

The Economic Outlook: How Hard A Landing?

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The US Recovery Has Slowed

- **The U.S. economy has slowed. after three strong years**
- **Not surprising after 17 consecutive Fed rate hikes.**
- **Housing is the only major weakness; the rest of the economy is still growing above 3%.**
- **The twin deficits are coming under control, with the government deficit at 1.9% of GDP last year.**
- **Stronger European growth and a weaker dollar will mean less drag from the trade deficit; the underlying deficit has been shrinking for a year.**
- **The Fed will probably cut rates early next year.**

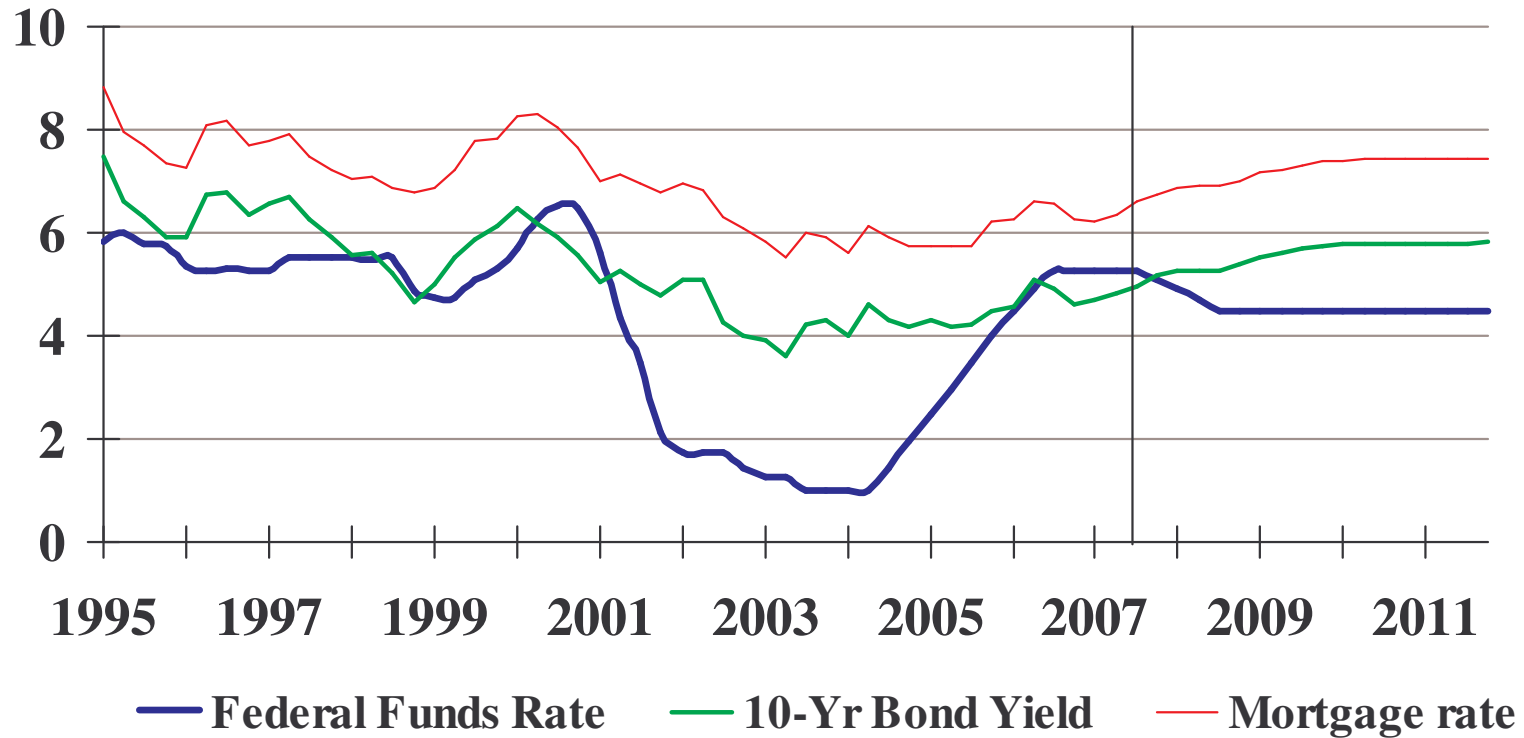
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The Fed Is Moving Toward Neutral

(Percent)



Source: Federal Reserve

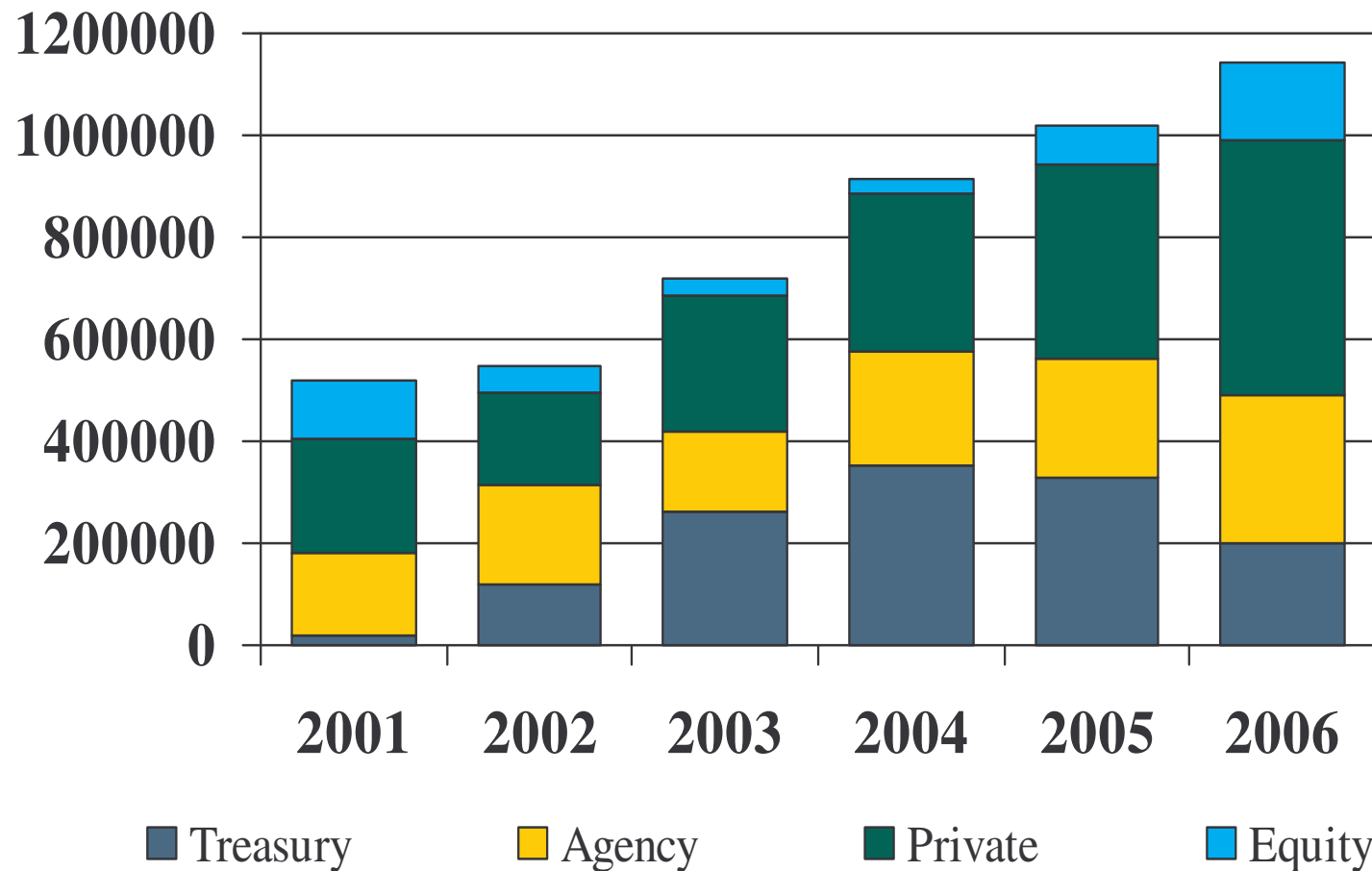
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Foreign Money Is Coming Into Private Bonds

(Net inflows of long-term capital, Millions of dollars)



Source: US Treasury

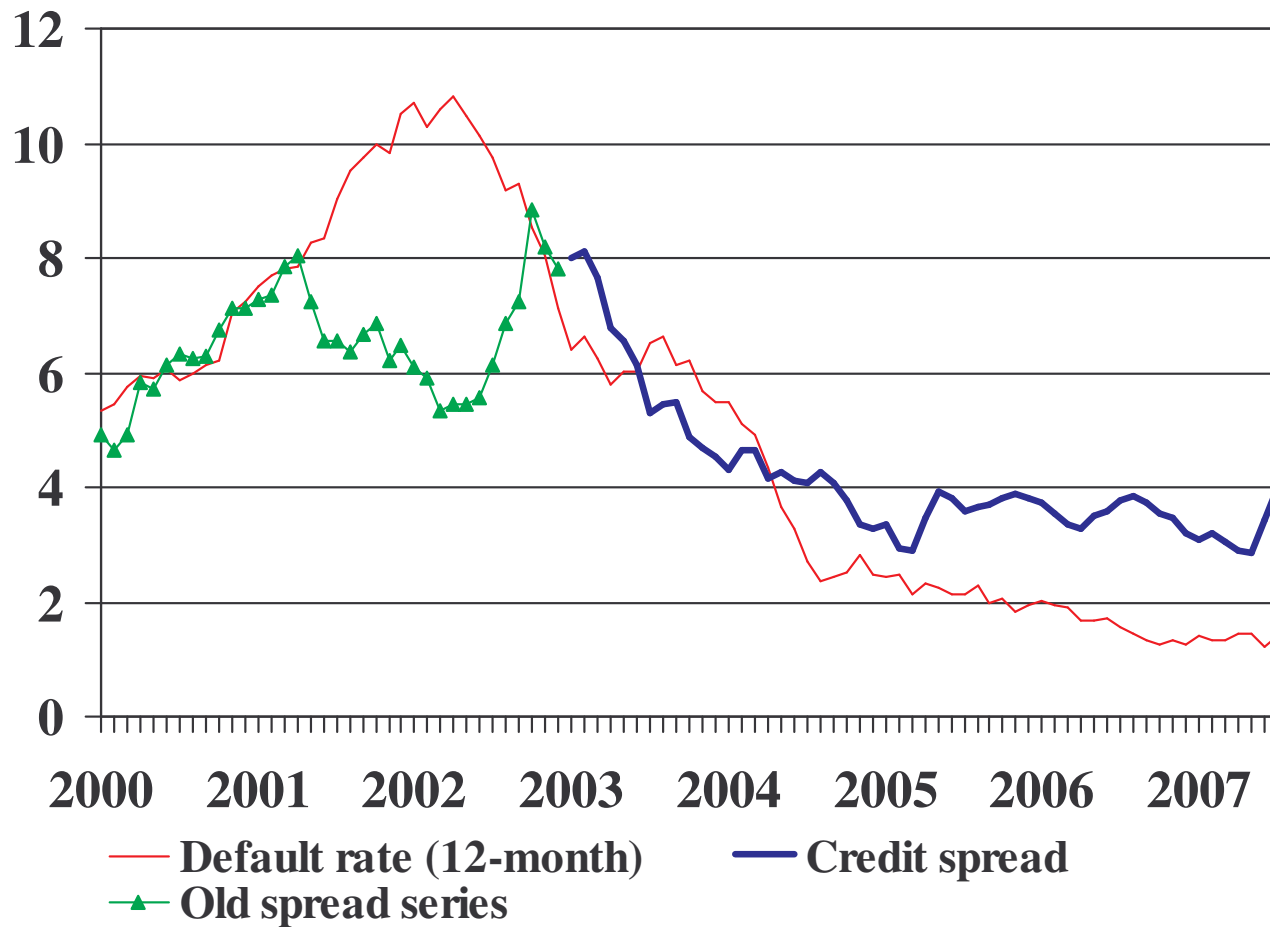
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Quality Spreads Grind Tighter

(Spread over Treasury yields, percentage points)



Source: S&P

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A Housing Bubble?

- **Housing was very affordable, thanks to low mortgage rates**
- **But what happens when rates went up?**
- **Home prices have outpaced incomes**
- **Ratio of home price to income hit a record high,**
- **Which cannot be maintained at higher rates**
- **There are big local bubbles**
 - E.g., New York, California, Boston, Florida
- **Higher mortgage rates have caused starts and sales to drop**
- **Housing looks less overvalued than other assets**

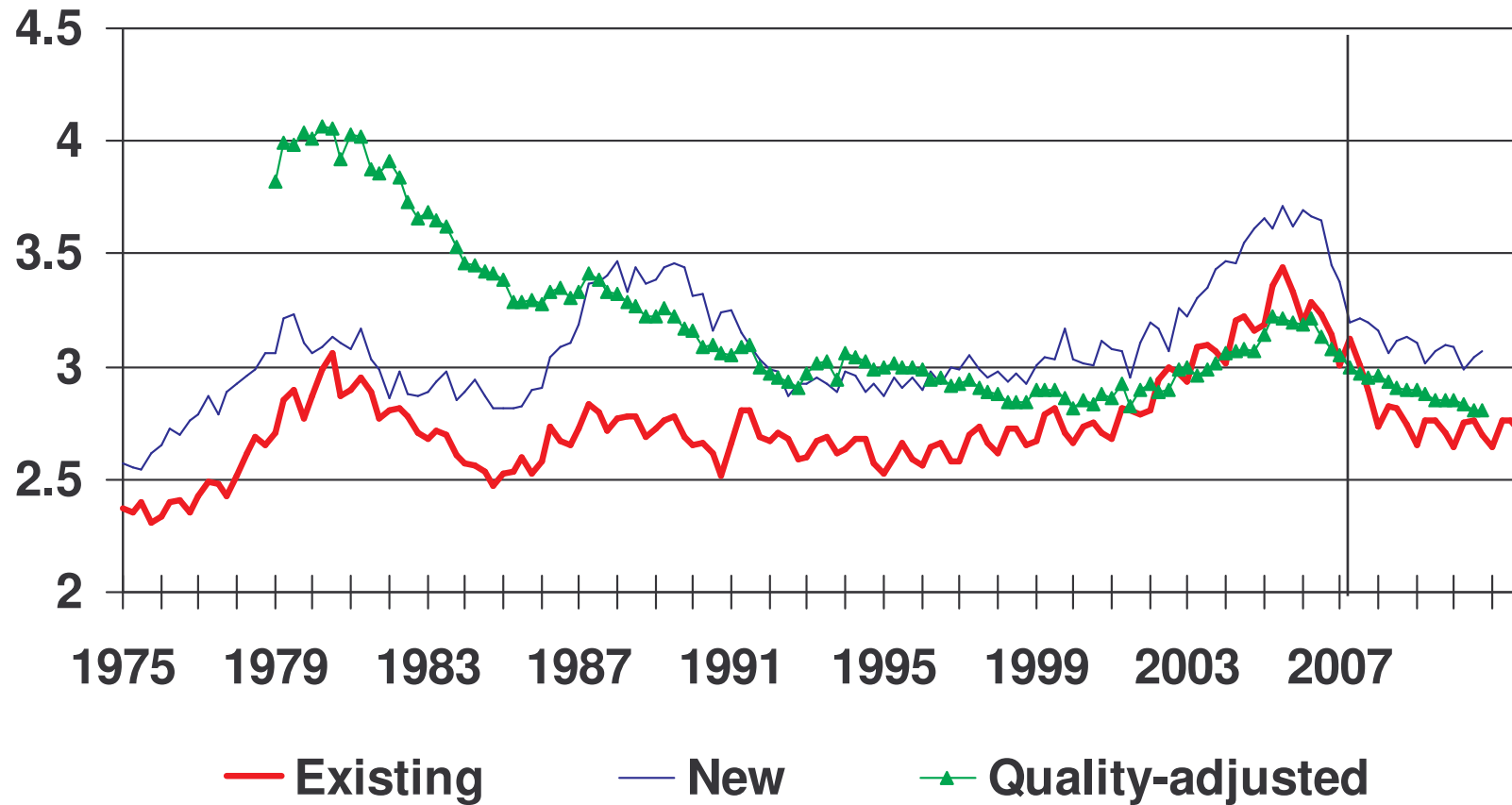
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Home Prices Are High Relative to Household Income

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



Source: BEA

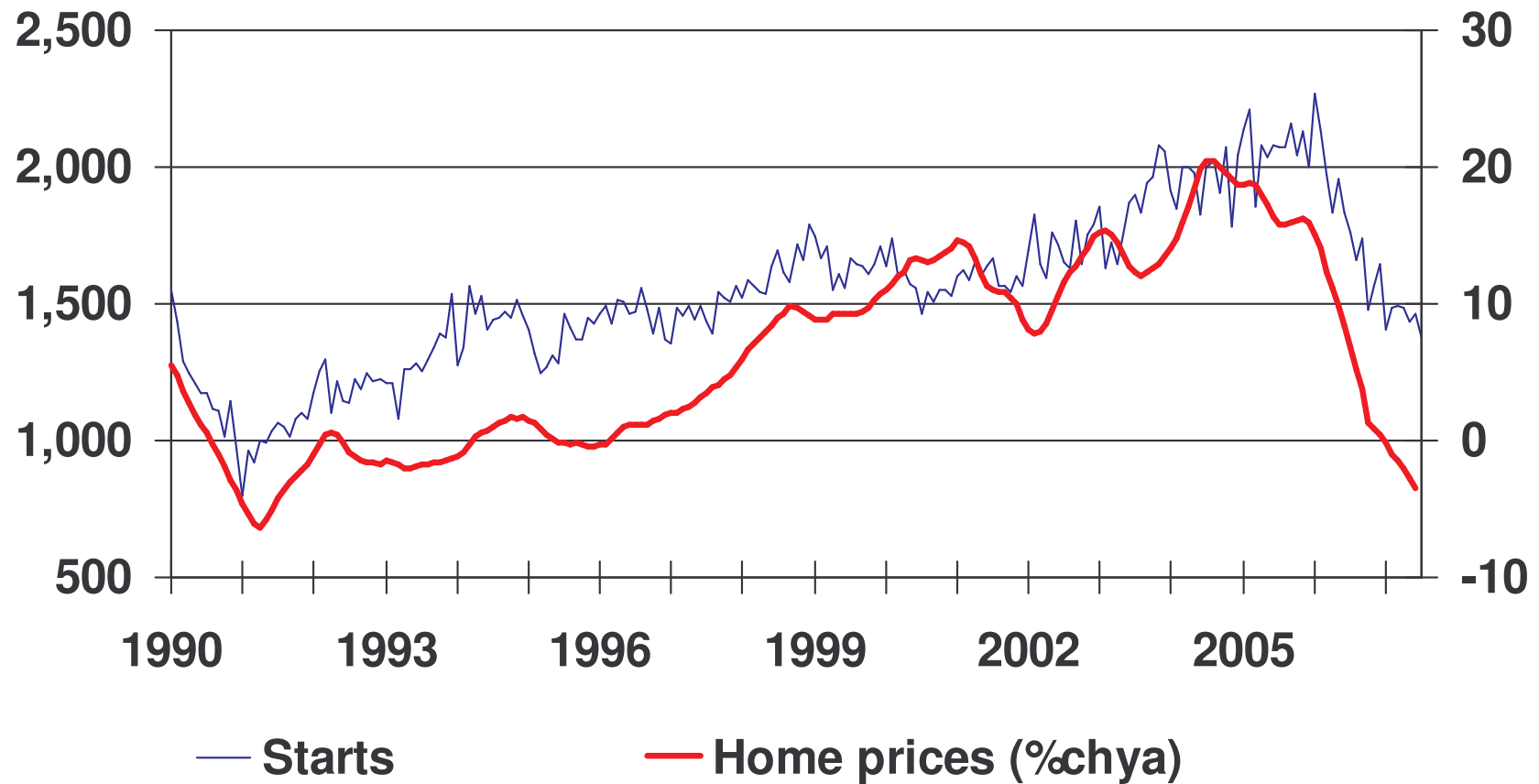
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The Housing Market Cycle

(Housing starts (1000) and 12-month % change in home prices (S&P/Case-Shiller))



Source: S&P and Census Bureau

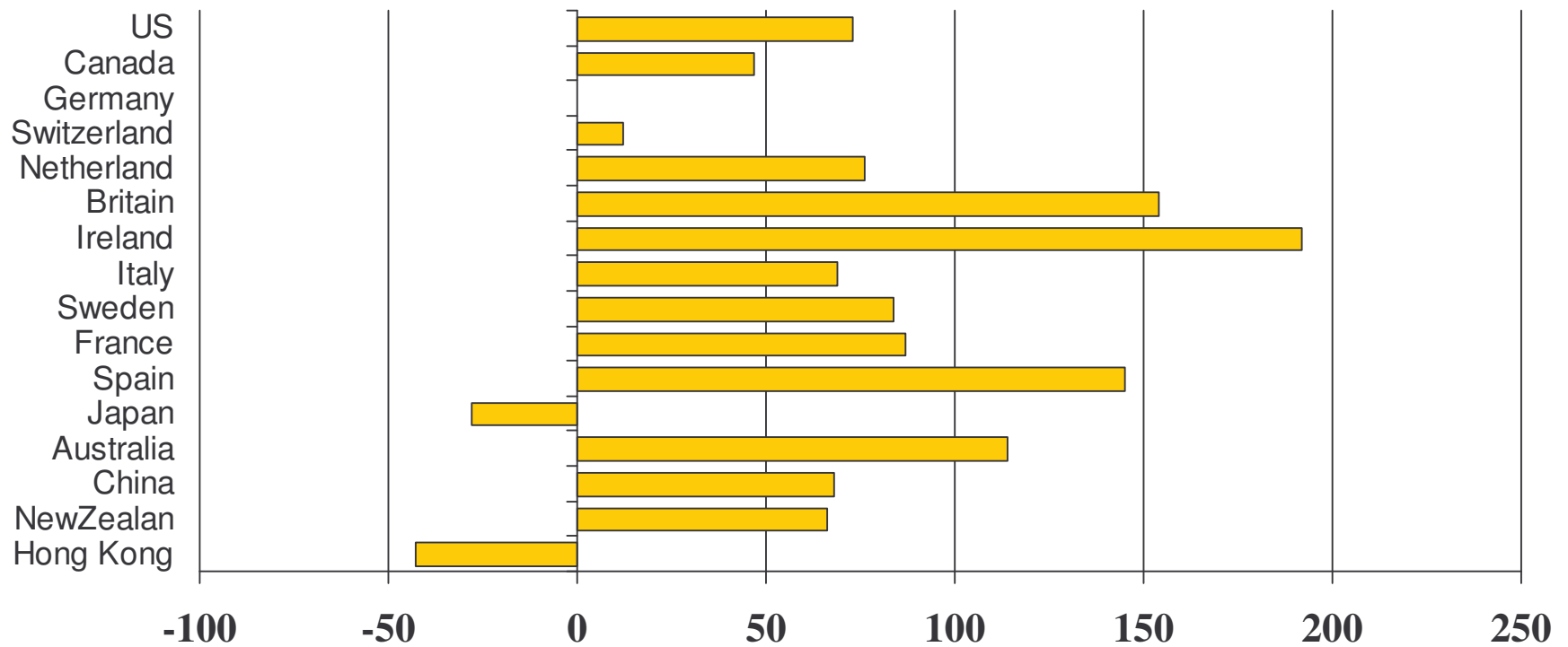
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Bubbles Are Everywhere

(Percent increase in home prices, 1997-2005)



Source: Mortgage Bankers' Association and S&P

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But the Weakness Isn't in the High-Priced Markets

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

	May-07 (12-month percent change)	2002-2005 average
Top 5		
Seattle	9.1	12.2
Charlotte	7.0	4.1
Portland, OR	5.7	13.1
Dallas	1.8	2.7
Atlanta	1.7	4.3
National average	-2.8	14.3
Bottom 5		
Detroit	-11.1	3.1
San Diego	-7.0	17.2
Tampa	-6.7	16.6
Washington	-6.3	19.5
Phoenix	-5.5	20.6

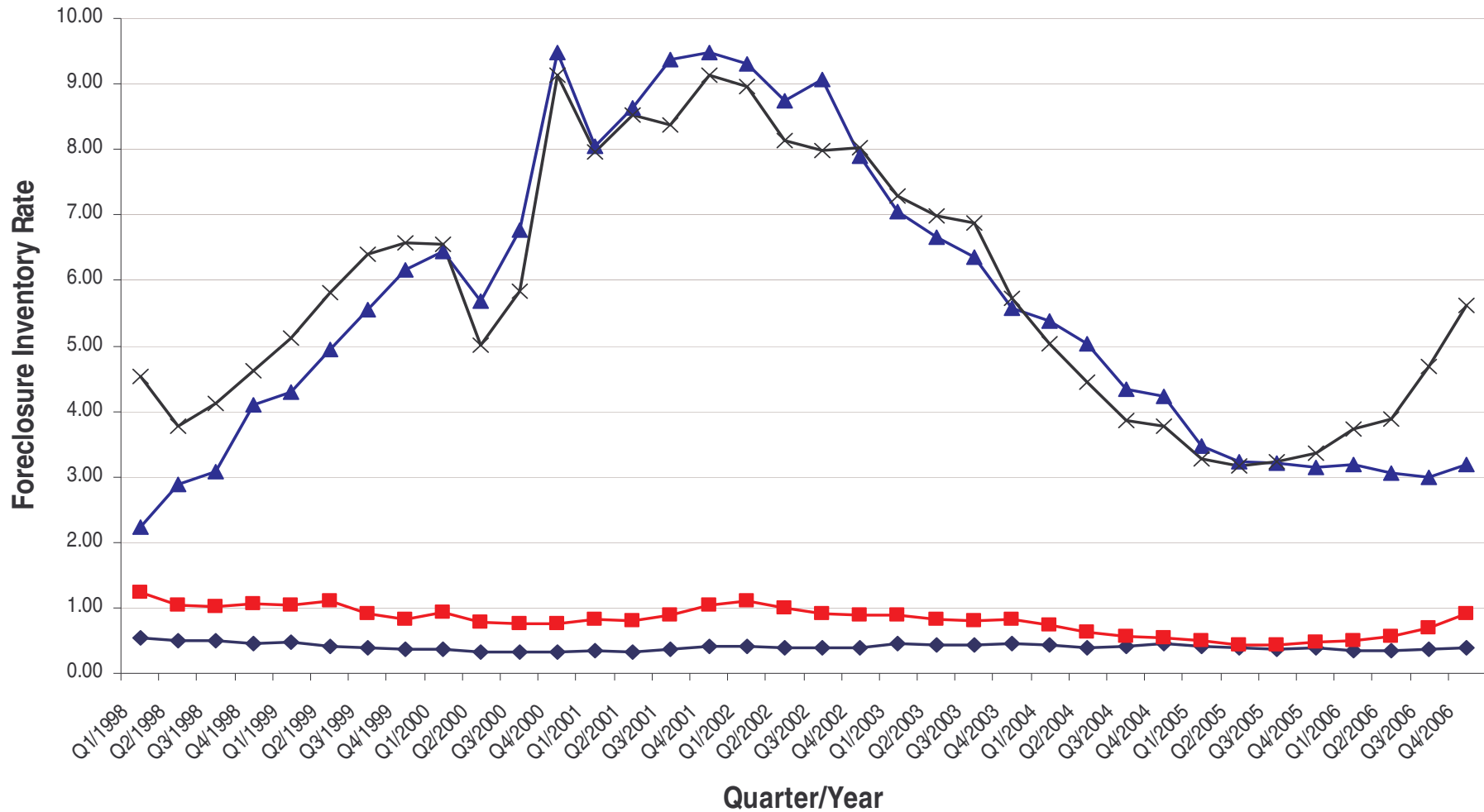
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Foreclosure Inventory Rate by ARM and Fixed



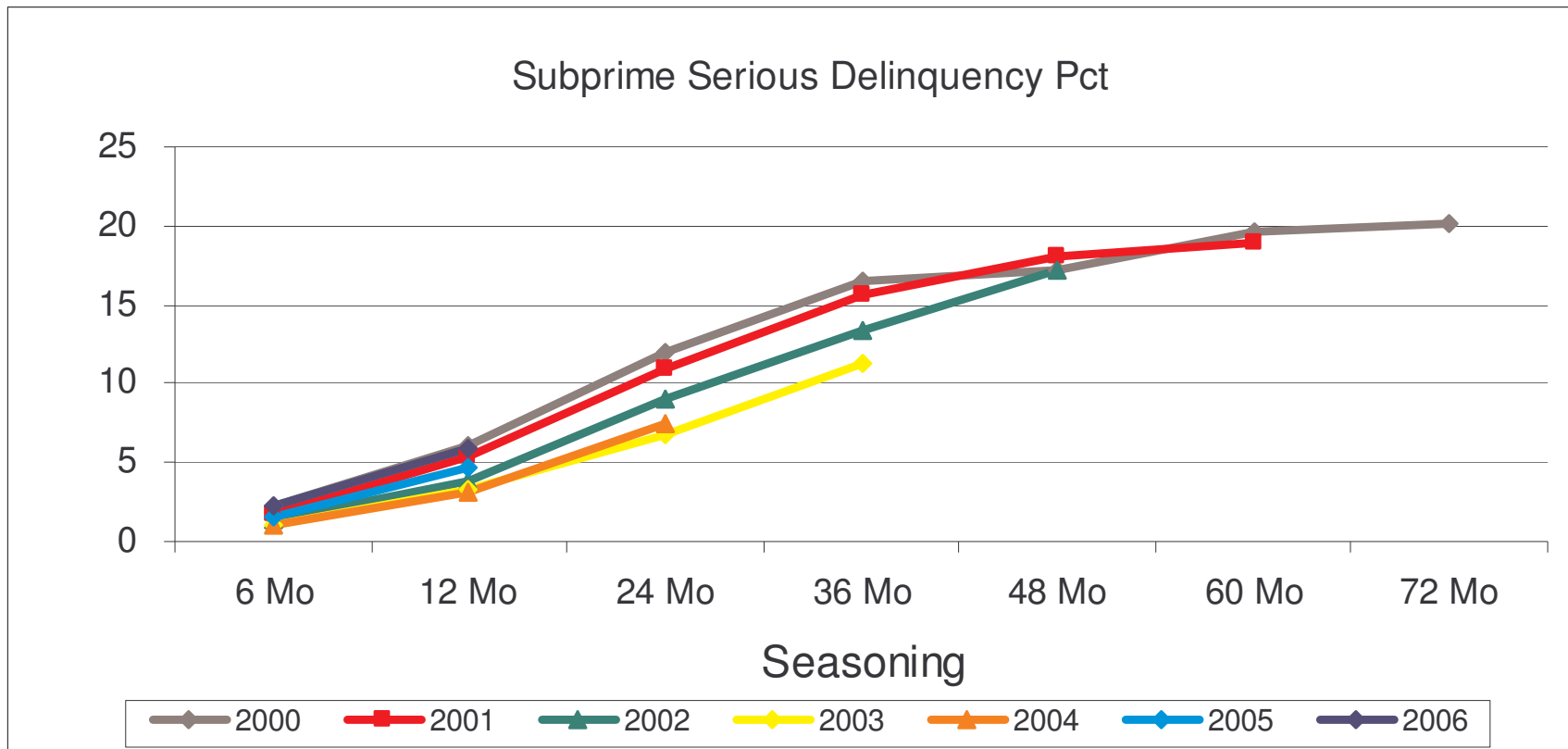
◆ Prime Fixed
 ■ Prime ARM
 ▲ Subprime Fixed
 × Subprime ARM

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Source: MBA's National Delinquency Survey



Subprime Delinquencies are Rising Fast



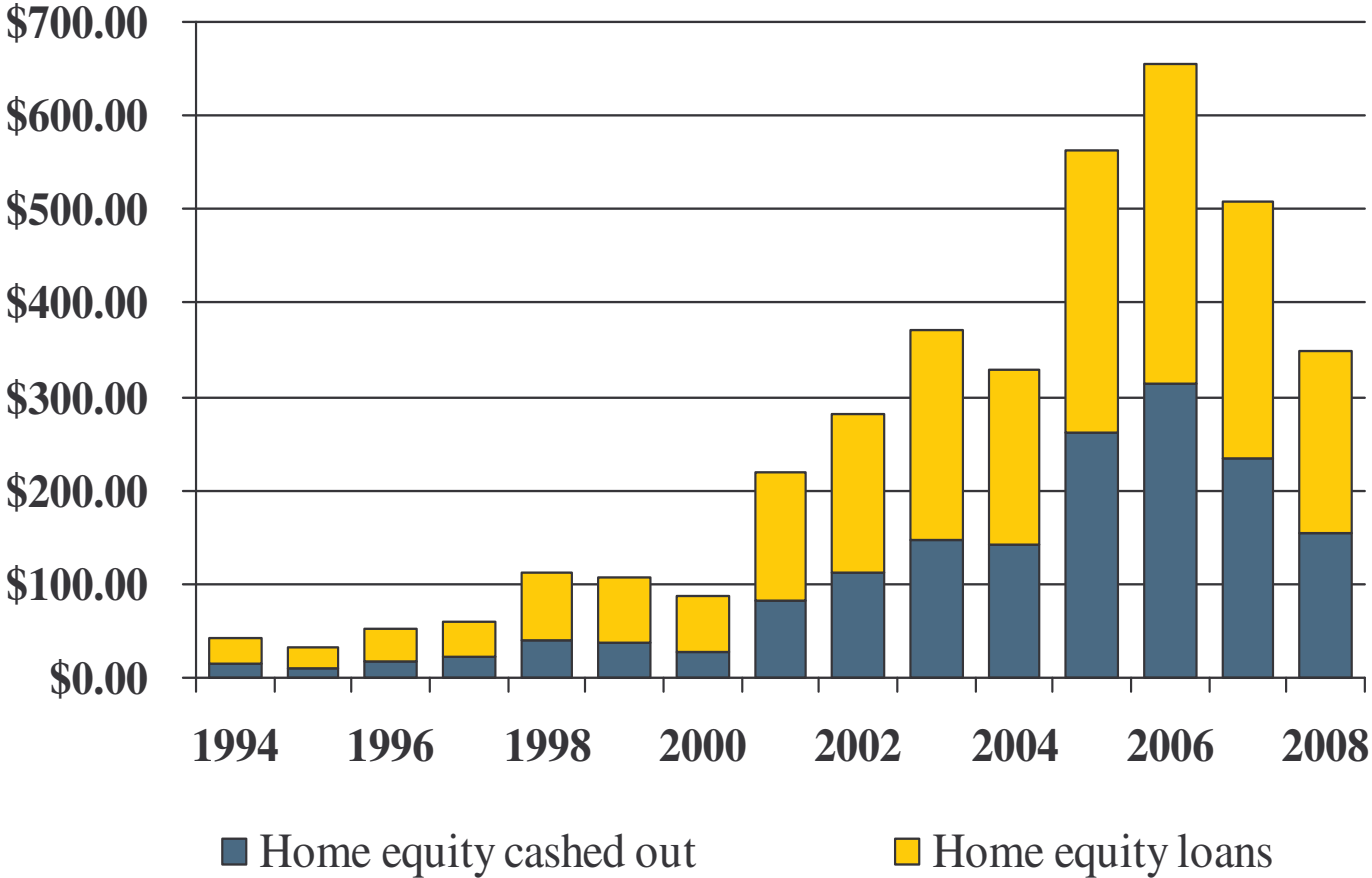
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Borrowing Against Your Home



Source: Freddie Mac

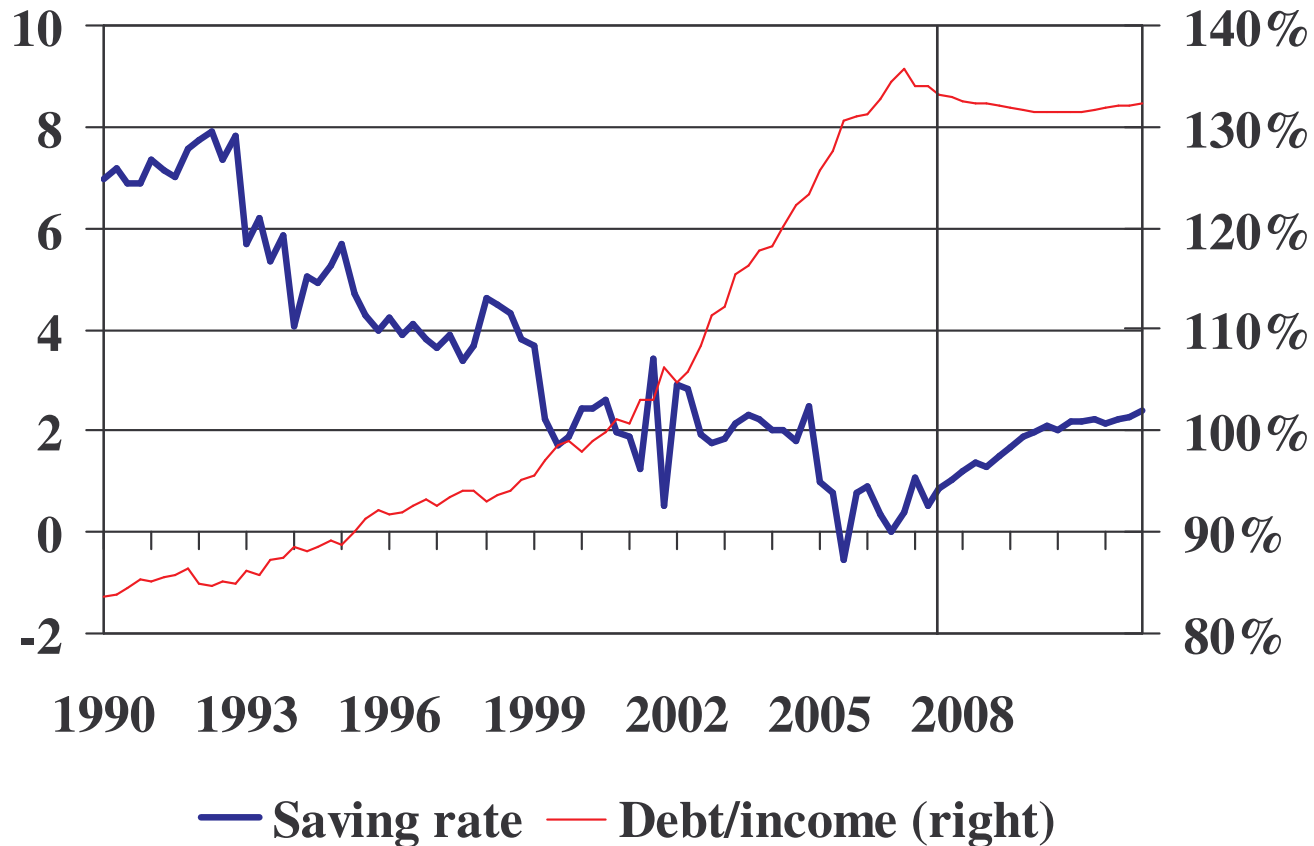
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Despite Earlier Reports, Americans Did Save

(Percent of after-tax income)



Source: BEA and Federal Reserve

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