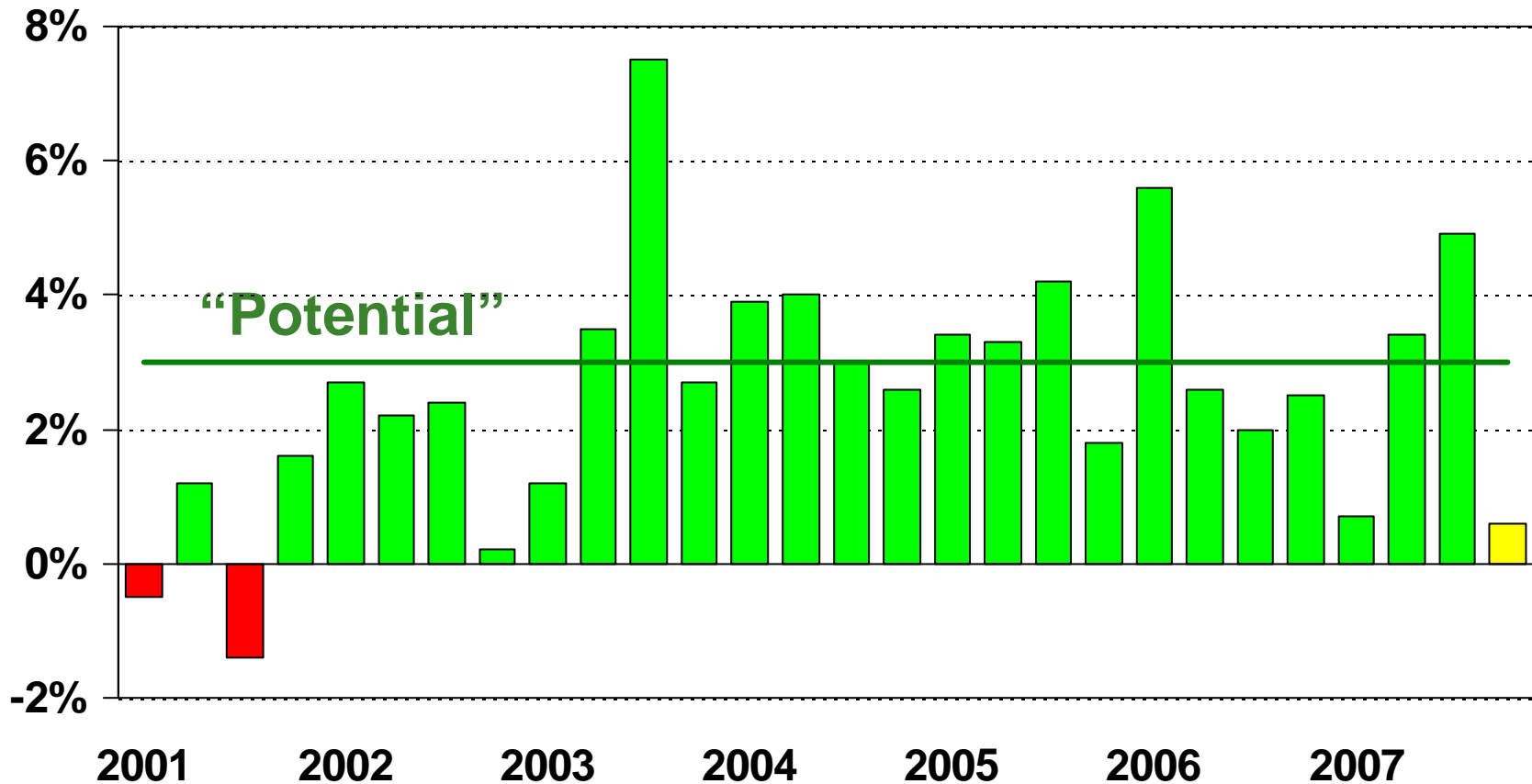

A Pregnant Pause

Economic Prospects for the Remainder of 2008

Carl R. Tannenbaum
Economic Consultant
CRTannenbaum@comcast.net
630-234-7548

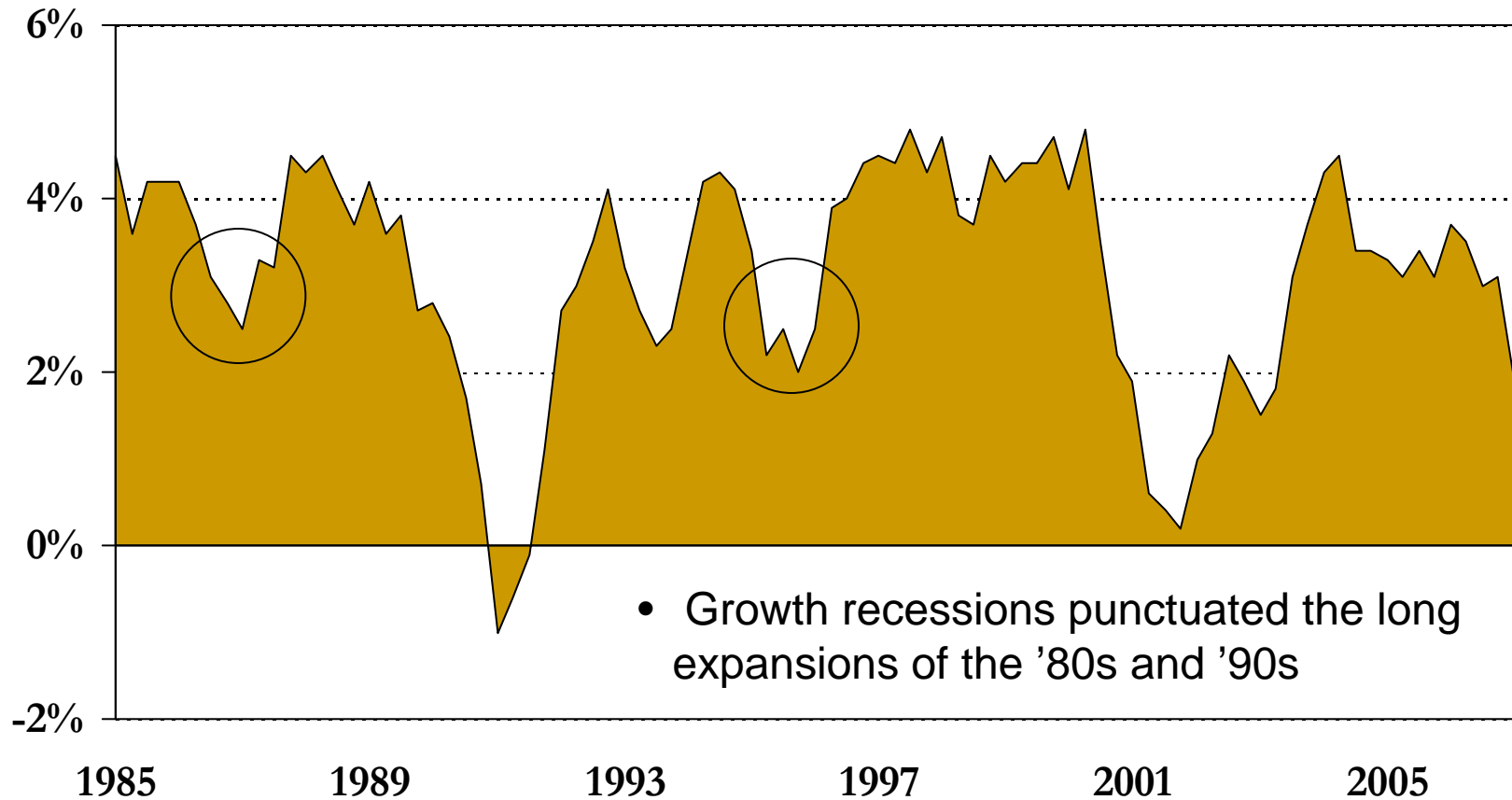
Let's Not Forget: Things Haven't Been That Bad!

Quarterly Change in US GDP, Annualized



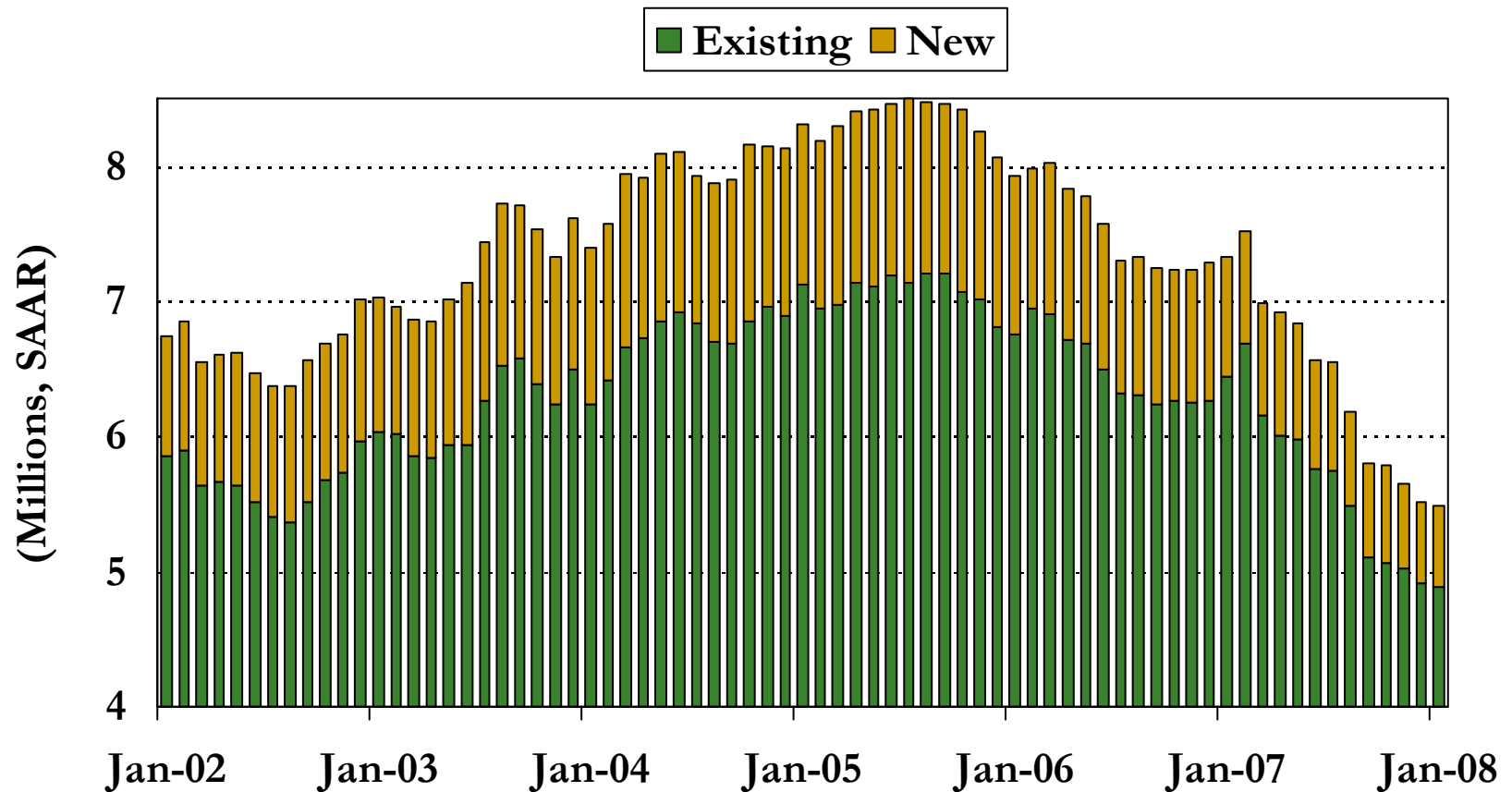
Expansions: Not Always Smooth Sailing

Year over Year Growth in Real GDP



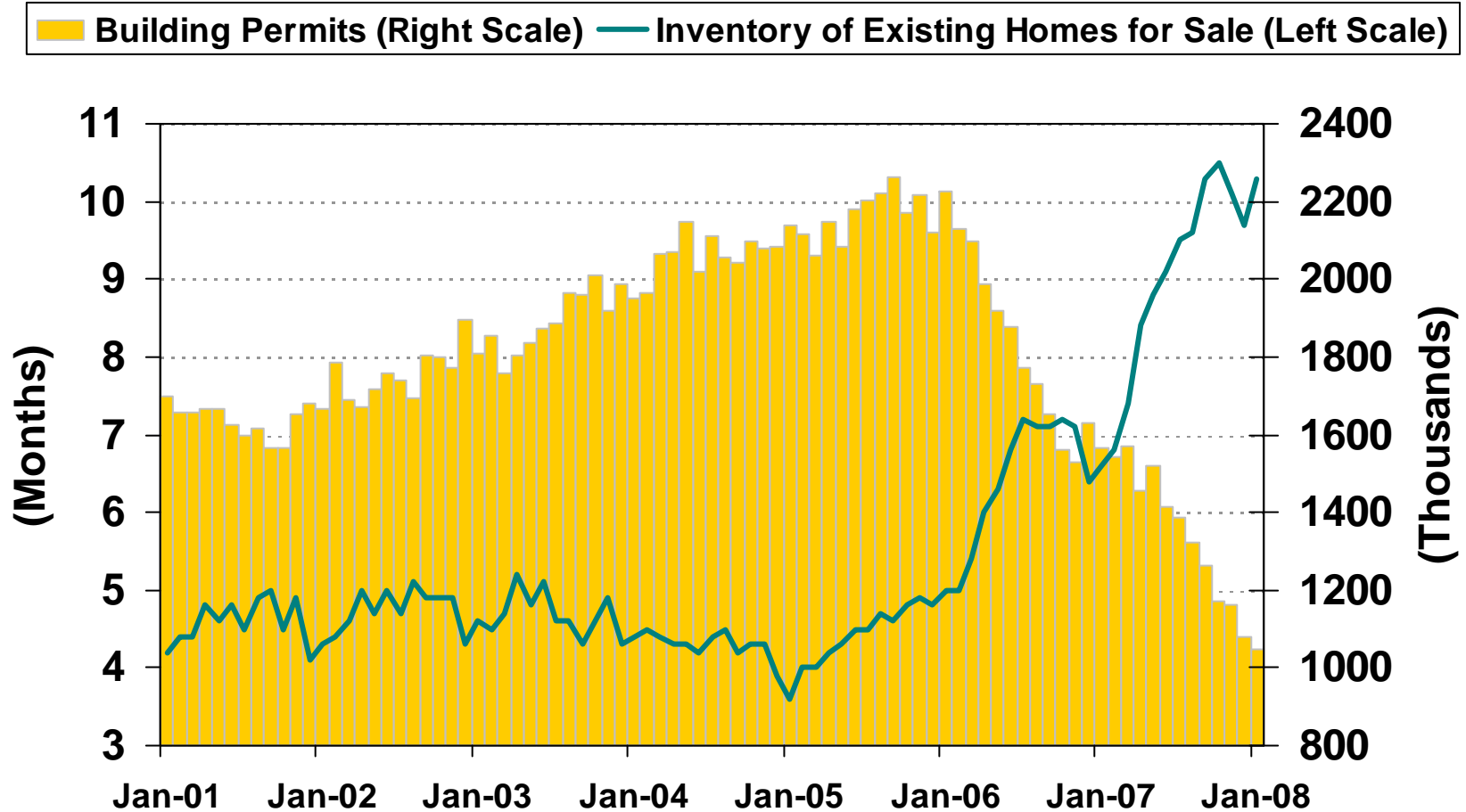
The Housing Correction

Trends in Home Sales



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

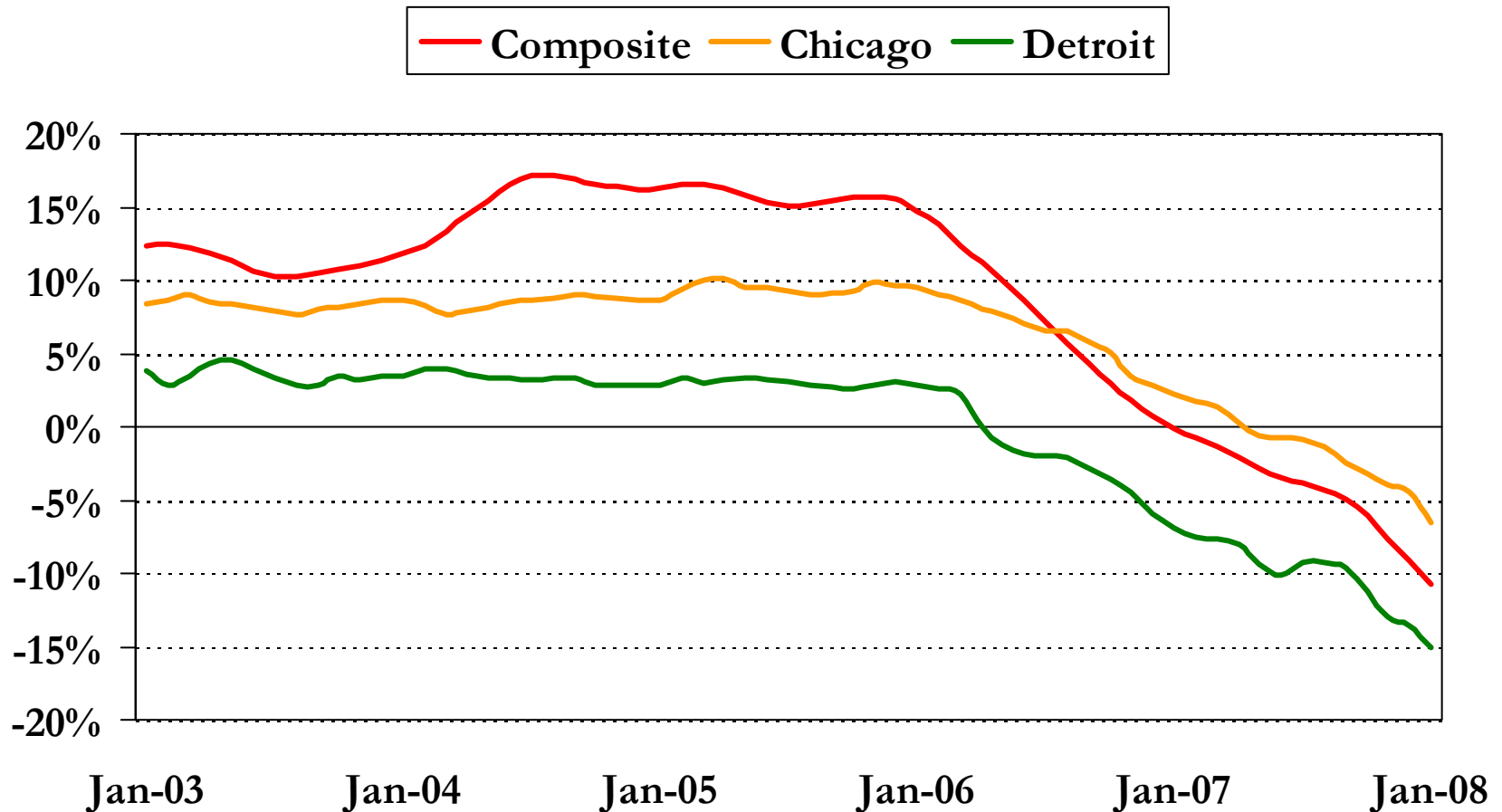
Putting the Hammer Down



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

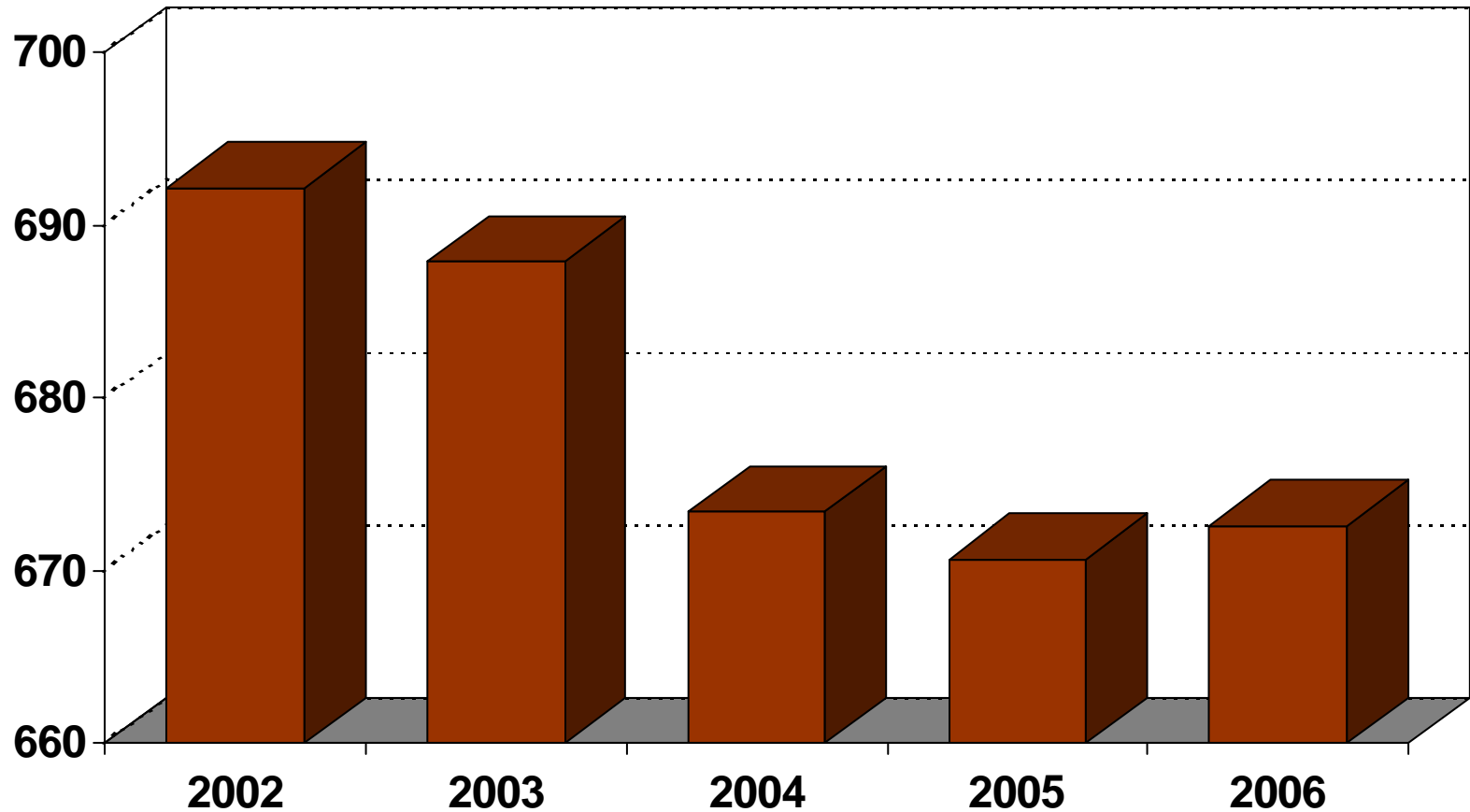
Home Prices

Year over Year Change, Case-Shiller Index

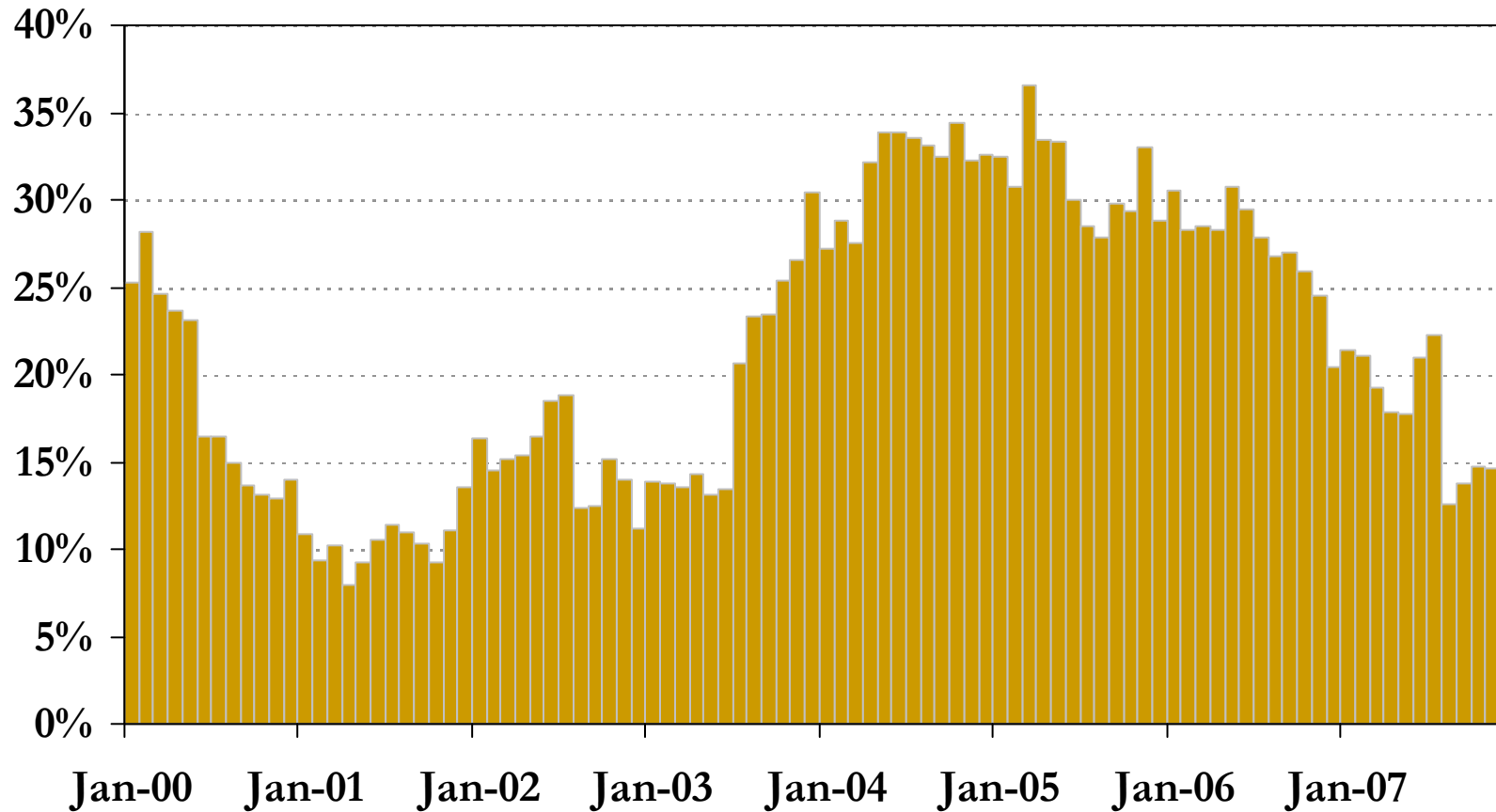


FICO Scores

Weighted Average of FICO Scores for Total Originations



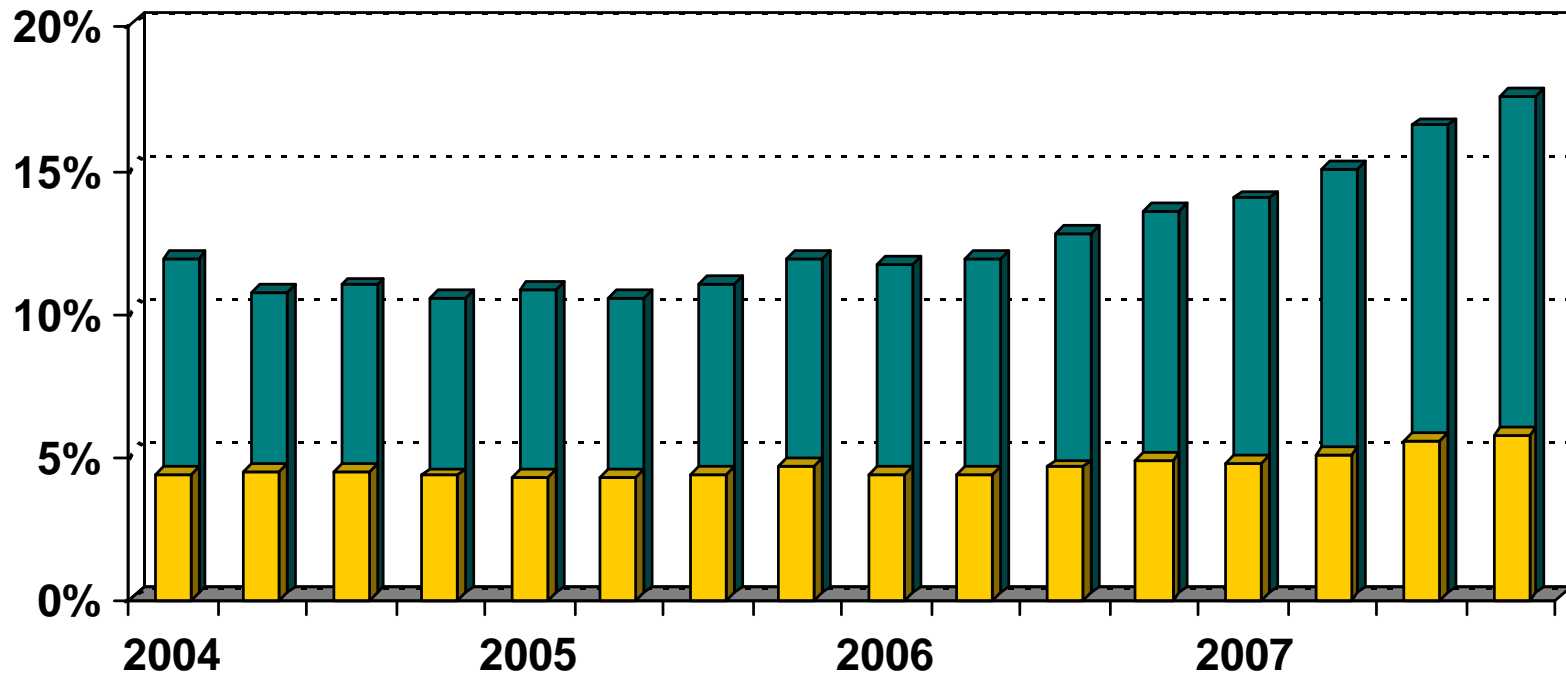
ARM Share of new originations



Past Their Prime

Home mortgages 30 or more days past due

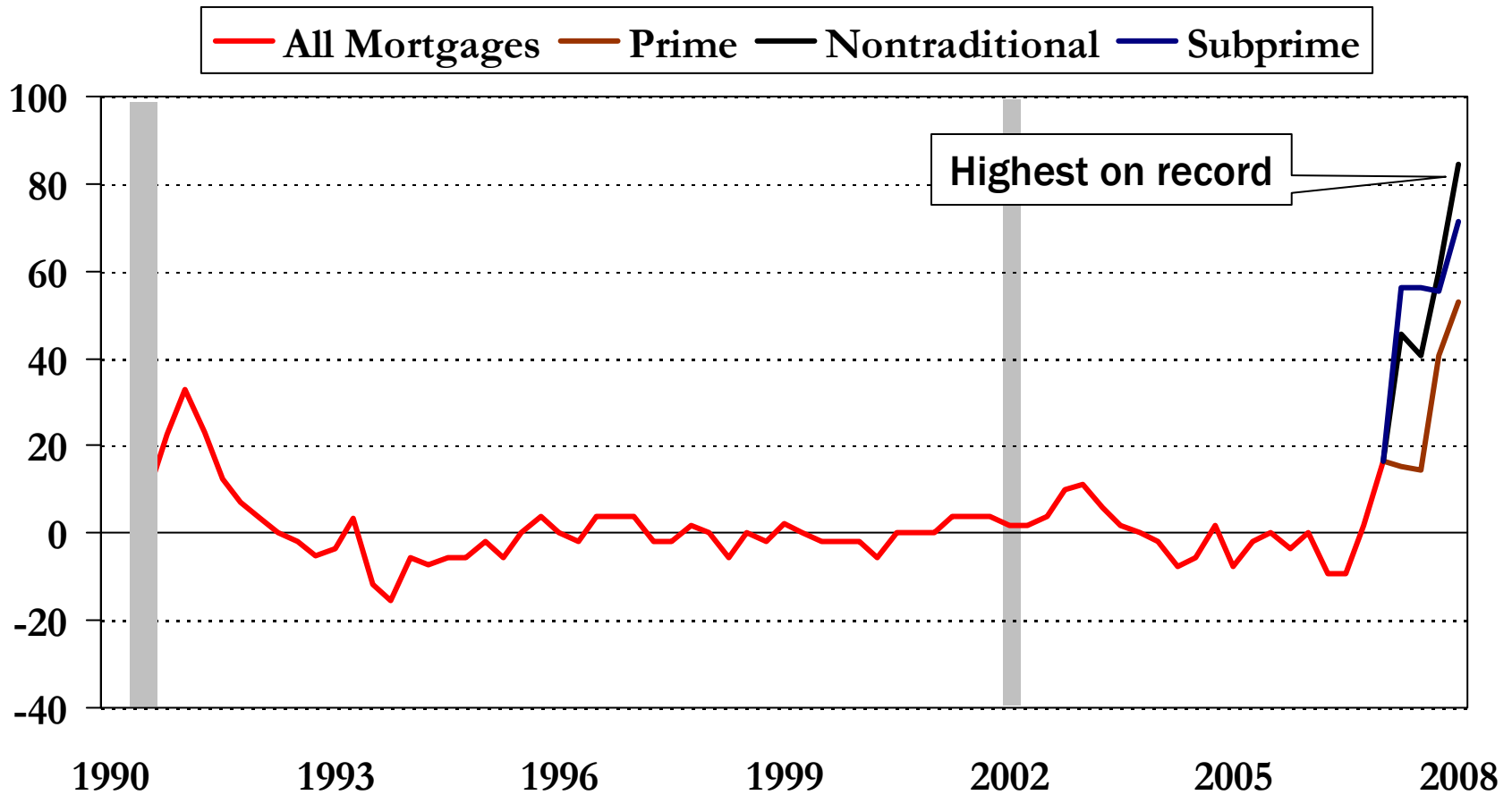
■ All Loans ■ Subprime Loans



Source: Mortgage Bankers Association

Senior Loan Officer Survey: Home Mortgages

Net Percentage of Respondents Tightening Credit

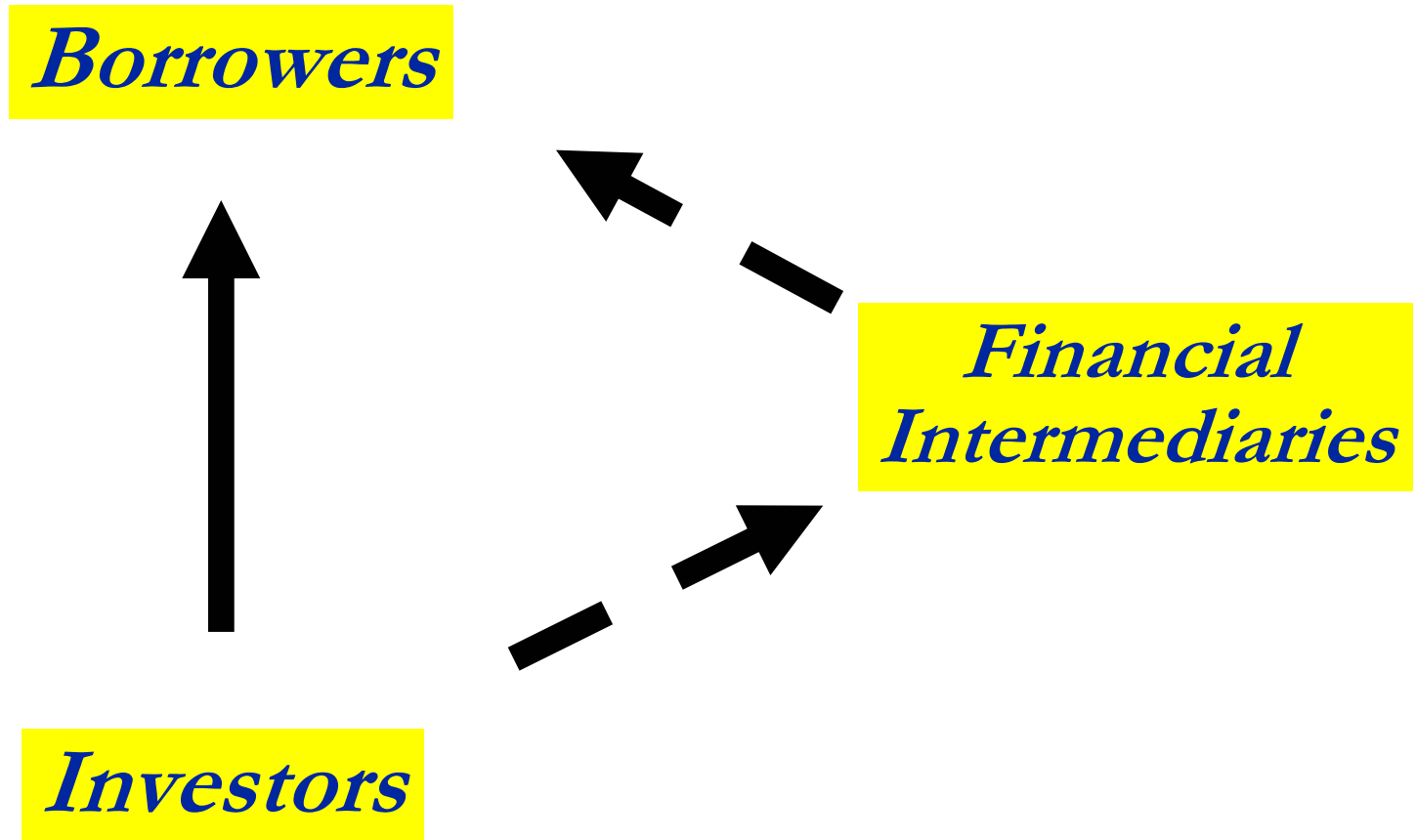


Source: Federal Reserve

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

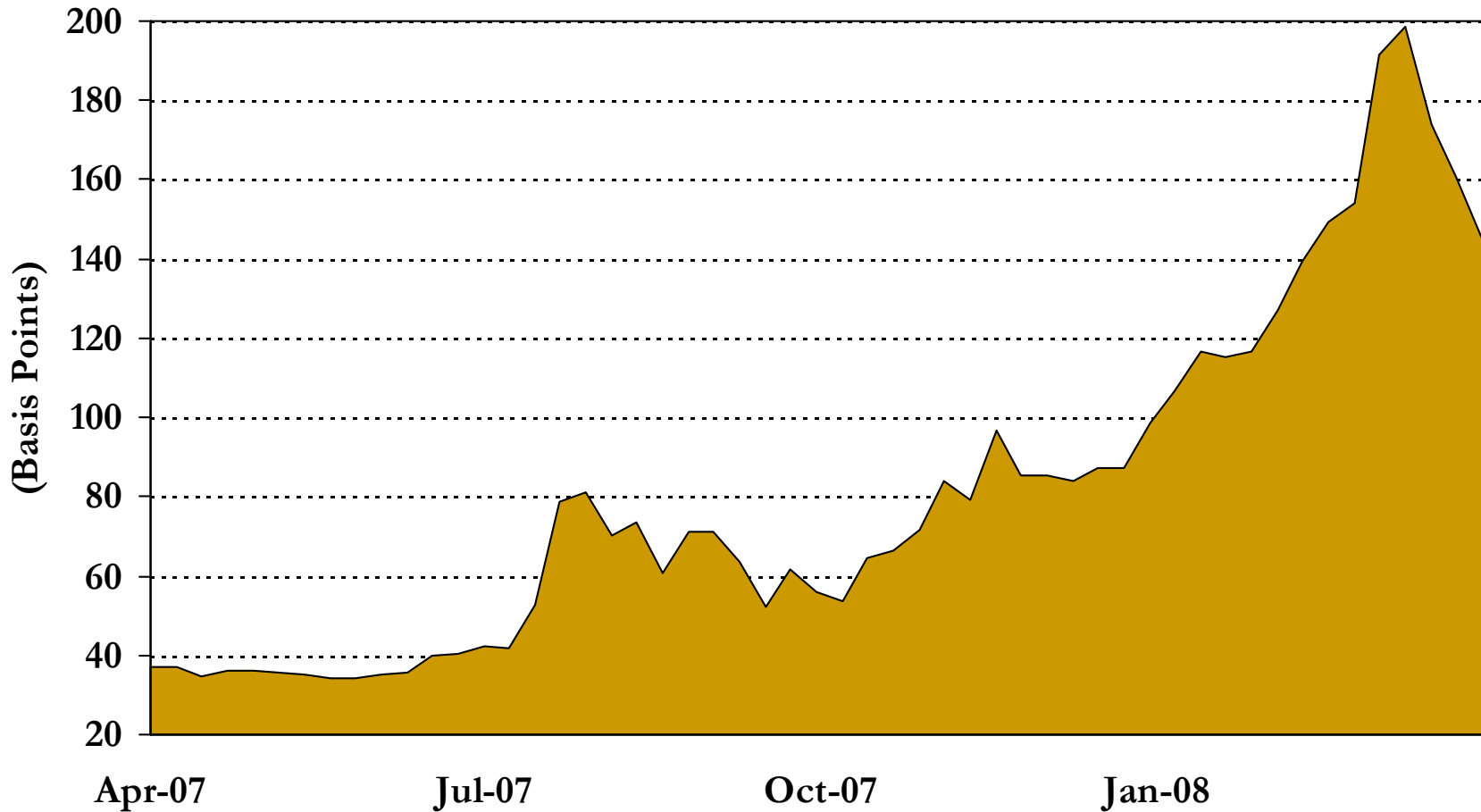


Spiraling Downward

- 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

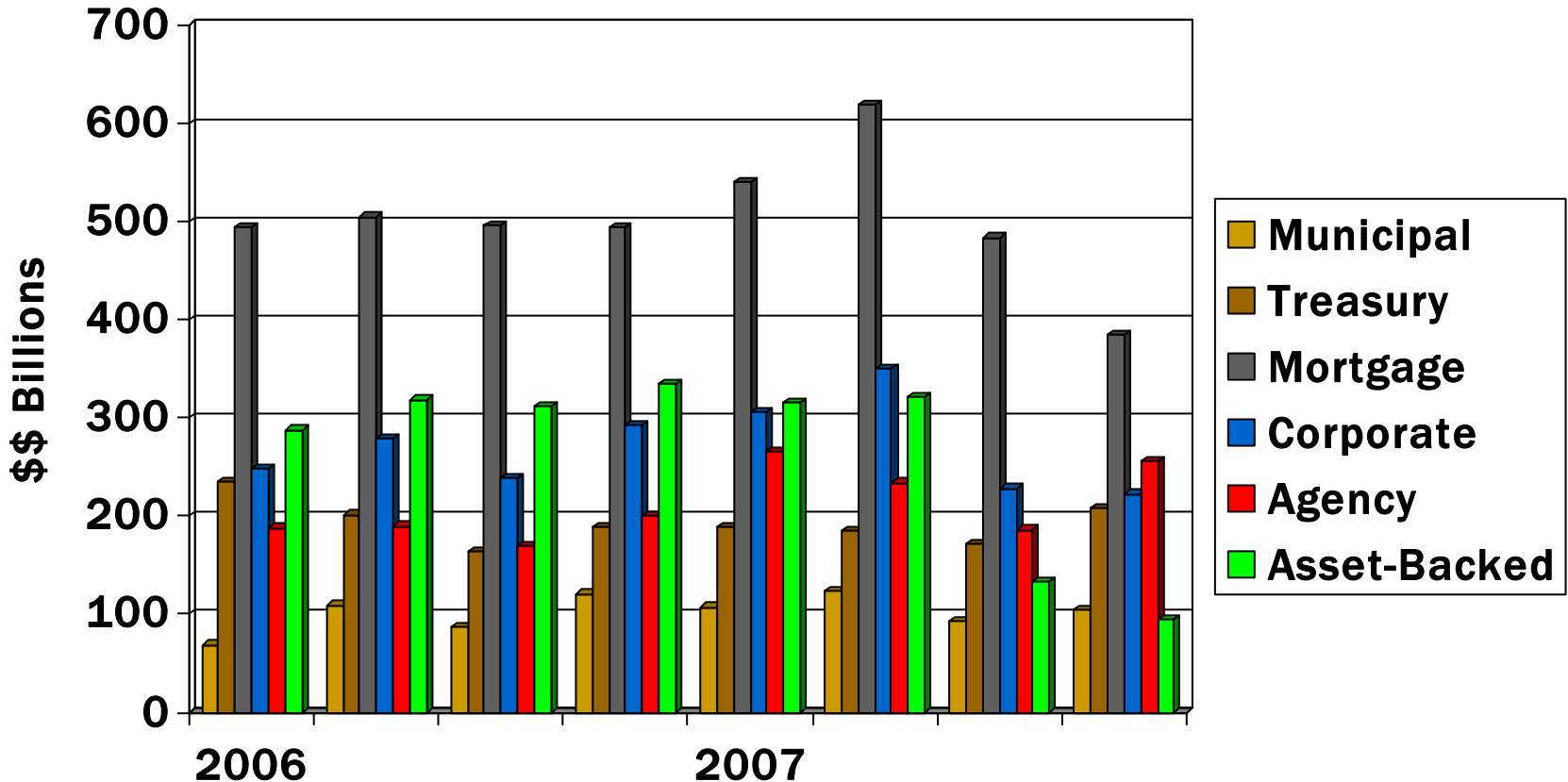
Corporate Creditworthiness

Composite of Credit Default Swaps



Source: Bloomberg

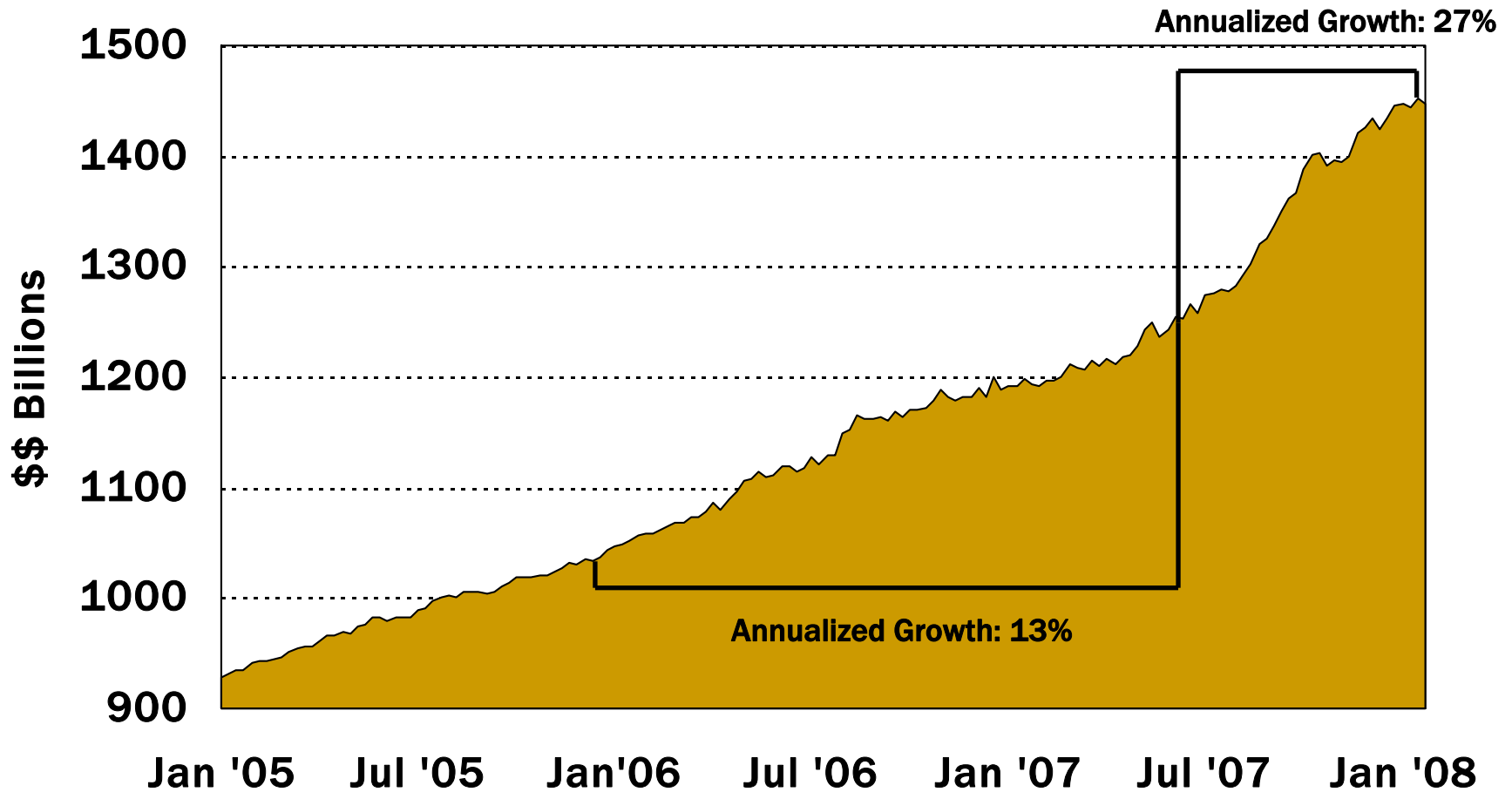
New Debt Issues



Source: SIFMA

Commercial and Industrial Loans

All Commercial Banks



Source: Federal Reserve

Tightening the Vise?

Rating Agencies

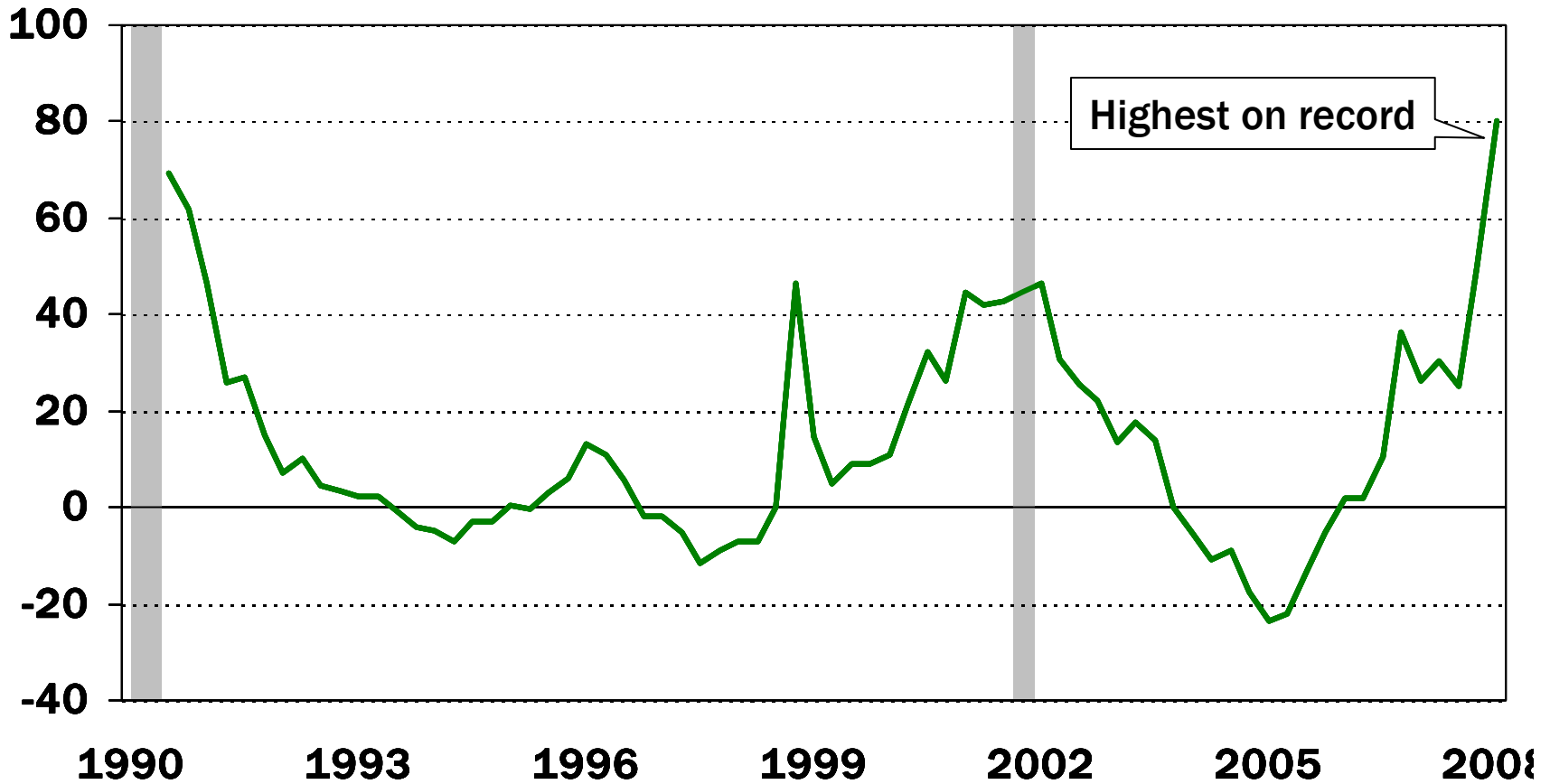
Congress

Bond Insurers

Regulators?

Senior Loan Officer Survey: Commercial Real Estate

Net Percentage of Respondents Tightening Credit

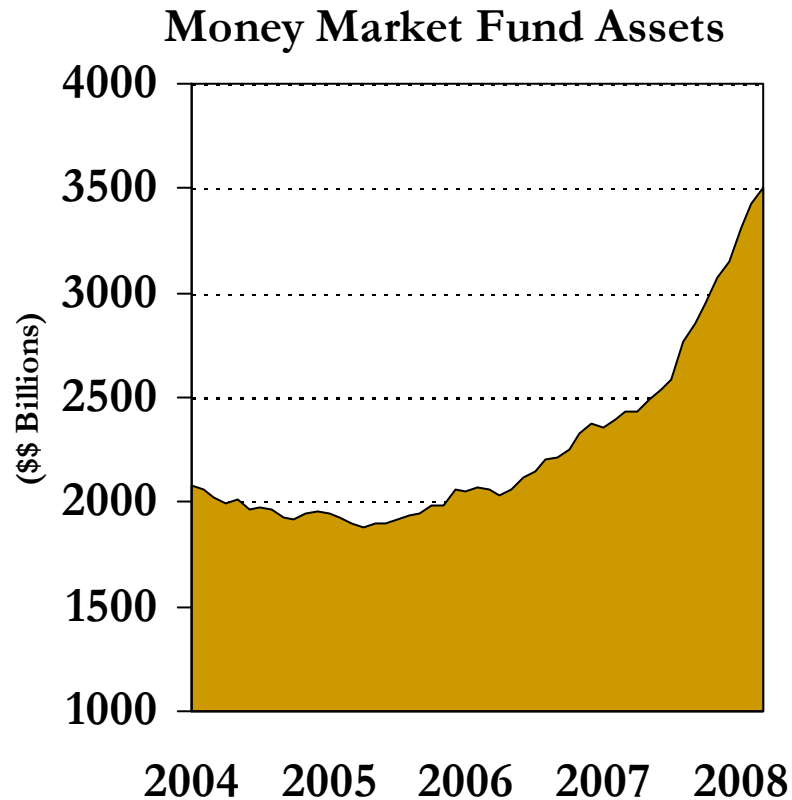


Source: Federal Reserve

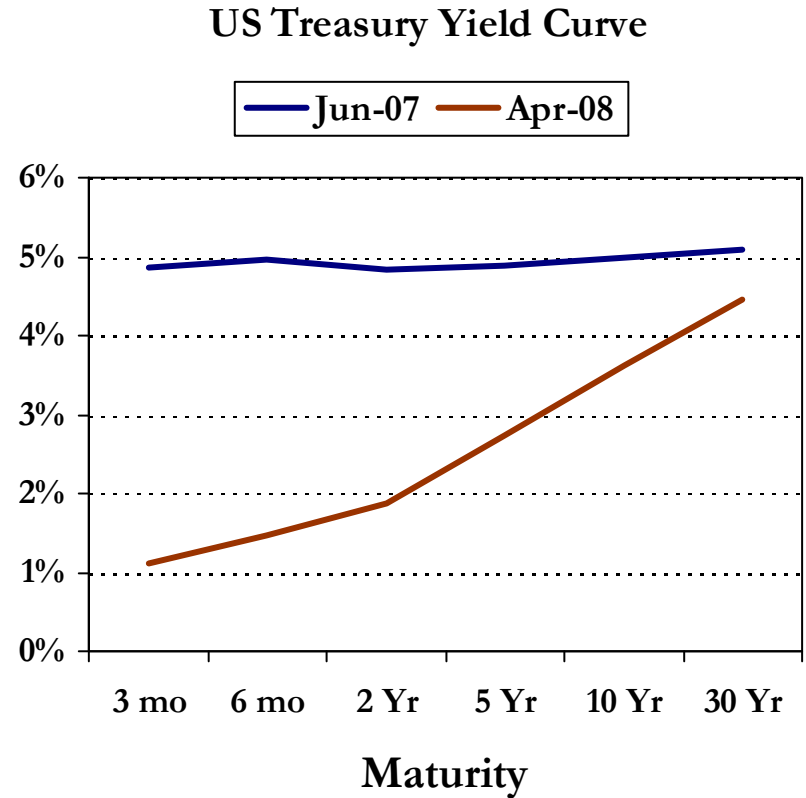
Impacts on Venture Capital/Private Equity

- **Difficult to raise debt; difficult to sell companies**
 - Capital more costly or simply unavailable
 - Covenants tighter
- **More inward focus: managing existing deals as opposed to seeking new ones**
- **Smaller deals, more minority interest**
- **Robin Hood economics: the discussion of carried interest**
- ***More restrictions just when we need fresh capital the most?!***

Signs of Investor Conservatism



Source: ICI



Source: Bloomberg

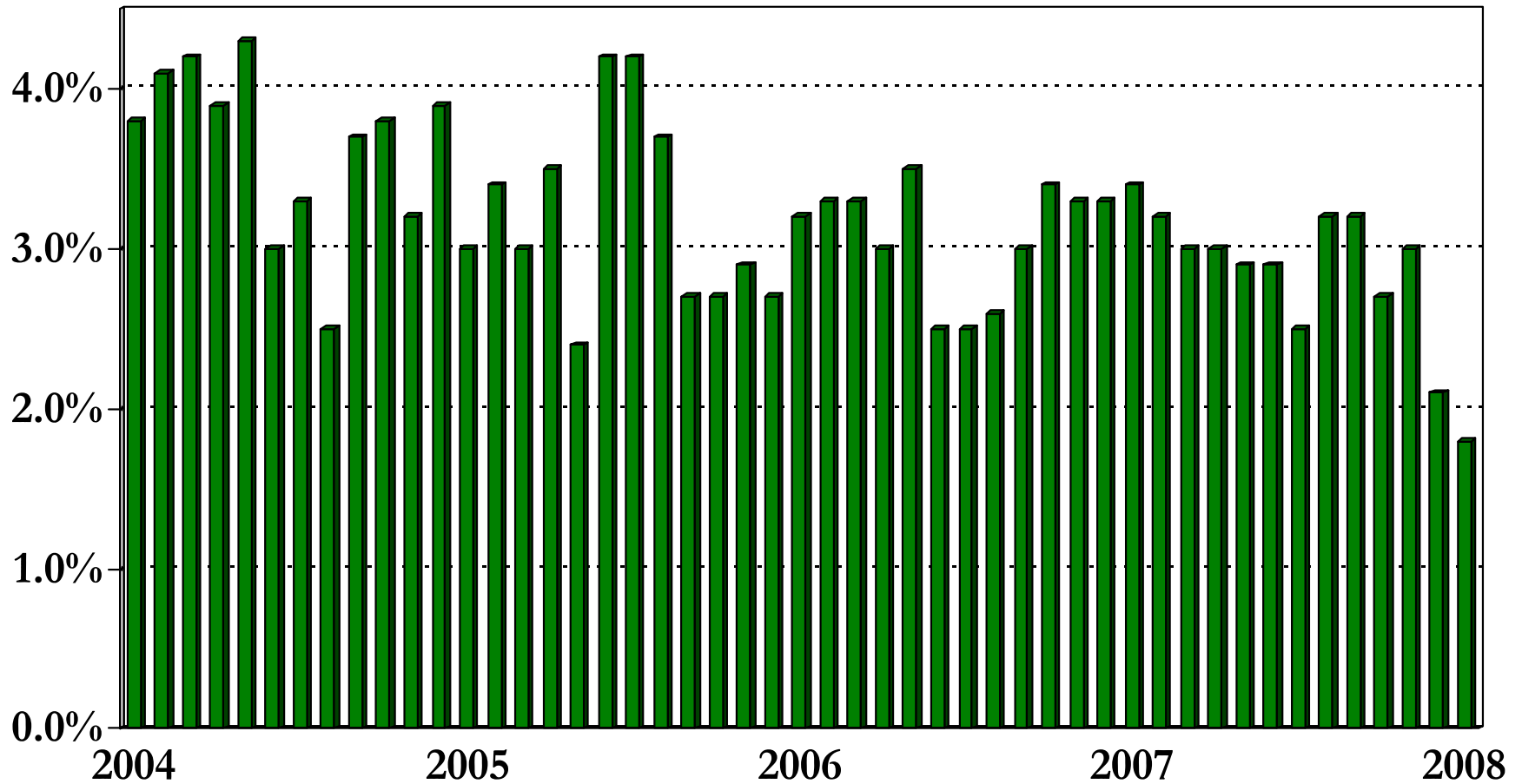
- ***This money will eventually have to go back to work!***

Conclusions: Credit

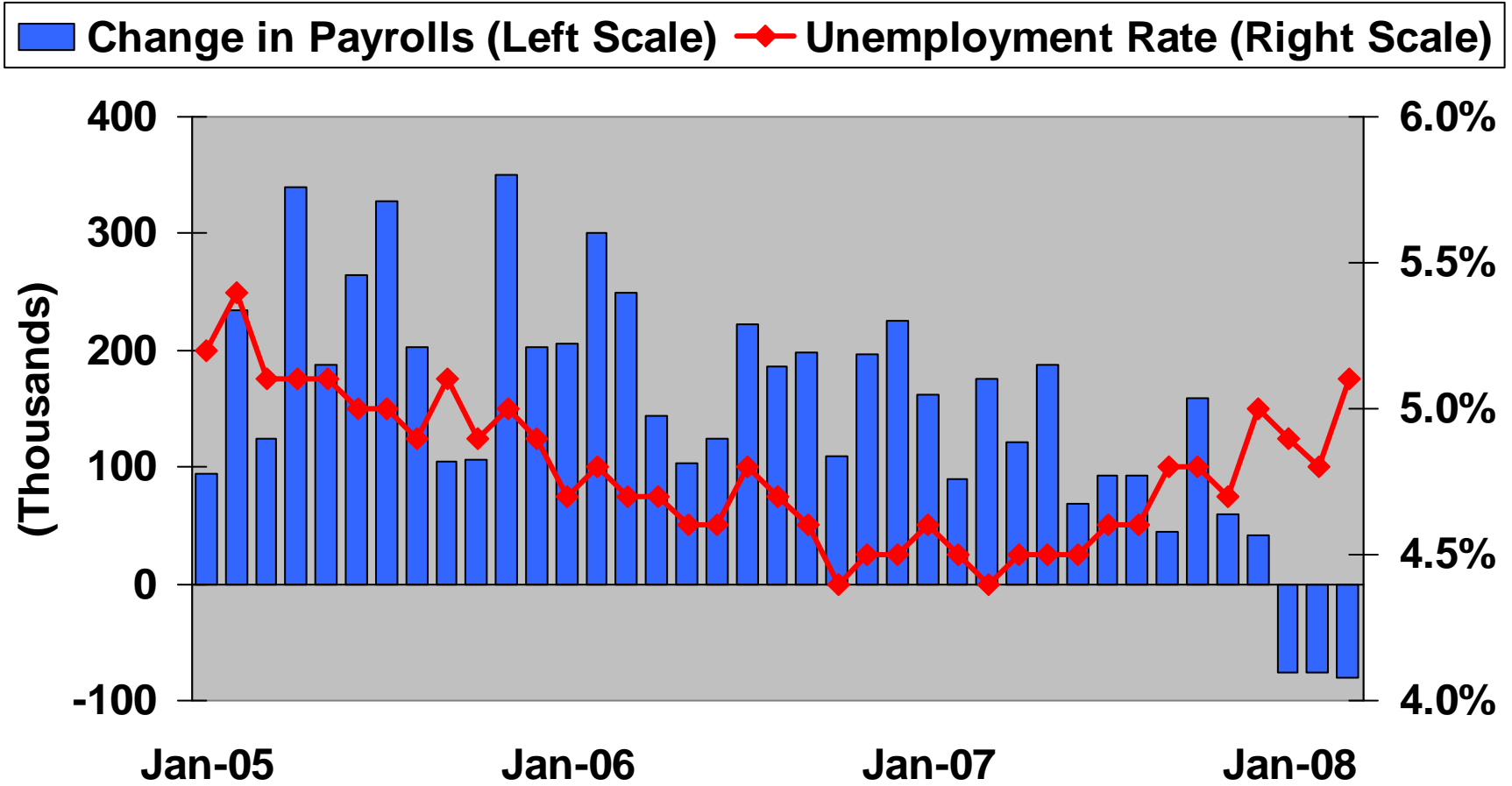
- We're working to avoid a credit crunch
- Wall Street firms remain under stress; high vulnerability to event risk
- Effect on community banks has been limited, but translation from Wall Street down to Main Street is possible
- We're seeing the downside of the modern financial markets

Real Personal Consumption

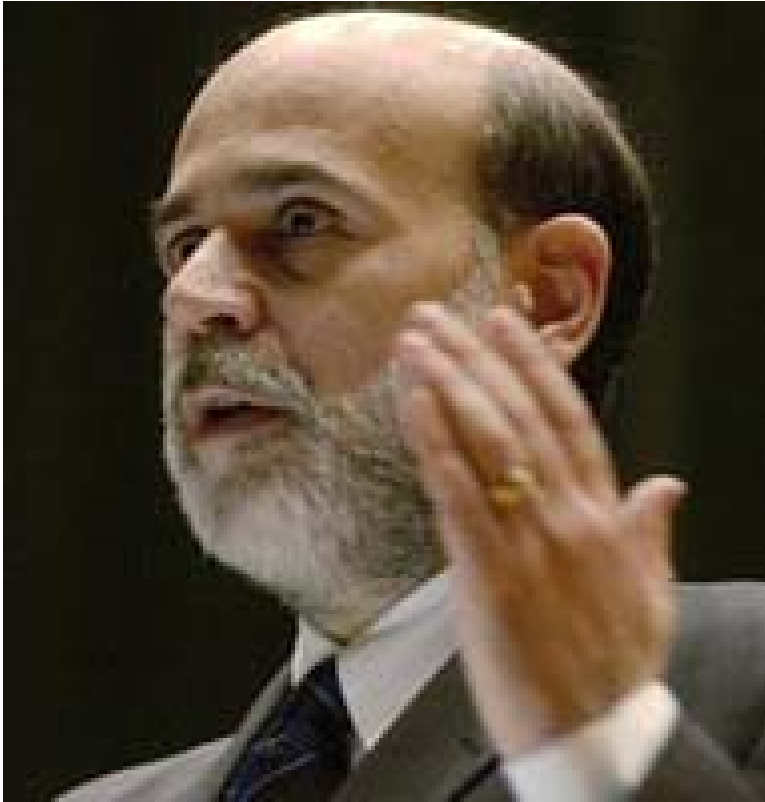
Year over Year Change



Employment Trends



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**

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; capital markets still not functioning well**
- **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

Economic Prospects for the Remainder of 2008

Carl R. Tannenbaum
Economic Consultant
CRTannenbaum@comcast.net
630-234-7548