

Government Finance Officers Association of Louisiana



MARK ROSA
OCTOBER 10, 2008

Economic Trends



- Slower Growth – 1%
- Higher Unemployment – 7%
- Fears of Recession – Remain since last year.
- Housing Collapse – I have graphs.
- Government Deficits – can they get bigger?
- Rising Inflation Pressures – 5%
 - High energy prices.

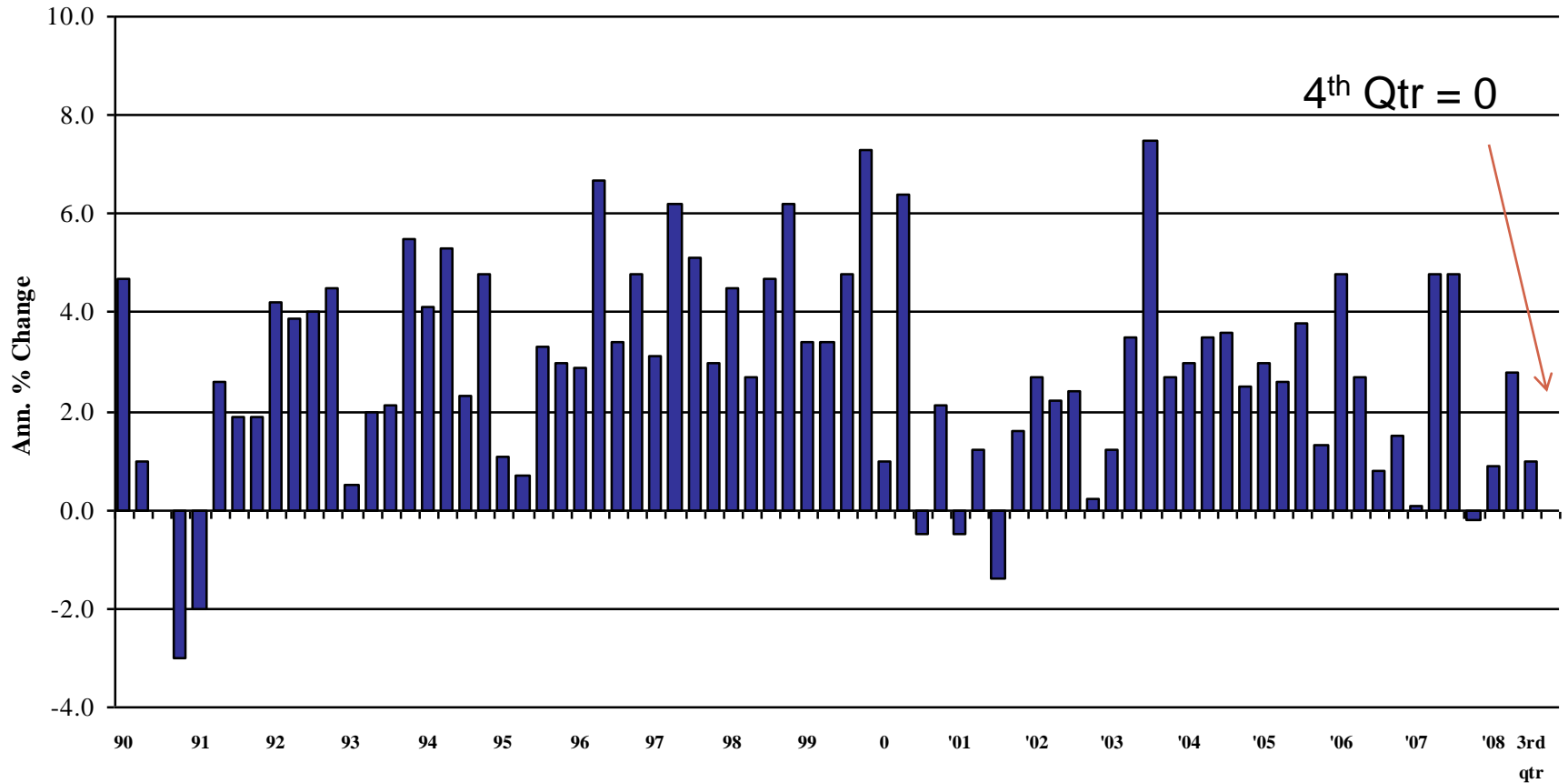
Gross Domestic Product

(billions of US dollars)



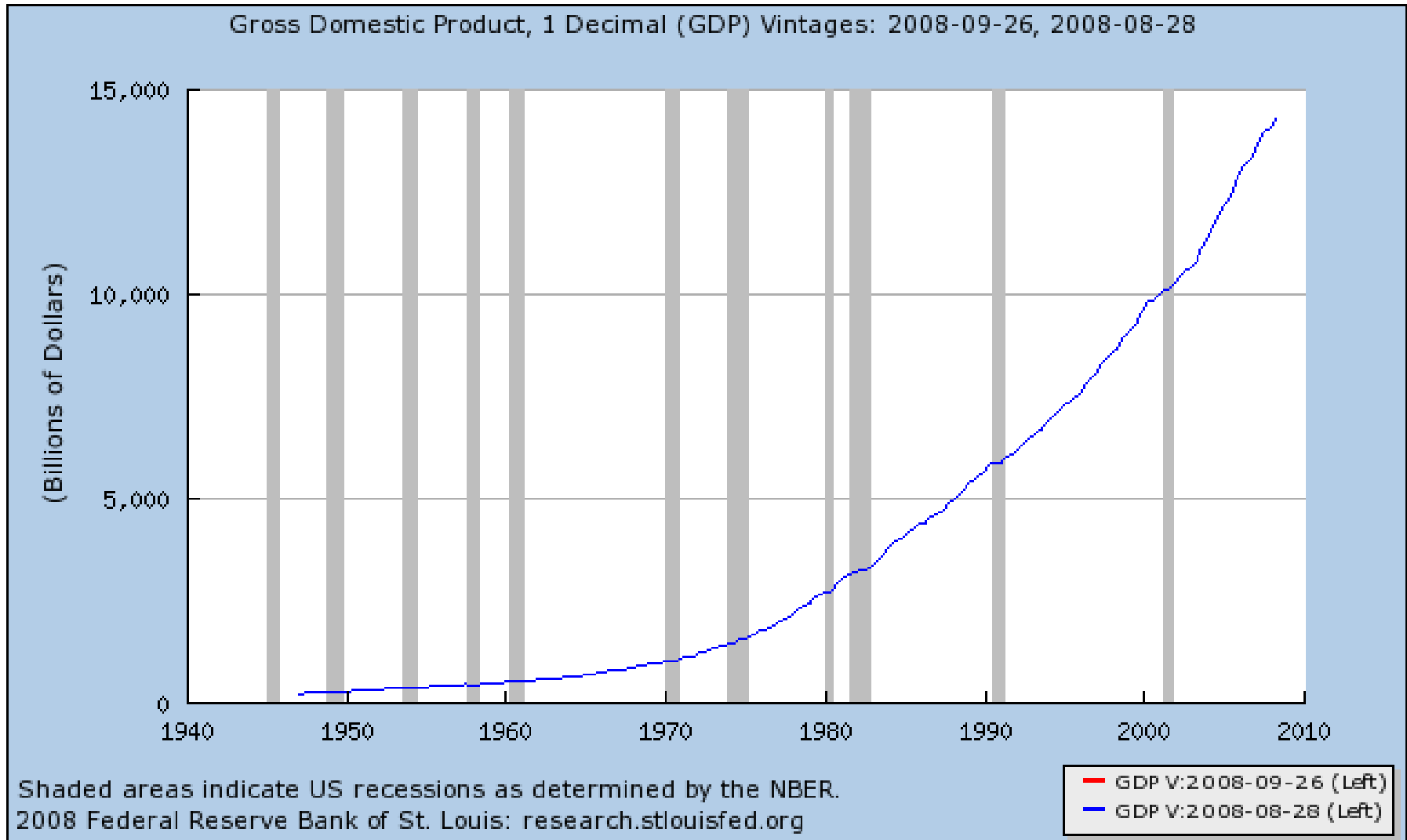
	2007	2006	2005	2004
United States	13,811	13,163	12,486	11,668
Japan	4,377	4,340	4,506	4,623
Germany	3,297	2,907	2,782	2,714
China	3,280	2,668	2,229	1,649
U.K.	2,728	2,345	2,193	2,140
France	2,562	2,231	2,110	2,003

Real Gross Domestic Product



Source: Commerce Department

US Gross Domestic Product from 1947 – Federal Reserve Bank

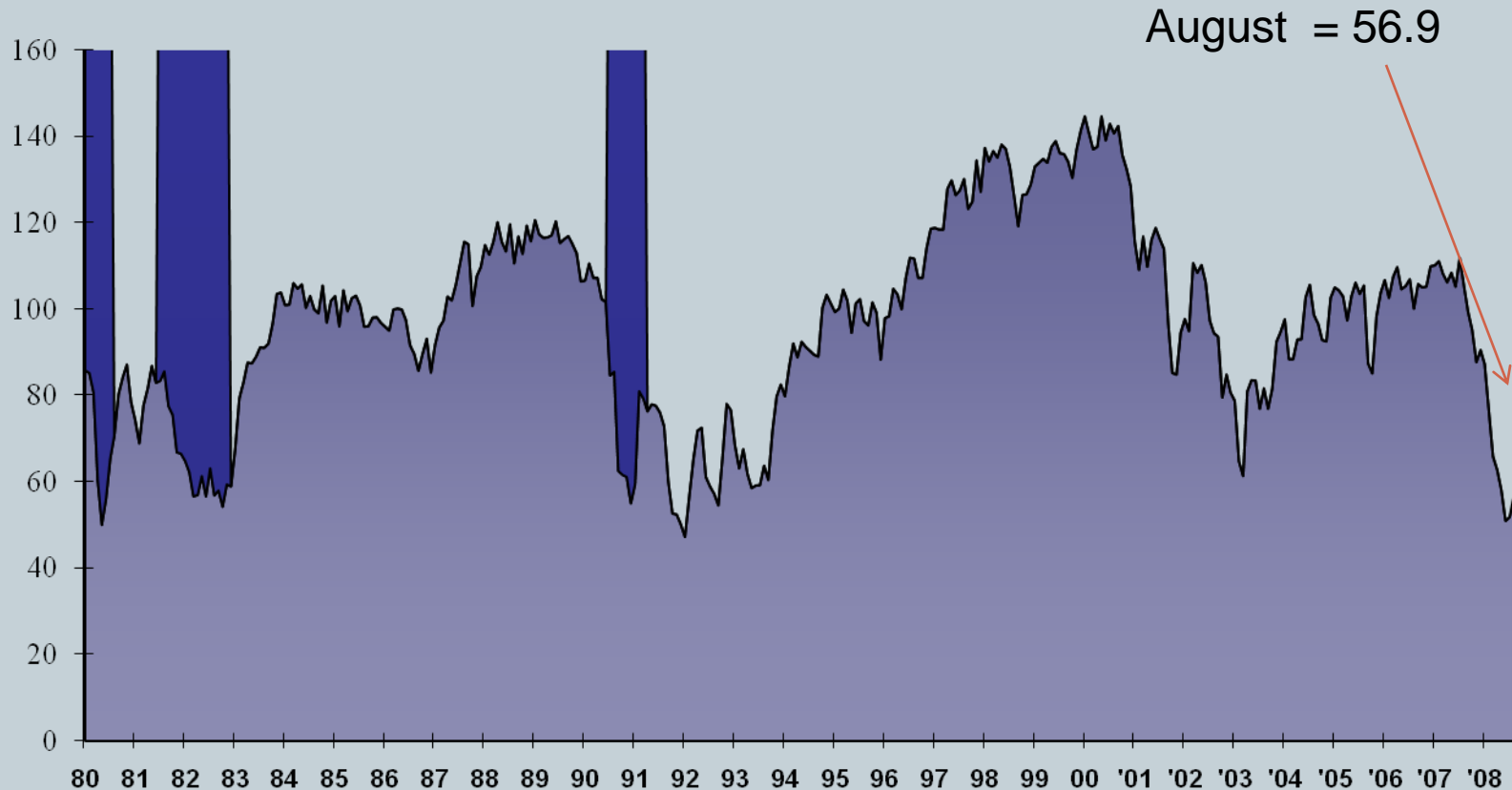


Consumer Confidence



- Tracked and reported by The Conference Board. A non-profit organization.
- The Consumer Confidence Survey reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitudes and buying intentions, with data available by age, income, and region.

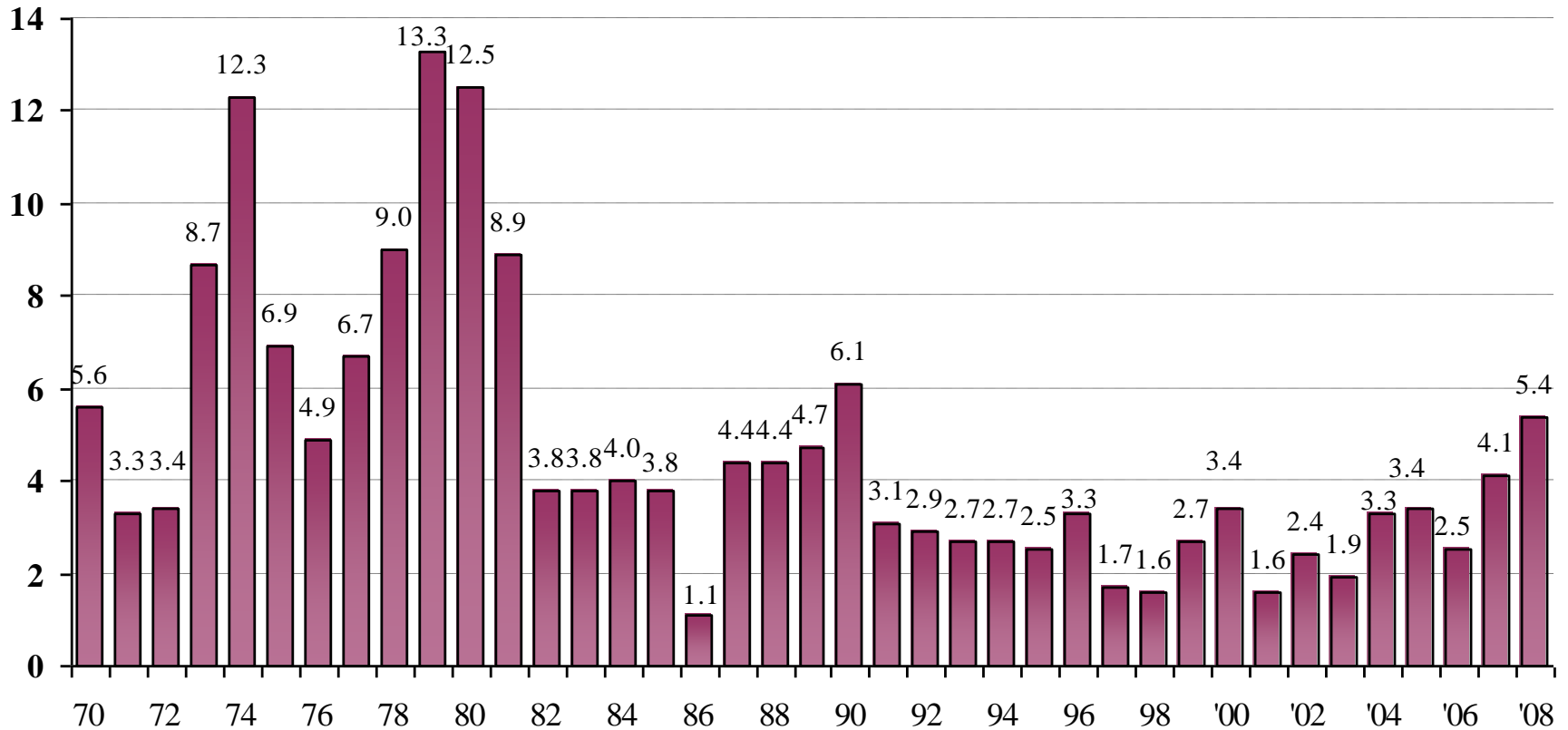
Consumer Confidence: 1980 to Present



Source: Conference Board

Consumer Price Index

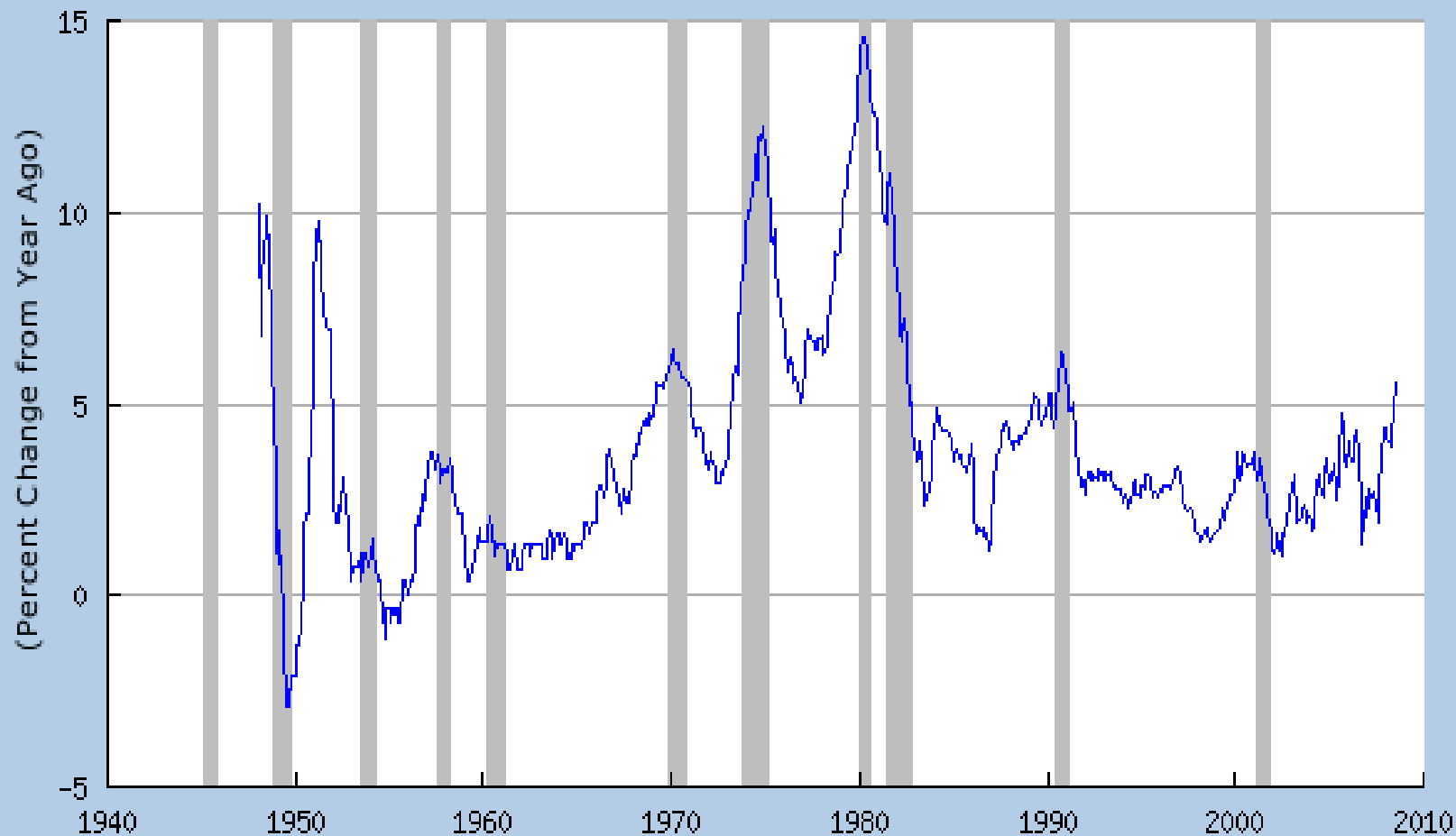
1970 to Present



Source: Labor Department

Consumer Price Index For All Urban Consumers: All Items (CPIAUCSL)

Source: U.S. Department of Labor: Bureau of Labor Statistics



Shaded areas indicate US recessions as determined by the NBER.

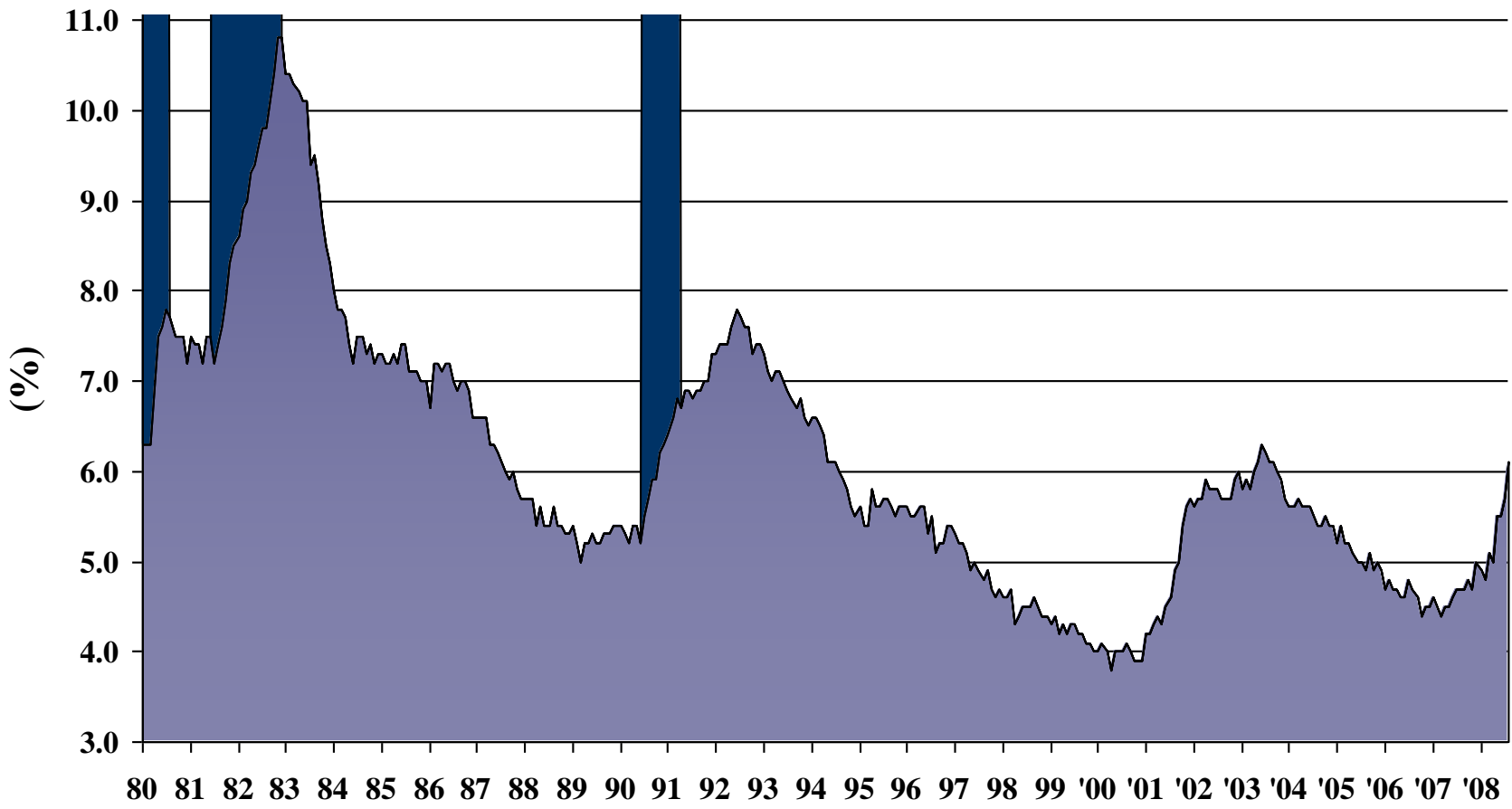
2008 Federal Reserve Bank of St. Louis: research.stlouisfed.org

US Productivity



- Increases and enhancements in worker productivity keeps downward pressure on inflation.
- \$80 - \$100 per barrel oil has not affected the economy to the extent that many would have believed.
- 80 people today are doing the work that required 100 in 2001.

Unemployment Rate



Work Woes

Initial jobless claims, four-week moving average

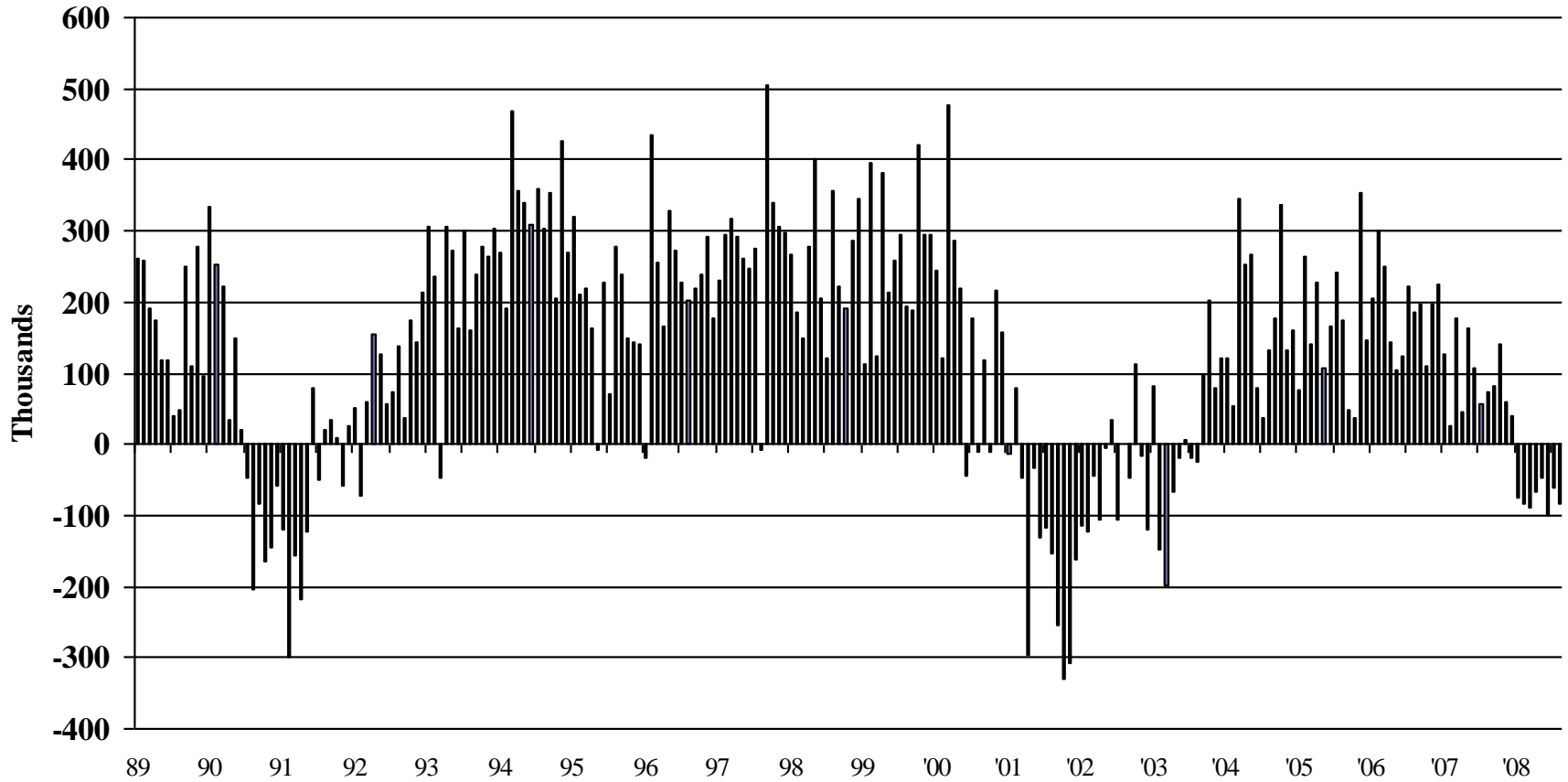


Note: Seasonally adjusted data

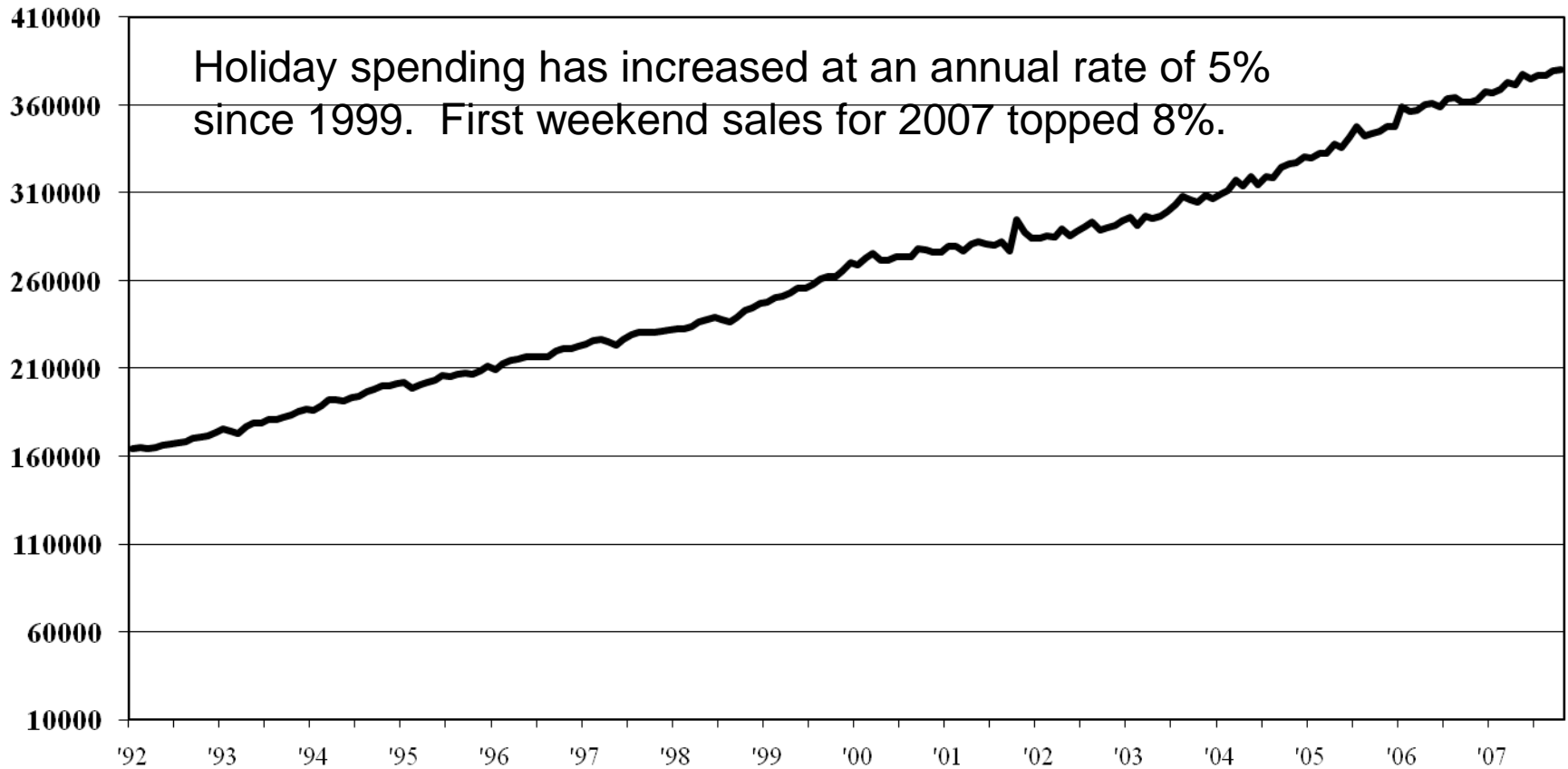
Source: Labor Department

Non-Farm Payrolls

(Monthly Changes SA)

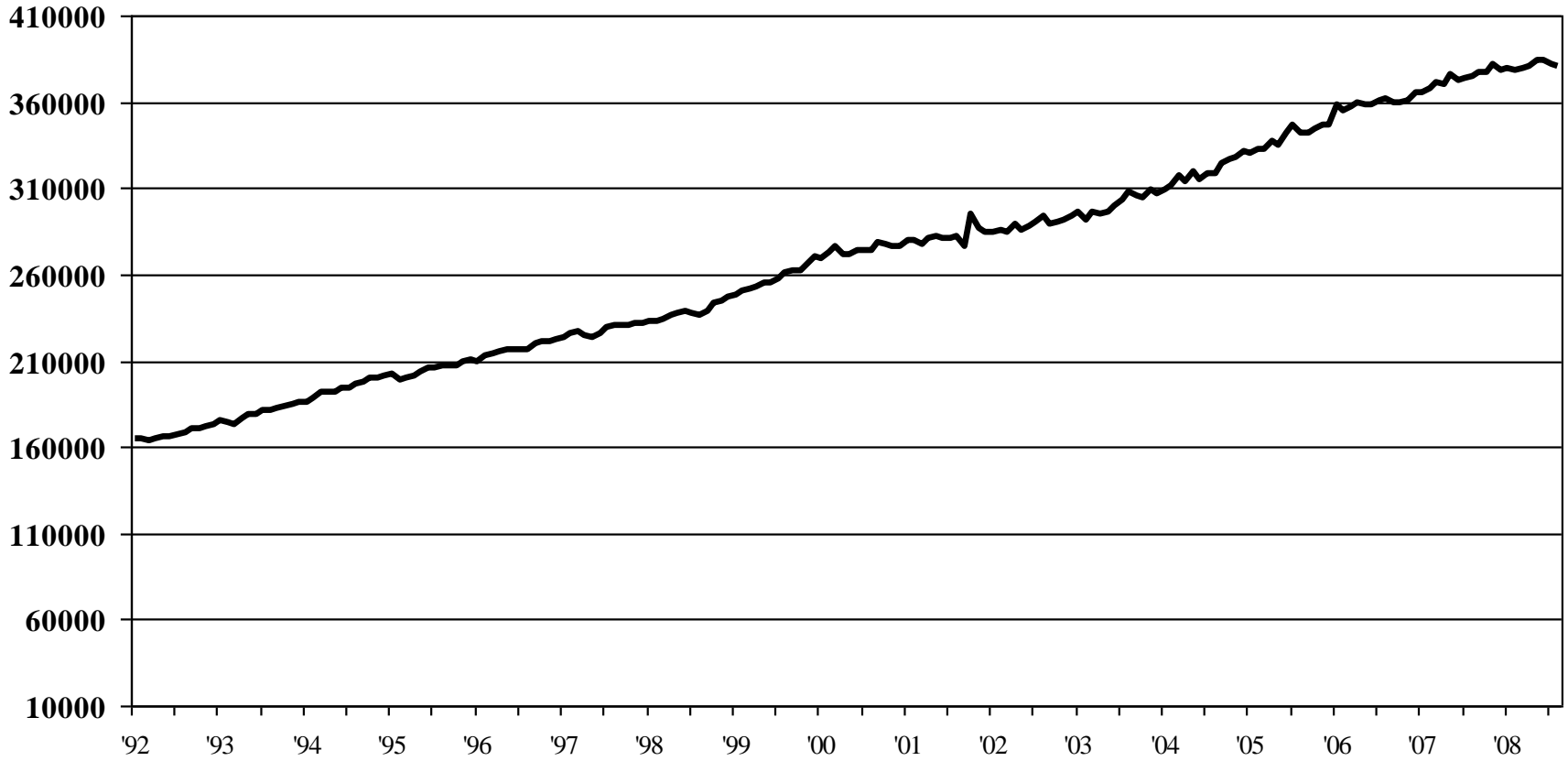


Retail Sales (\$Millions, SA)



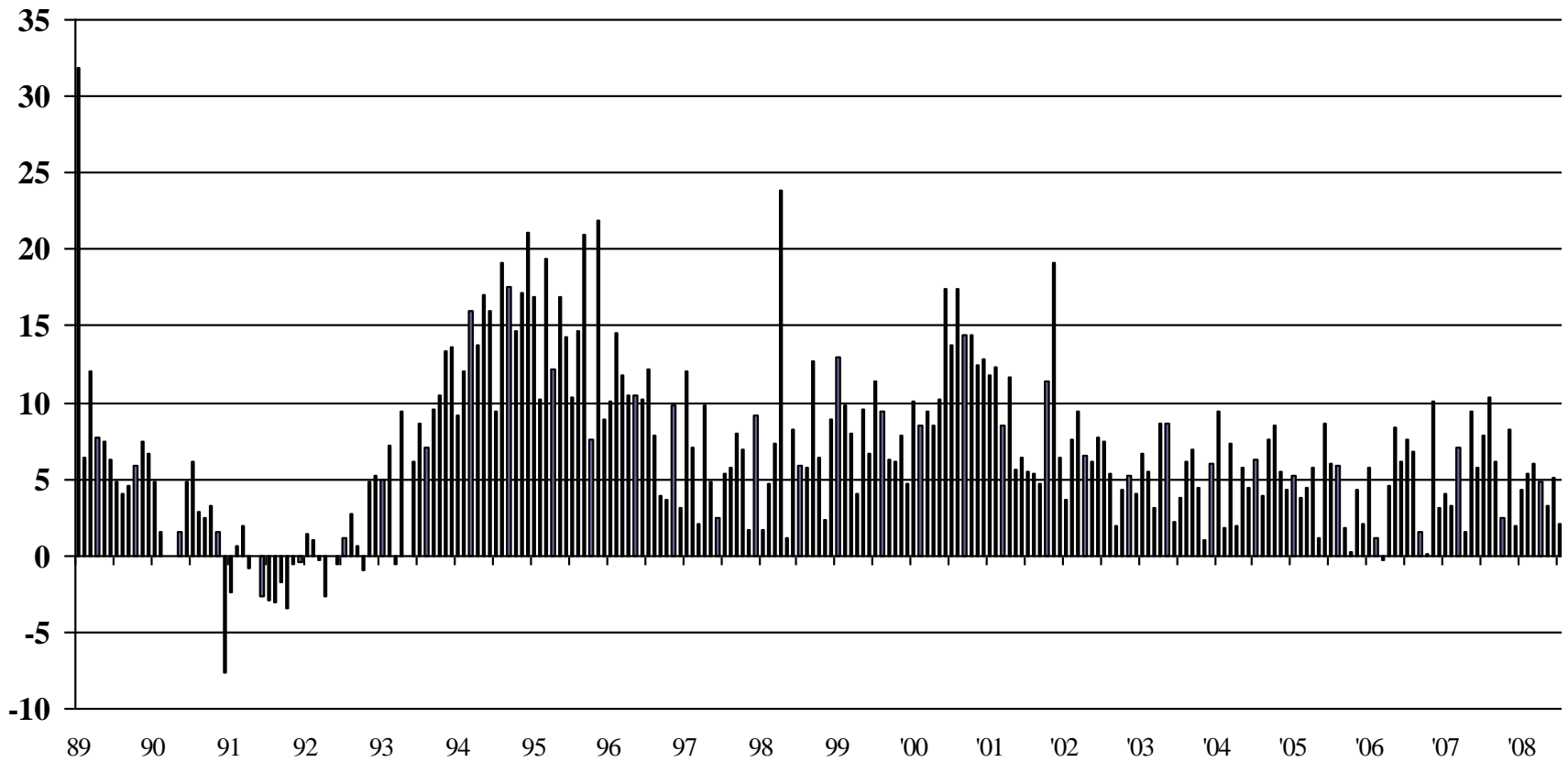
Source: Commerce Department

Retail Sales (\$Millions, SA)



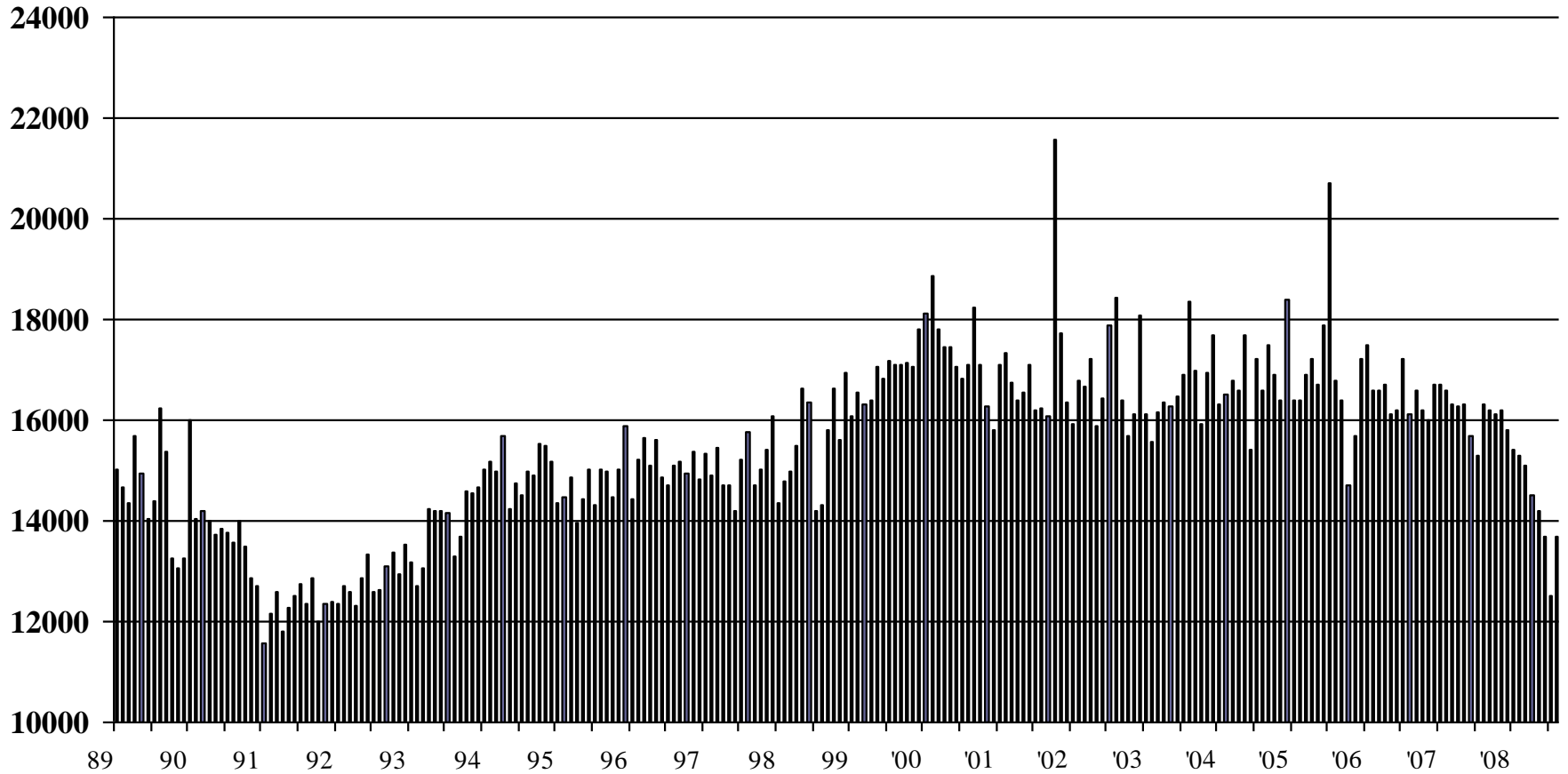
CONSUMER DEBT

(Percent change at annual rate)



Vehicle Sales

(Monthly Data, SAAR. Latest: August, 2008)

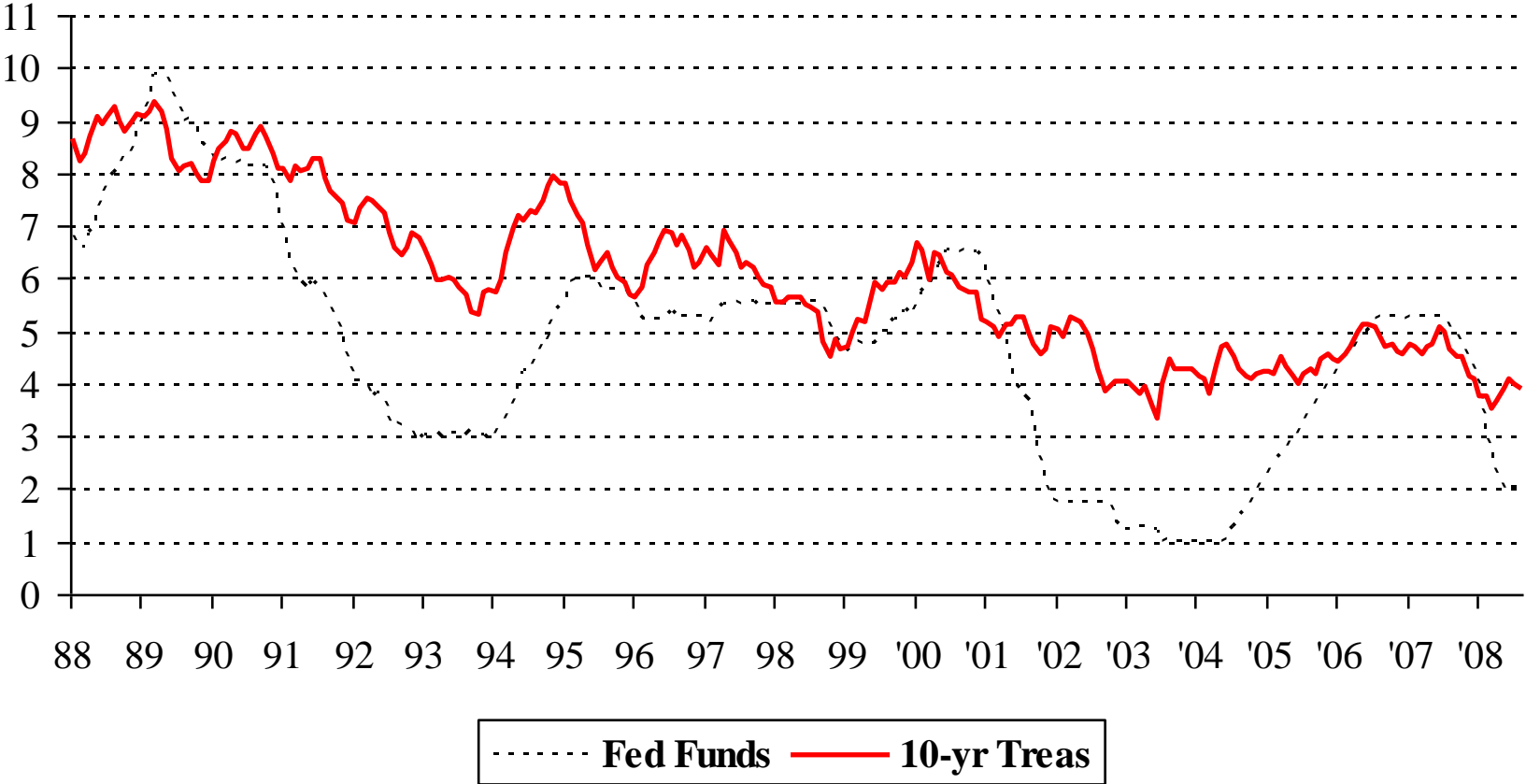


Vehicle Sales



- The largest Chevy dealership in the US filed for bankruptcy in September (08). The 89-year old firm was responsible for billions in sales.
- 600 of the 20,000 dealerships in the US are expected to close.
- Vehicle sales are at a 15-year low.
- Automakers, already under financial stress, are forecasting tougher times in 2009.

Interest Rates 1988-2008



Mortgage Rates (Conventional, FHLMC) 1988-2008



Existing Home Sales

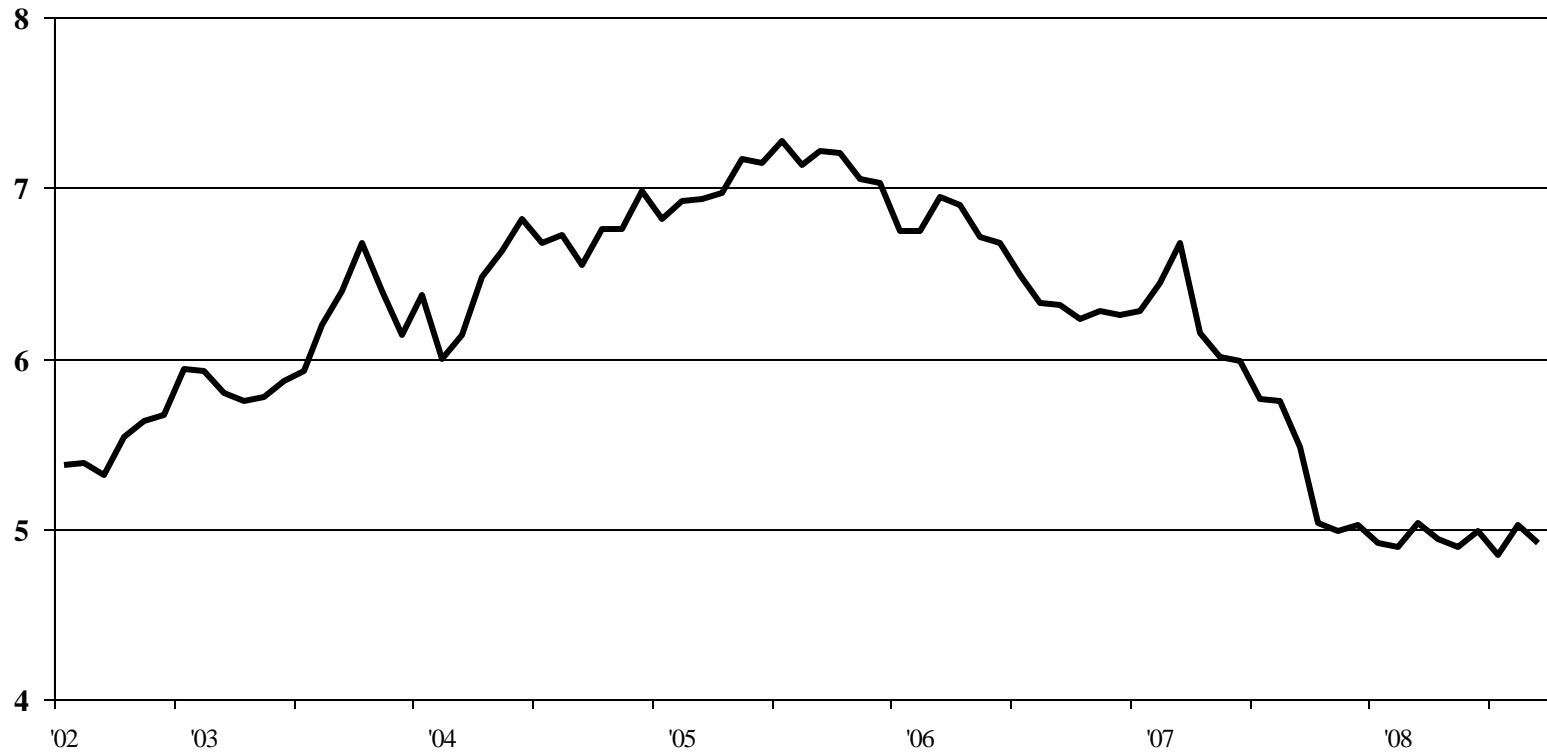
(Millions, SAAR)



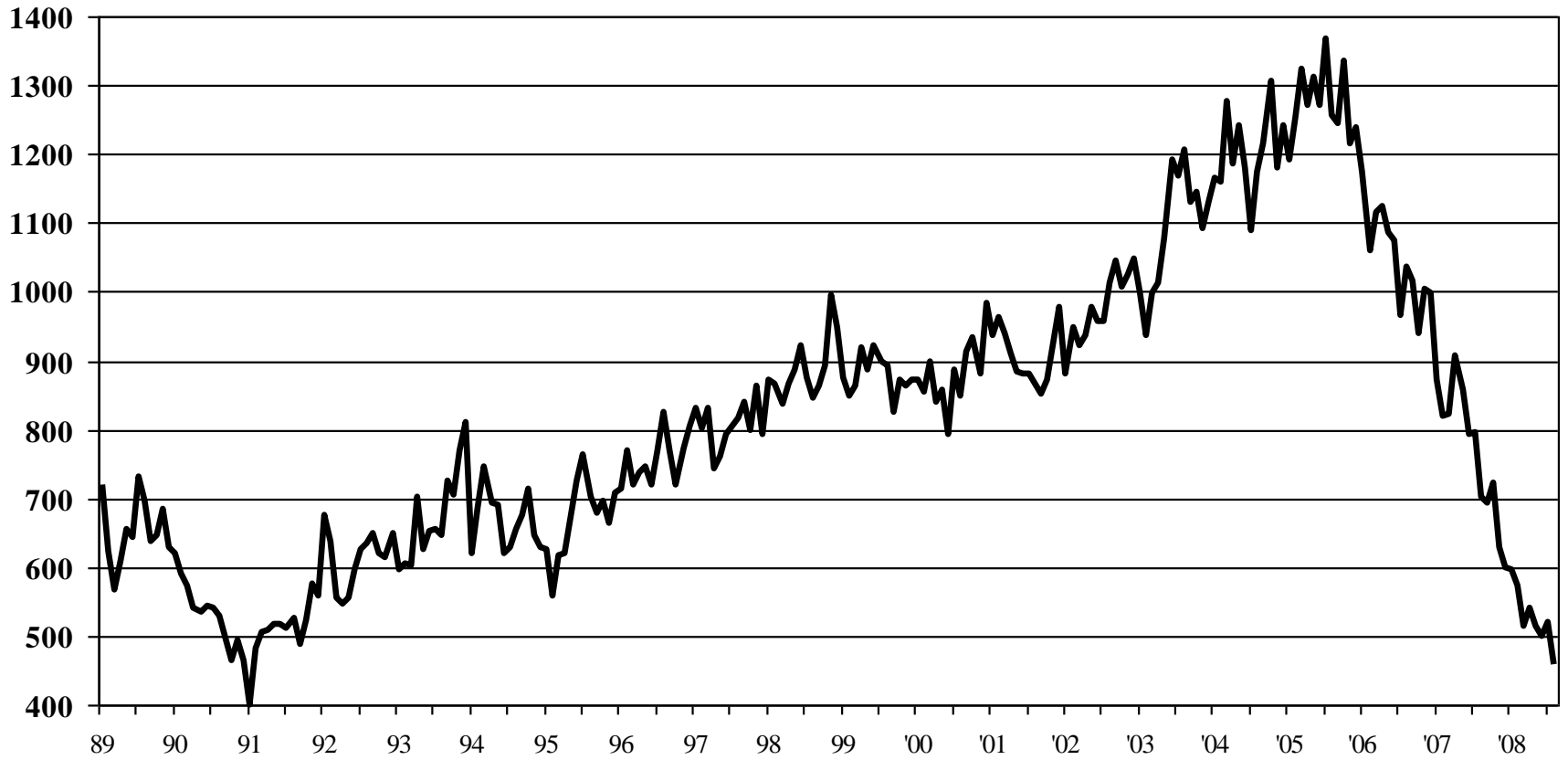
Source: National Association of Realtors

Existing Home Sales

(Millions, SAAR)



New Home Sales



Mortgage Market



- Post-War Legislation:
 - Deposit Institutions Deregulation & Monetary Control Act (DIDMCA, 1980).
 - ✦ Phased out Federal Reserve Regulation “Q”
 - Allowed *deposit* rates to ‘float’ with the market.
 - *S&L CRISIS was the result.*

Mortgage Market



- Solution to S&L Crisis:
 - The adjustable rate mortgage.
 - Home Equity Credit Lines
 - Interest-Only Payments

Mortgage Market



- **Securitization**

- Financial institutions used to hold the mortgage until maturity.
- Securitization made the loans easy to sell with Wall Street's help.
- Bank unloads the loan the day that it is made.
- Wall Street unloads the securitized loans to investors further shifting the risk and distancing themselves from the underlying loan.
- There is big money to be made here.

Mortgage Market



- Prime loans are great
 - Credit scores (FICO) of 680 and above.
- Sub-prime loans are better!
 - Credit scores less than 620.
 - No down payments.
 - Lack of income documentation.
 - Interest Only payments.
 - Negative Amortization possible.
 - Simultaneous second mortgages (up to 125% LTV).
 - Non-Owner occupied.
 - *Buyer walks away from the closing with a check.*

Credit Scores



- Credit Scores 680 + = A
 - 620 – 679 = B
 - 600 – 619 = C
 - 550 – 599 = D
 - 549 and below = E
-
- Experian, FICO

Mortgage Market



- **The Making of a Bubble:**
 - Investors, like brokers have no attachment to the mortgage.
 - Commercial: “Buy the home you want, not the home you can afford.”
 - “Land is the best investment, they are not making any more of it.”
 - TV Program: Flip This House

Mortgage Statistics



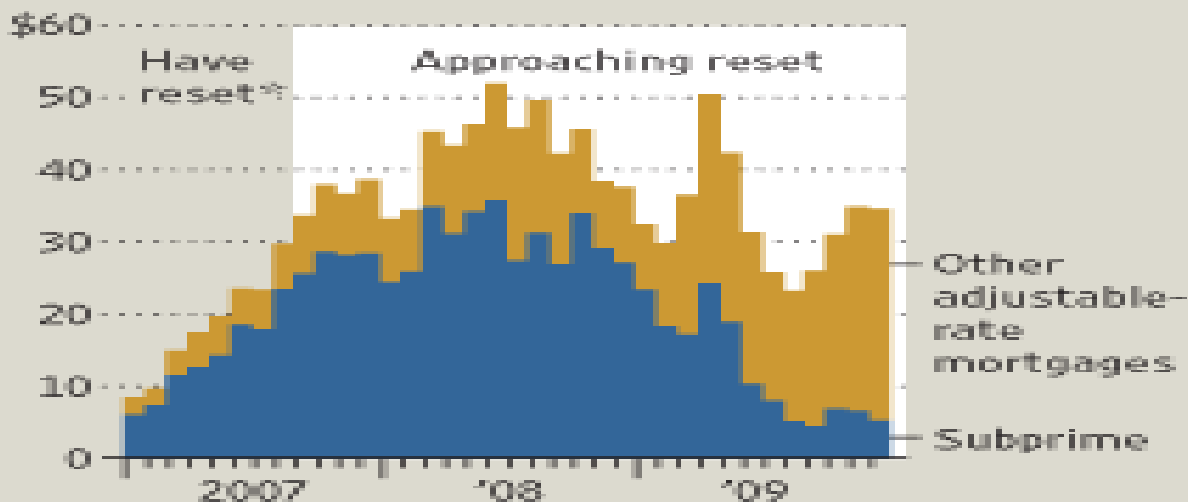
- 450,000 ARMS reset in 4th quarter of 2007.
- Mortgage debt grew by \$4 trillion from 2000-2005.
 - Half are refinances
 - 2002 Fed survey found that ~25% of refi funds were used to pay for consumer expenditures.
- \$50 billion of sub-prime ARMS will reset for the first time in October.

Resets expected on \$362 billion in mortgages.



More to Come

The subprime loan crisis could accelerate as rates on loans reset. Balance on loans, in billions



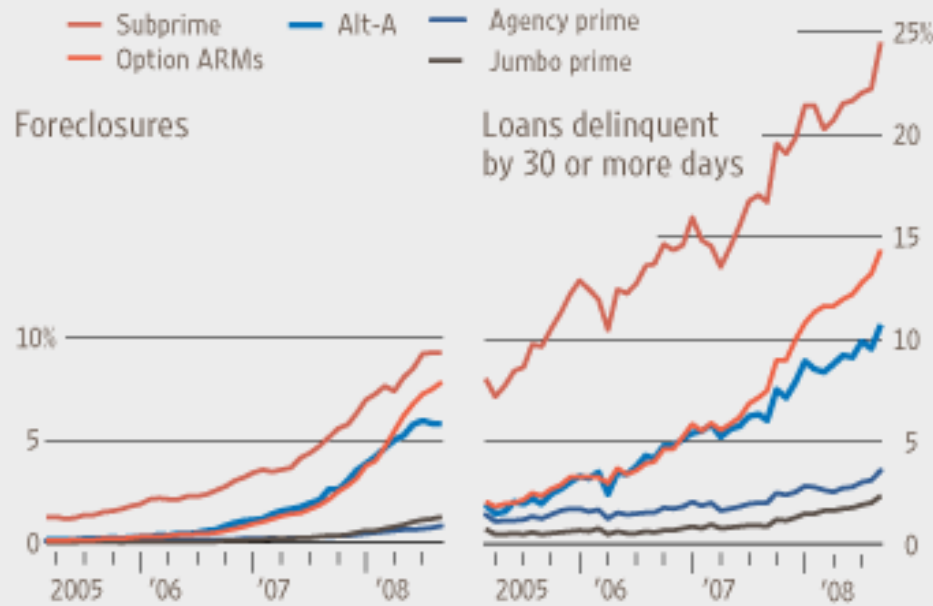
*Figures don't include mortgages that were refinanced or otherwise paid off before or after reset.

Note: Data are as of Sept. 1

Source: Banc of America Securities

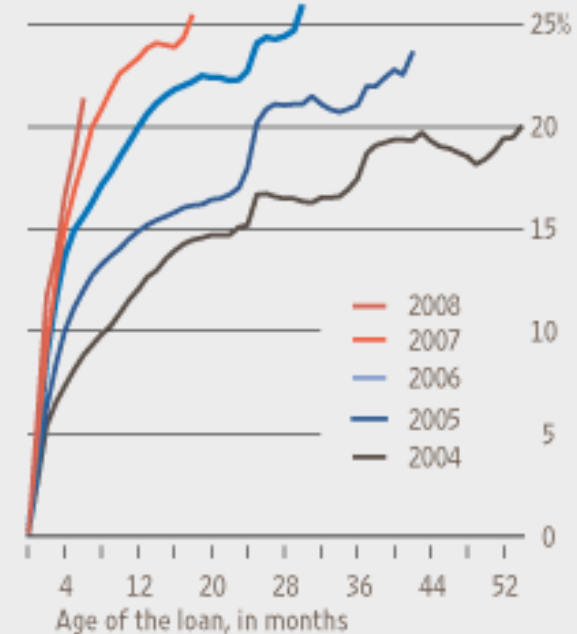
At the Heart of the Matter

More mortgages of all types are going bad...



...Sooner

Subprime delinquencies by vintage



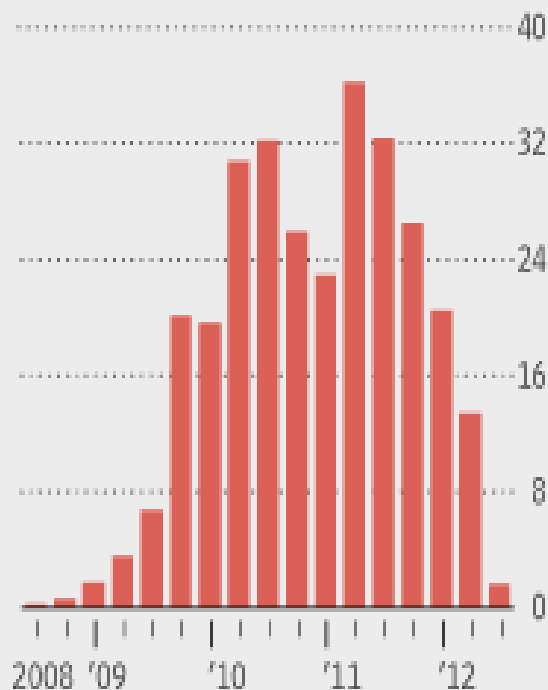
Notes: Mortgages originated between January 2004 and August 2008, excluding home-equity loans. Subprime and Alt-A loans are non-agency, non-government loans. Subprime loans are either identified as such by the servicer or have an original FICO score of less than 620. Alt-A loans are loans made without full documentation and have original credit scores of 620 to 719.

Source: LPS Applied Analytics

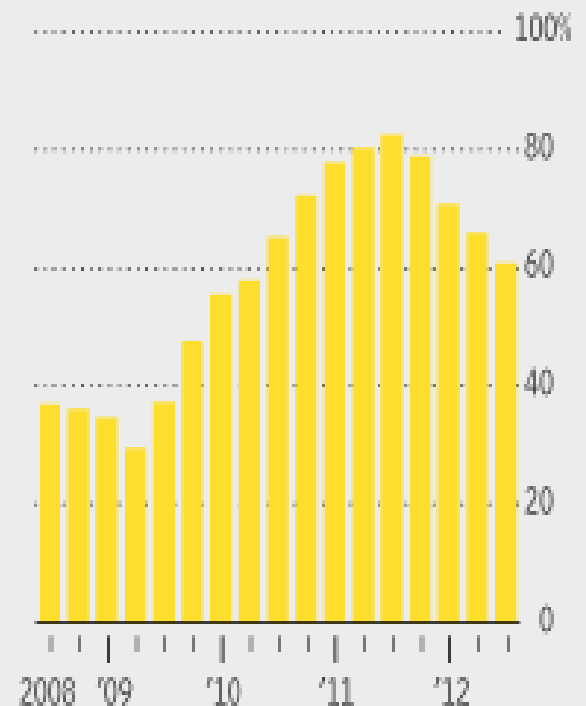
Next on the Block

The next blow to the housing market could come from 'option ARMs.' Borrowers who opted to make a minimum payment on these loans could see their monthly payments jump when they begin to make full payments. Many of them now owe more than their homes are worth.

Balance outstanding on option ARMs that are scheduled to be recast* in each quarter; in billions



Relative payment shock, or the average percentage by which borrowers' payments will jump once their mortgages are recast.



*Option ARMs on which payments will be recalculated; estimates exclude loans that are paid off early. Sources: LoanPerformance; Barclays Capital

Recession Worries



- The economy has gone into recession 6 of the 7 times since 1960 that short-term interest rates topped longer-term bond yields.
- In 2007, the difference between three-month bills and benchmark 10-year notes was close to the widest since 2001.

YIELD CURVE



- The best leading economic indicator.

	3-month rate	10 year rate
• September 2000	6.00%	5.70%
• July 2003	0.95%	4.35%
• March 2005	2.75%	4.25%
• March 2006	4.59%	4.81%
• November 2006	5.10%	4.60%
• February 2007	5.16%	4.58%
• October 3, 2007	3.97%	4.56%
• October 3, 2008	0.50%	3.61%
• Fed raised short-term rates 17 times from June, 2004 to June, 2006.		

<HELP> for explanation.

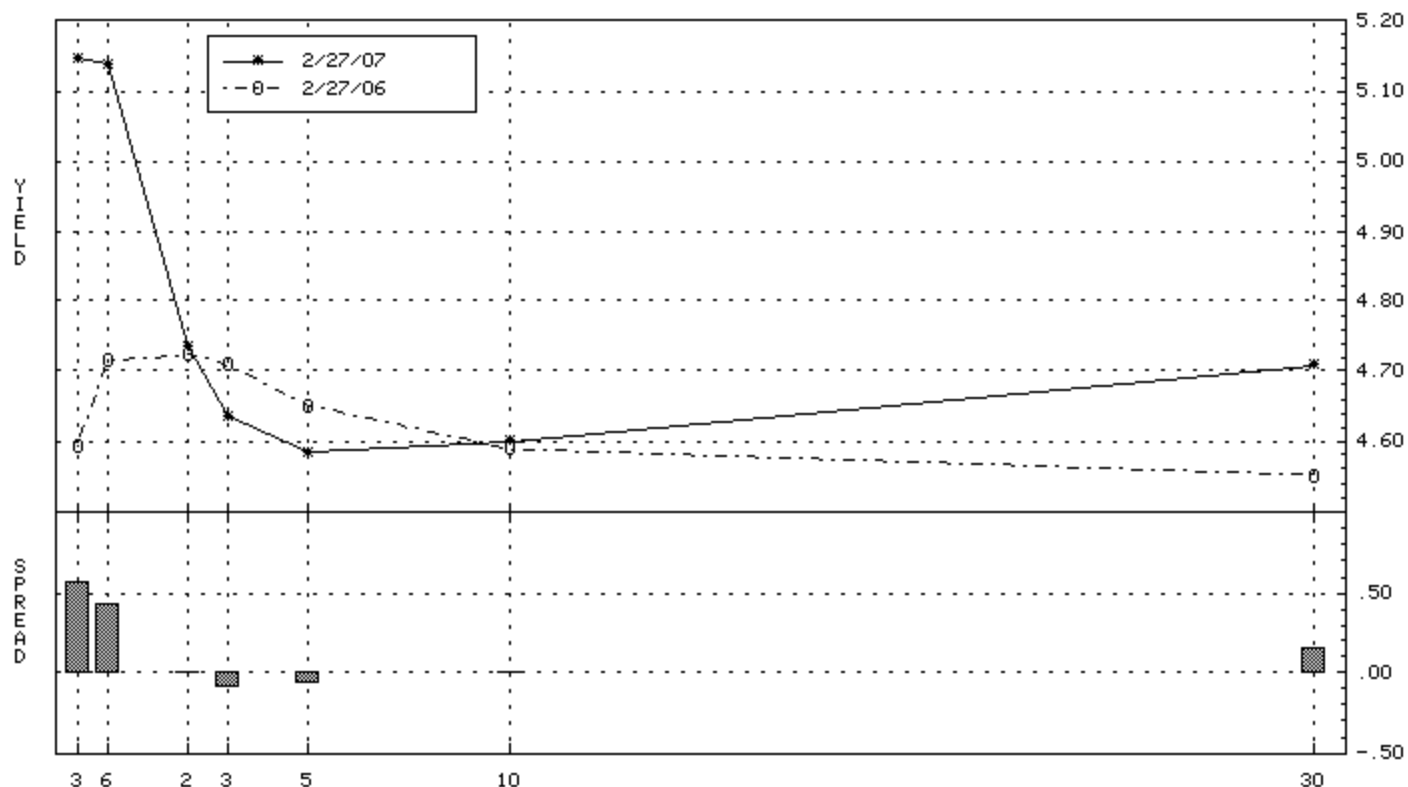
N117 Govt C15

HISTORICAL YIELD CURVE

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DATE RANGE 2/27/06 2/27/07

MTY RANGE 3M 30Y



Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2007 Bloomberg L.P.
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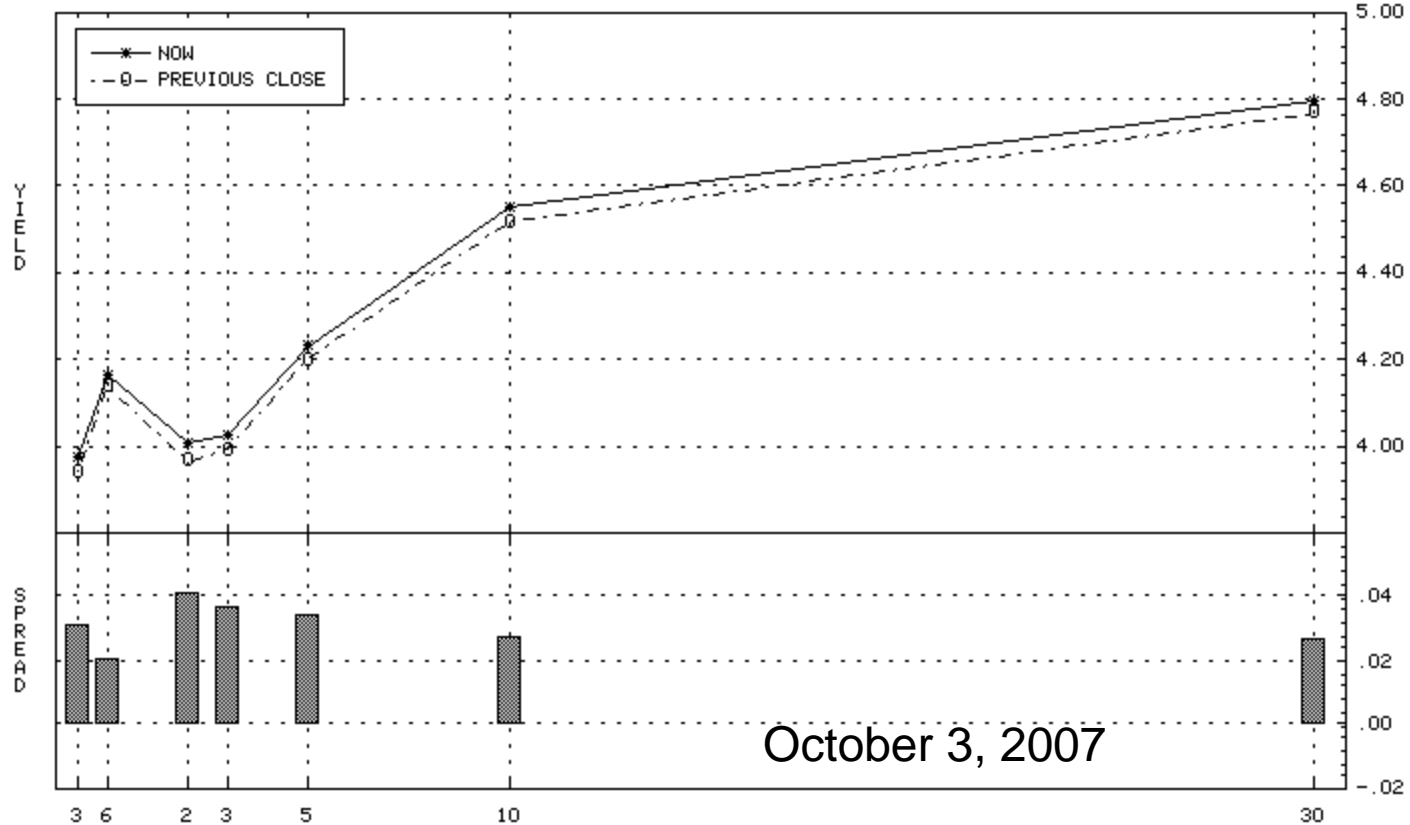
<HELP> for explanation, <MENU> for similar functions.

Msg:B.ELLIOTT

12:40

YIELD CURVE (BLOOMBERG GENERIC-ASK)

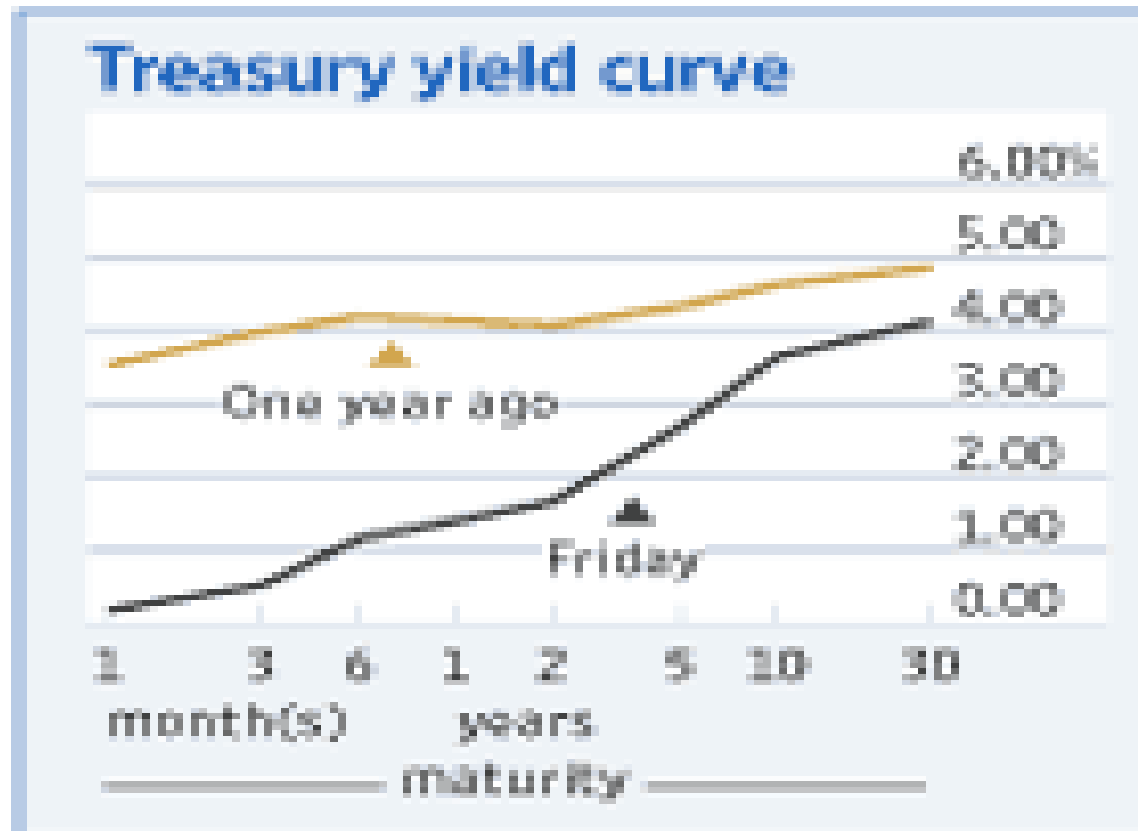
PAGE 1 OF 2



October 3, 2007

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2007 Bloomberg L.P.
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Treasury Yield Curve – October 3, 2008



Federal Funds implied Probability – three meetings out.

<HELP> for explanation.

ComdtyFFIP

Export Data
Go to WIRP
Straight From The Lab - Federal Funds Implied Probability

Method: Options Futures (Live) Binary Options
Current Fed Fund Target Rate: 2.00

Last Calculated 10/01 16:30 EST
FOMC Date: 10/29/2008

Fed Move	Current	1 Day Ago	1 Week Ago	1 Mo. Ago
Decrease to 1.75	56.0 %	78.0 %	80.0 %	0.0 %
Decrease to 1.50	44.0 %	22.0 %	0.0 %	0.0 %
Increase to 2.25	0.0 %	0.0 %	0.0 %	20.0 %
No Change -- 2.00	0.0 %	0.0 %	20.0 %	80.0 %

FOMC Date: 12/16/2008

Fed Move	Current	1 Day Ago	1 Week Ago	1 Mo. Ago
Decrease to 1.50	48.2 %	32.8 %	21.7 %	0.0 %
Decrease to 1.75	36.5 %	62.9 %	63.7 %	0.0 %
Decrease to 1.25	15.3 %	4.3 %	0.0 %	0.0 %
Increase to 2.50	0.0 %	0.0 %	0.0 %	0.8 %

FOMC Date: 01/28/2009

Fed Move	Current	1 Day Ago	1 Week Ago	1 Mo. Ago
Decrease to 1.50	43.9 %	29.6 %	18.0 %	0.0 %
Decrease to 1.75	38.0 %	59.5 %	56.5 %	0.0 %
Decrease to 1.25	13.4 %	3.8 %	0.0 %	0.0 %
No Change -- 2.00	4.7 %	7.1 %	23.0 %	49.2 %

Overview
Current Implied Probability
Historical Implied Probability
Future Implied Probability

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000

Current Probabilities for FOMC Date 10/29/08

Target Rate	Probability
1.50	44.0 %
1.75	56.0 %
2.00	0.0 %
2.25	0.0 %

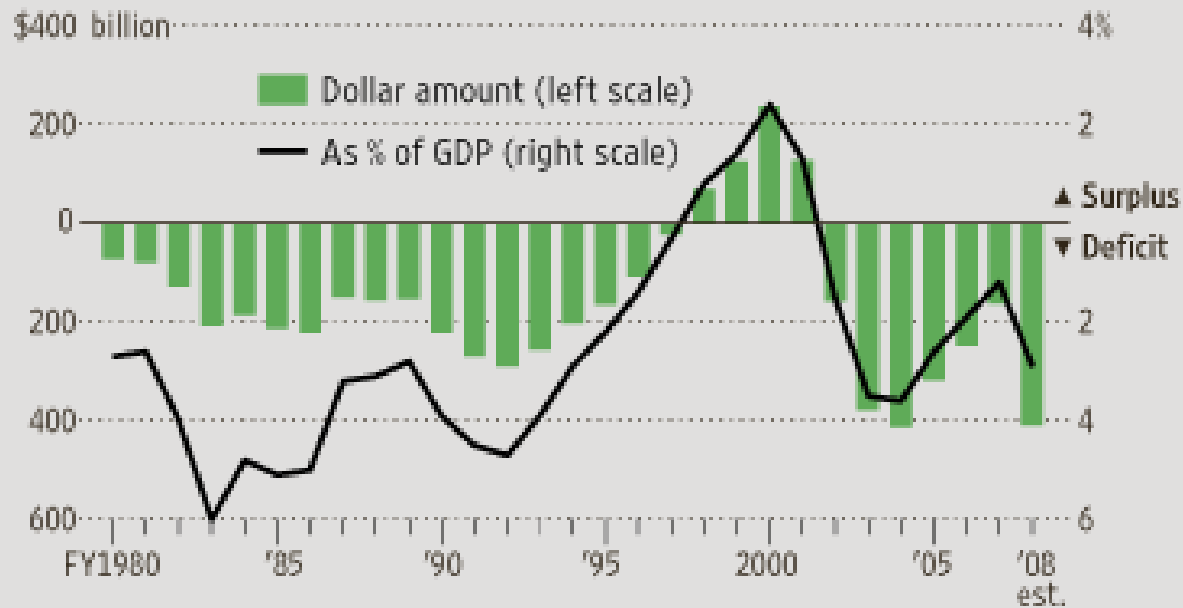
Economist Estimates Number of Estimates: 63
 High: 2.25 Low: 1.50 Average: 1.98 Median: 2.00

This screen shows the implied probability of changes to the Fed funds target rate based on the price of Fed funds futures. The open interest information is used to selectively filter out unreliable prices. A tree of conditional moves over future periods is backed out using a equal relative move condition, i.e., move probabilities do not depend on the starting rate level.

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Deeper Deficits Ahead?

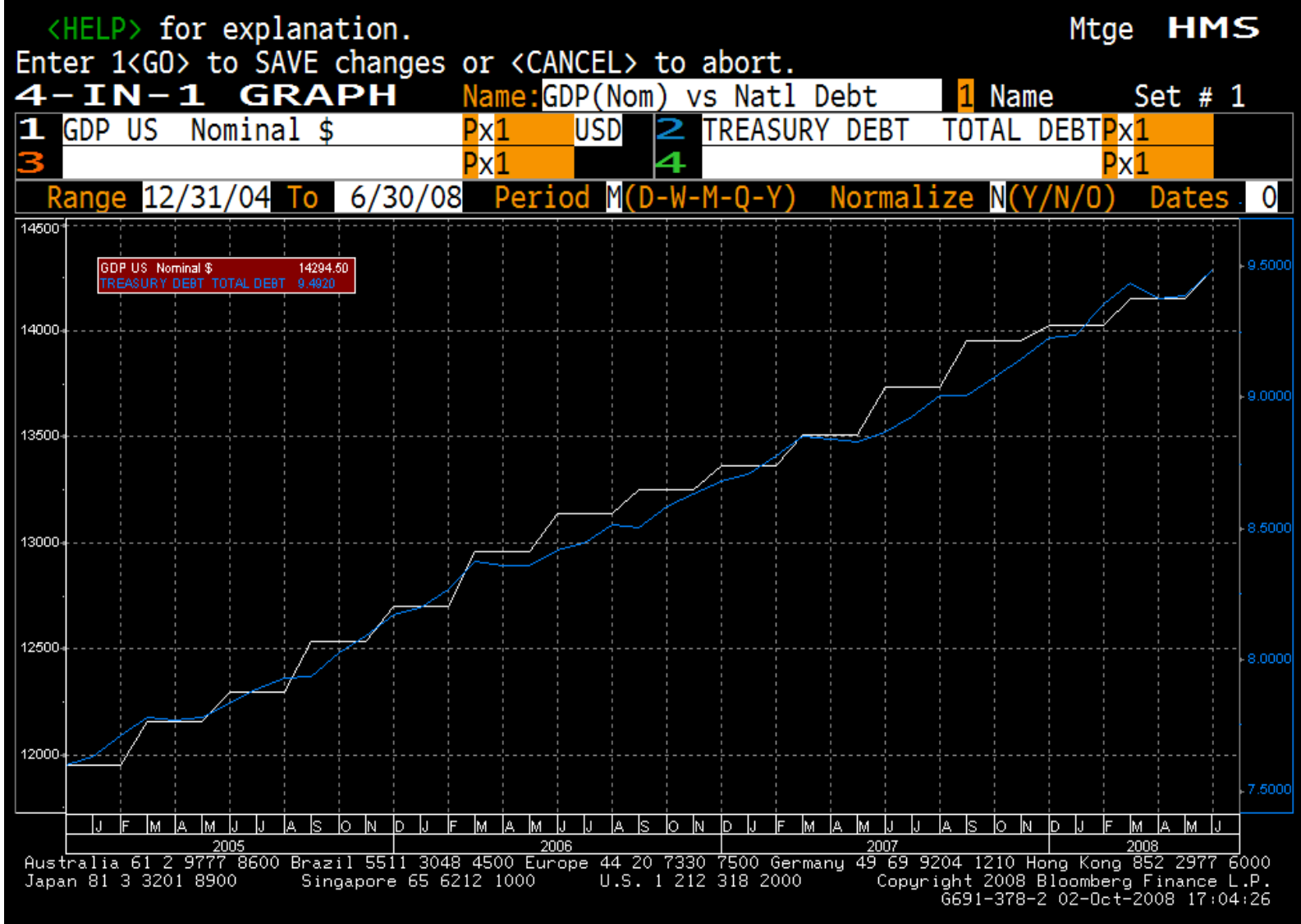
Federal budget surplus/deficit



Note: Fiscal year ends Sept. 30

Source: Office of Management and Budget

US GDP vs Total Treasury Debt



2009 Forecast



- Economic growth will slow to 2% this year, below the long-term sustainable trend growth rate of 3.5%. Blame the housing sector.
- Inflation will moderate to 2.5%.
- The unemployment will hit 7% before the end of 2008 and may increase into 2009 if economic conditions do not begin to turn.
- Oil prices will fall to below \$100 per barrel. Europe's economy will reduce the value of the Euro against the dollar; if there is a global recession, analysts expect oil to hit \$50-\$60 per barrel.
- Yuk.

Contact



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