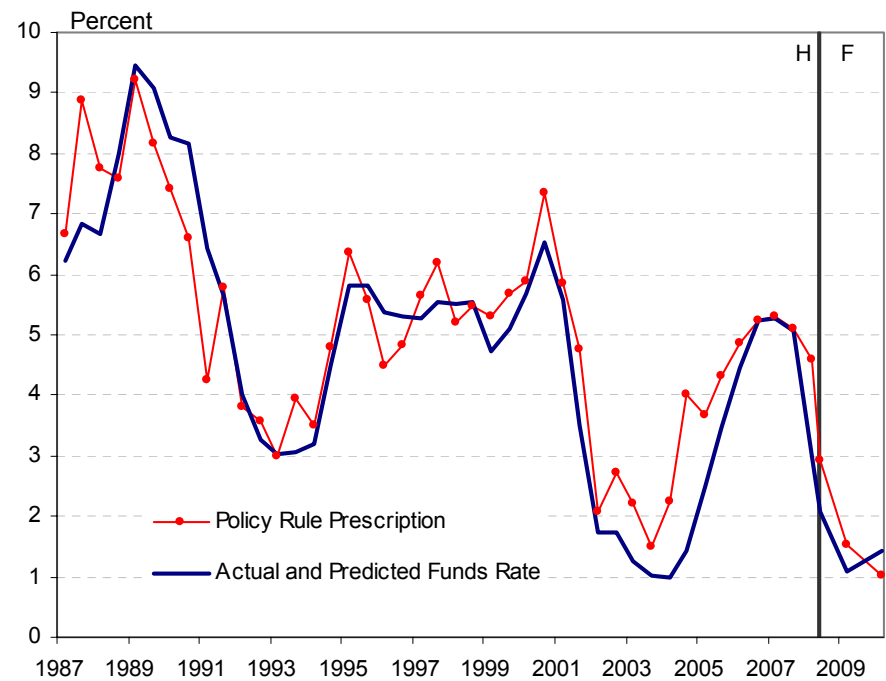


# Monetary Policy Easing: Taylor Rule Perspective

## Backward-looking Policy Rule (Based on macroeconomic outcomes)



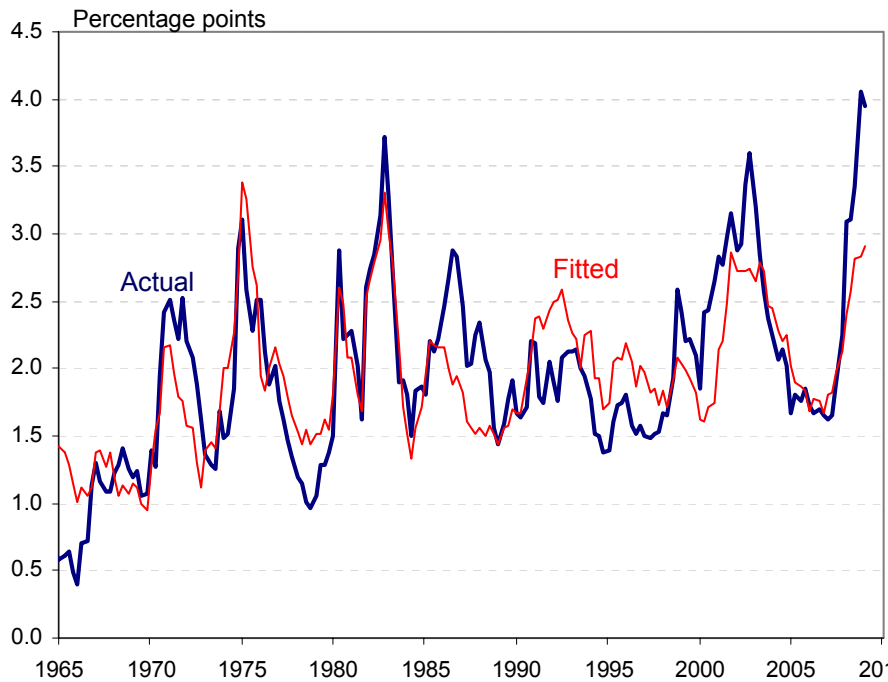
## Forward-looking Policy Rule (Based on FOMC forecasts)



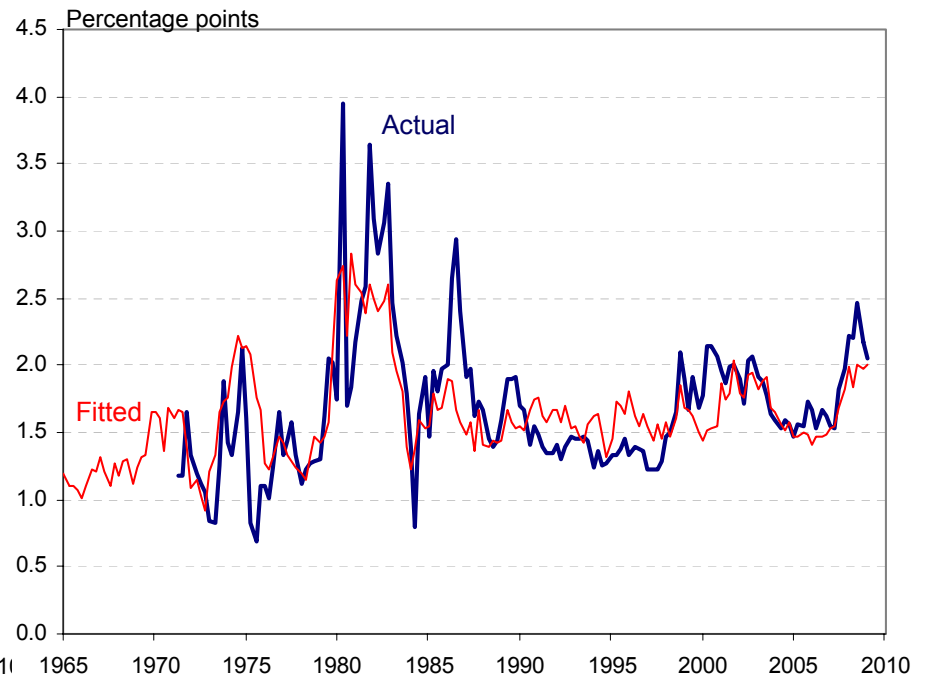
# Credit Tightening: Cyclical or Structural?

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## Baa Corporate Yield Spread

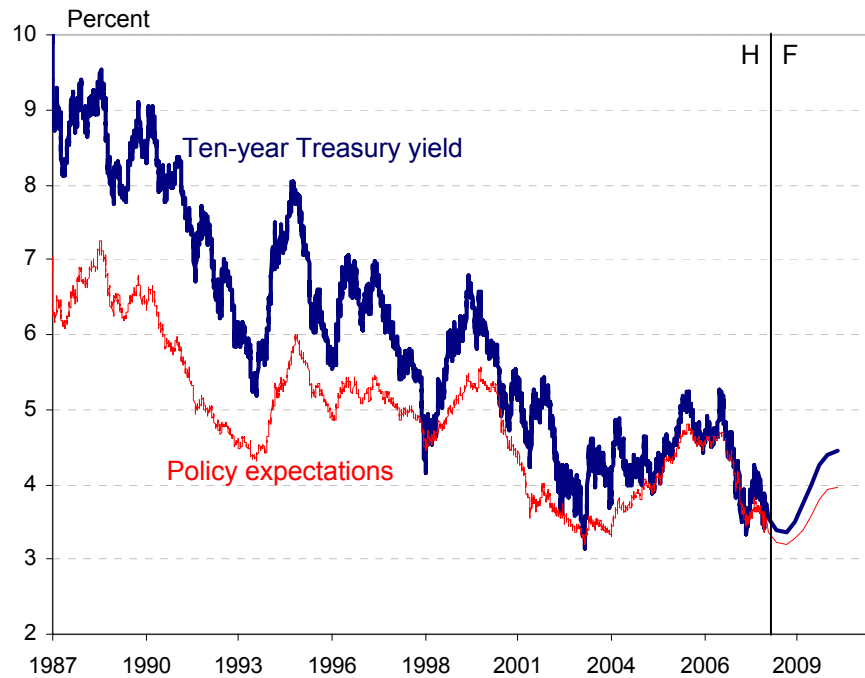


## Conforming Mortgage Spread

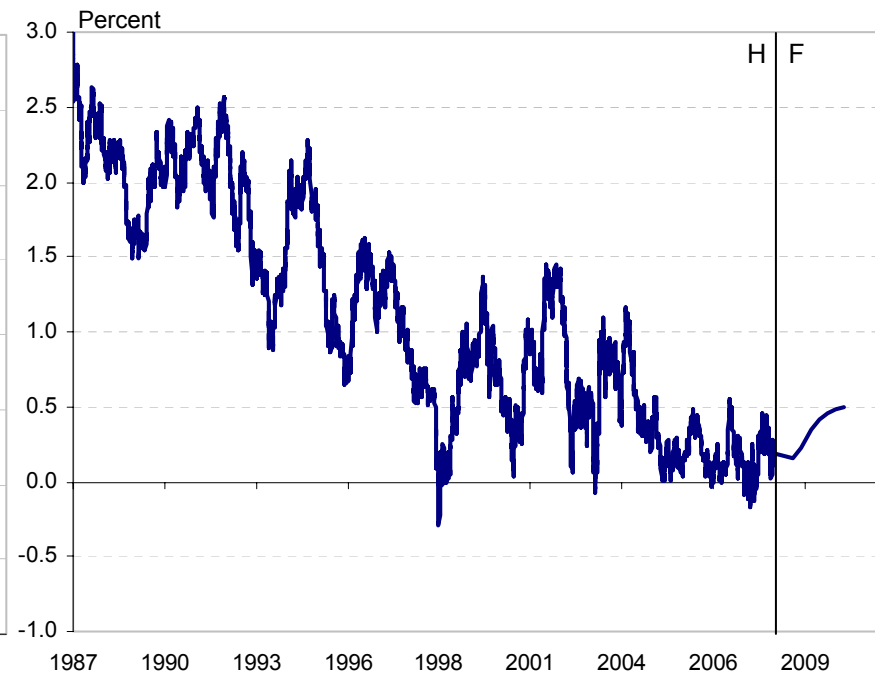


# Treasury Yields: Extreme Lows

## Treasury Yield and Policy Expectations



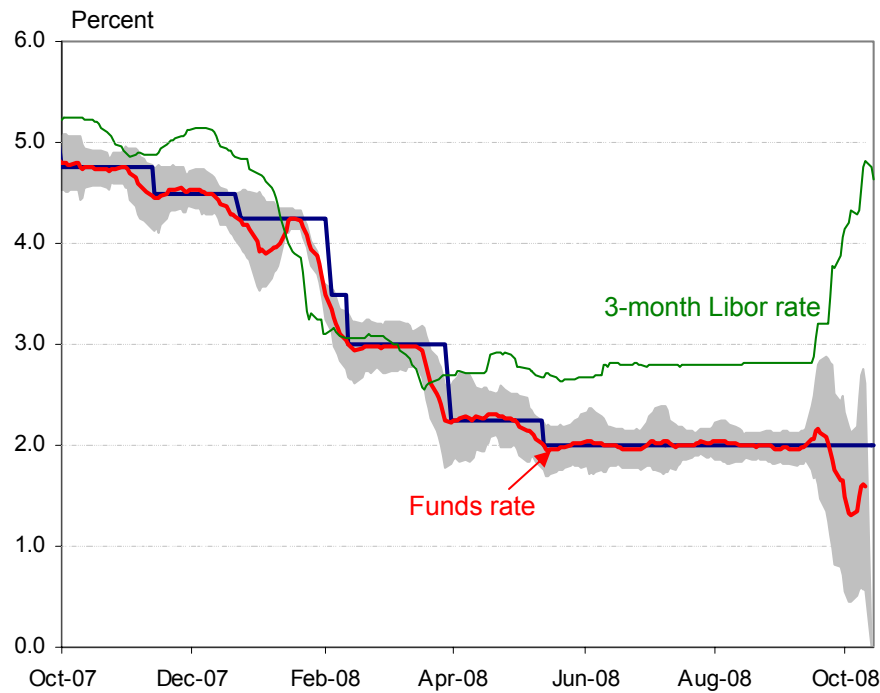
## Term Premium



Decomposition shown here is from the Kim-Wright term structure model.

# Funding Markets: Pressure on Term Rates

## Federal Funds Rate and Libor



\*Federal funds rate is a ten-day moving average. The range shown shows the intraday variation, measured as +/- one standard deviation.

## Libor Credit Spread (Relative to OIS Rate)



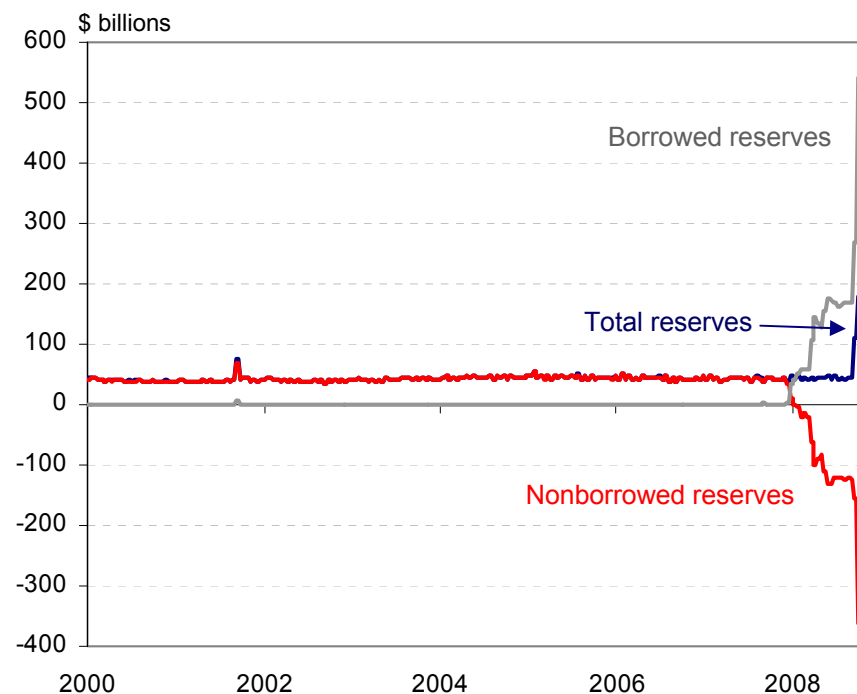
# Fed Balance Sheet: Remarkable Transformation

## Federal Reserve Liquidity Policies

	Current (\$ bil)	Announced (\$ bil)
<b>Term Lending Facilities</b>		
28-day RPs	80	100
TAF	149	600
TSLF	192	200
<b>Other Facilities</b>		
FX Swaps	377	620
AMLF	139	Unlimited
GSE Debt	14	Unlimited
CPFF	0	Unlimited
<b>Standing Facilities</b>		
Discount Window	98	Unlimited
PDCF	123	Unlimited
<b>Rescue Operations</b>		
Maiden Lane	29	29
AIG	70	118
<b>Total</b>	<b>1271</b>	<b>1667</b> (plus Unlimited)

The Fed has committed to an additional \$300 TAF over year end, not counted above, and will also conduct TOP auctions of TSLF for additional amounts over year end. TSLF operations do not add reserves but do use the Fed's holdings of Treasuries. Amounts of AMLF and CPFF are limited by amount of outstanding commercial paper; the amounts of DW and PDCF are limited by eligible collateral.

## Reserves Supplied by the Federal Reserve



# Fed's Liquidity Policies: A Crowded H.4.1

## Condition Statement of Federal Reserve Banks

October 9, 2008

### 1. Factors Affecting Reserve Balances of Depository Institutions

Millions of dollars

Reserve Bank credit, related items, and reserve balances of depository institutions at Federal Reserve Banks	Averages of daily figures			Wednesday Oct 8, 2008
	Week ended Oct 8, 2008	Change from week ended		
		Oct 1, 2008	Oct 10, 2007	
Reserve Bank credit	1,494,726	+ 103,605	+ 636,273	1,575,626
Securities held outright	490,942	+ 2,401	- 288,671	490,684
U.S. Treasury <sup>1</sup>	476,594	- 18	- 303,019	476,579
Bills <sup>2</sup>	18,423	0	- 248,596	18,423
Notes and bonds, nominal <sup>2</sup>	411,731	0	- 60,411	411,731
Notes and bonds, inflation-indexed <sup>2</sup>	39,832	0	+ 4,079	39,832
Inflation compensation <sup>3</sup>	6,609	- 18	+ 1,910	6,593
Federal agency <sup>2</sup>	14,347	+ 2,418	+ 14,347	14,105 ← GSE purchases
Repurchase agreements <sup>4</sup>	81,143	- 1,857	+ 43,072	100,000 ← Term RPs
Term auction credit	149,000	- 143	+ 149,000	149,000 ← TAF
Other loans	420,160	+ 52,364	+ 419,903	430,866
Primary credit	75,010	+ 30,547	+ 74,897	98,107 ← Discount window
Secondary credit	4	- 282	+ 4	0
Seasonal credit	39	- 35	- 105	33
Primary dealer and other broker-dealer credit <sup>5</sup>	134,066	- 13,626	+ 134,066	122,940 ← PDCF
Asset-backed commercial paper money market mutual fund liquidity facility	145,890	+ 23,786	+ 145,890	139,481 ← ALMF
Other credit extensions	65,151	+ 11,975	+ 65,151	70,304 ← AIG
Net portfolio holdings of Maiden Lane LLC <sup>6</sup>	29,452	+ 39	+ 29,452	29,487 ← Maiden Lane
Float	-1,042	+ 173	- 533	-1,545
Other Federal Reserve assets	325,071	+ 50,627	+ 284,050	377,135 ← FX swaps
Gold stock	11,041	0	0	11,041
Special drawing rights certificate account	2,200	0	0	2,200
Treasury currency outstanding <sup>7</sup>	38,745	+ 14	+ 92	38,745
<b>Total factors supplying reserve funds</b>	<b>1,546,713</b>	<b>+ 103,619</b>	<b>+ 636,366</b>	<b>1,627,613</b>

# Fed/Treasury Options

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- Clarity on TARP/intention to re-capitalize banks
- Libor facility from the Fed
  - Fed would need make lending appear secured
  - In that case, it could target Libor
  - It could act as counterparty to both sides
- Guaranteeing bank liabilities
  - Raising deposit insurance to unlimited
  - Broader guarantee

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