

## The Shape of Things to Come

*... the market's split rating*

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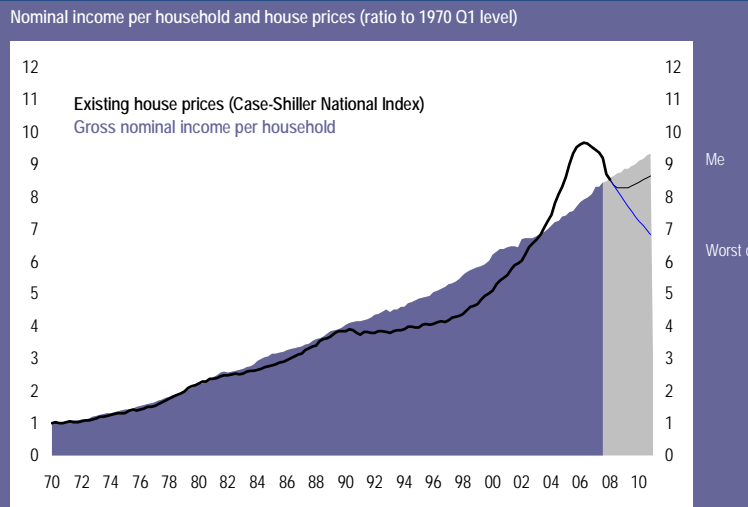


2008 ...  
not so great



# A housing debacle de-bacled ...

# If we're supposed to afford our houses, prices come down

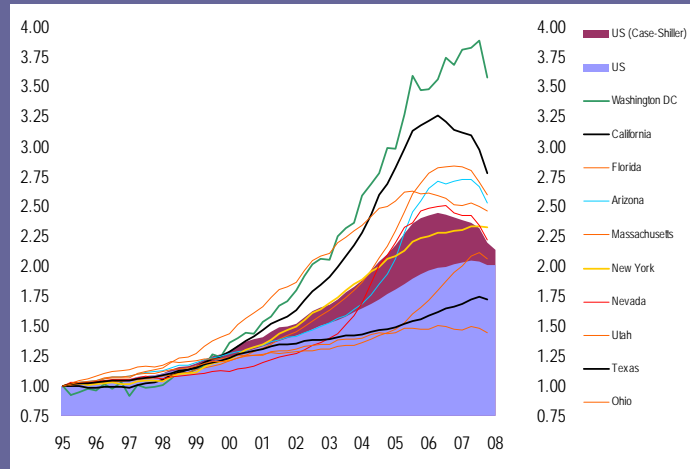


Sources: Standard & Poor's; US Department of Commerce

## The worst excesses are the ones correcting the most

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Selected real estate markets (ratio to 1995 Q1 level)



Sources: OFHEO, Standard and Poor's

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## A credit market meltdown ...

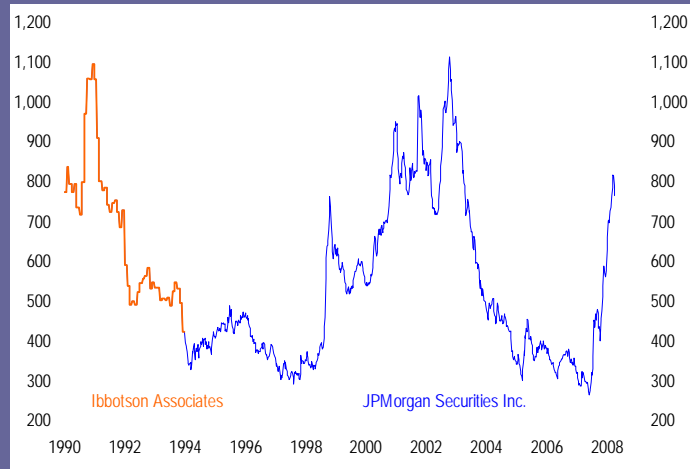
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## The risk-taking community is in shock

High yield debt yield less 10-year Treasury yield (basis points)



Source: JPMorgan Chase & Co.

## Wall Street's coming clean fast

Nominal income per household and house prices (ratio to 1970 Q1 level)

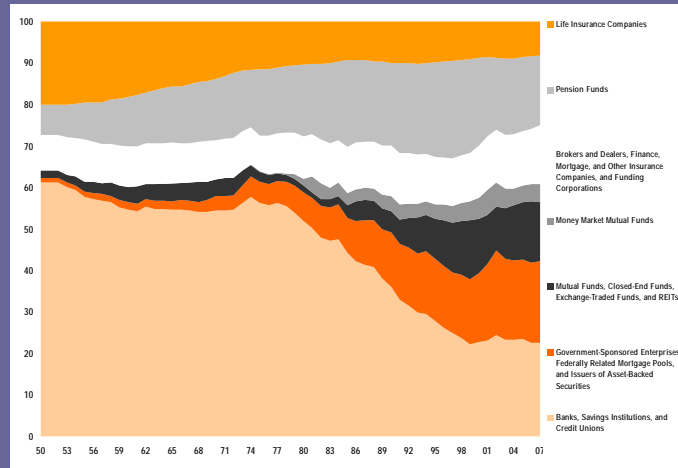
Write-down Scenarios for Assets Held by Leveraged Financial Institutions		
	Total	
	US companies	Foreign institutions
To date	\$300 billion = \$143 billion	\$157 billion
Assumptions behind worse case scenarios: If house prices fall 25% more If homeowners walk as quickly as they have		
Worse-case scenario	\$460 billion	
Residential		\$230 billion
Loan Impairments		\$110 billion
Commercial real estate		\$120 billion
Memo:		
Tier 1 Risk-based ratio (2007 Q3)	10.2	
If US write-downs total \$230 billion	8.1	
Capital Adequacy Standards (Tier 1 Risk Based Capital Ratio)		
Well capitalized	>6	
Adequately capitalized	>4	
Undercapitalized	>3	
Significantly undercapitalized	<3	
Critically undercapitalized	Tangible equity <2%	

Sources: Bloomberg; JPMorgan Chase & Co.

## This is the key challenge ... reinventing securitized finance

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Assets held at financial intermediaries (share of all assets held at financial intermediaries)

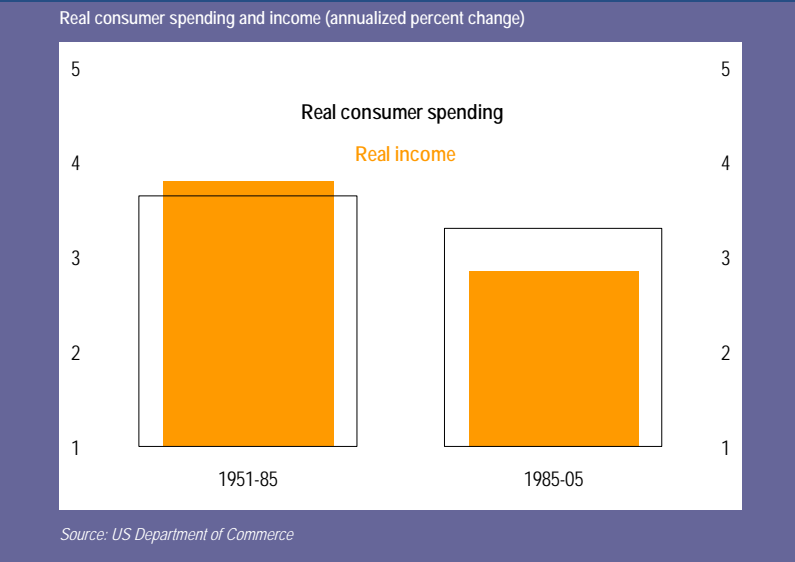


Source: Federal Reserve Board

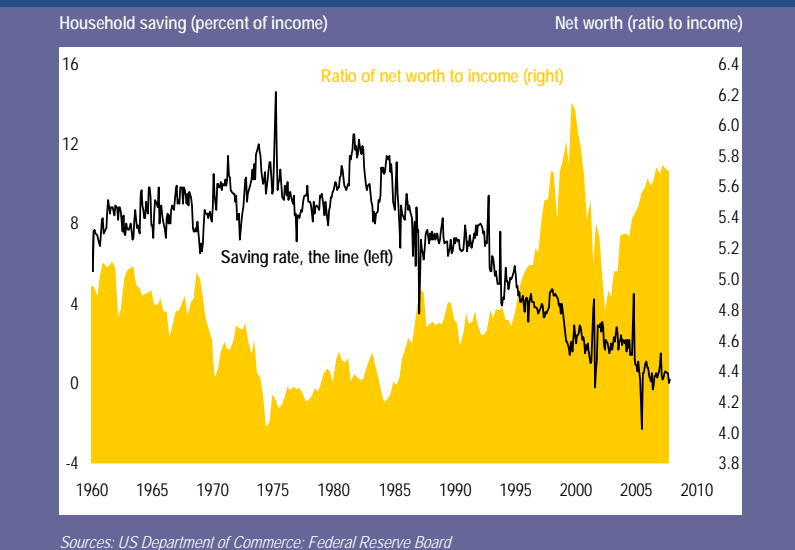
## A consumer normalization ...

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### ... back to life as they once knew it ...

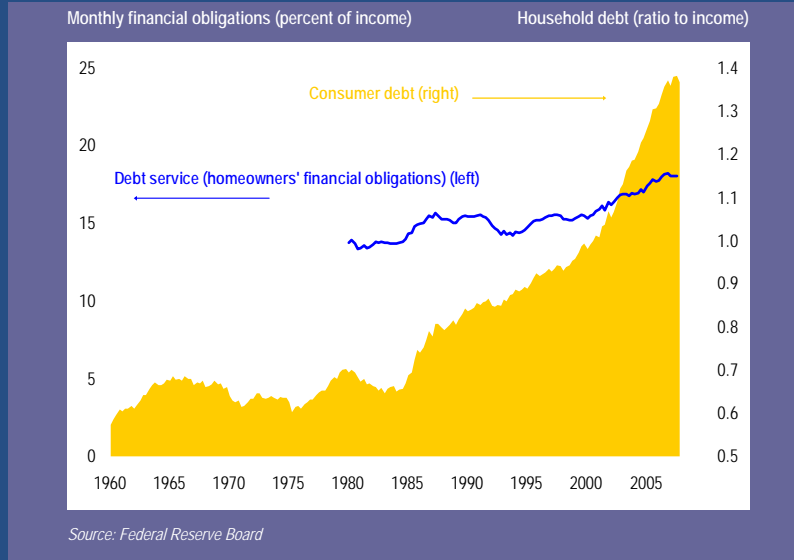


### ... we'll be saving the old fashioned way, out of income ...



## ... and leverage growth will have to match income

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An oil gusher ...

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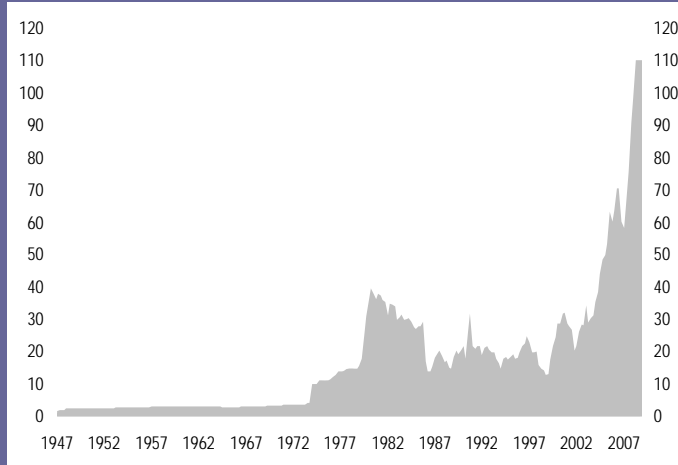
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## A waking, impoverished world is commodity hungry ...

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Petroleum (WTI, dollars per barrel)



Source: Bloomberg

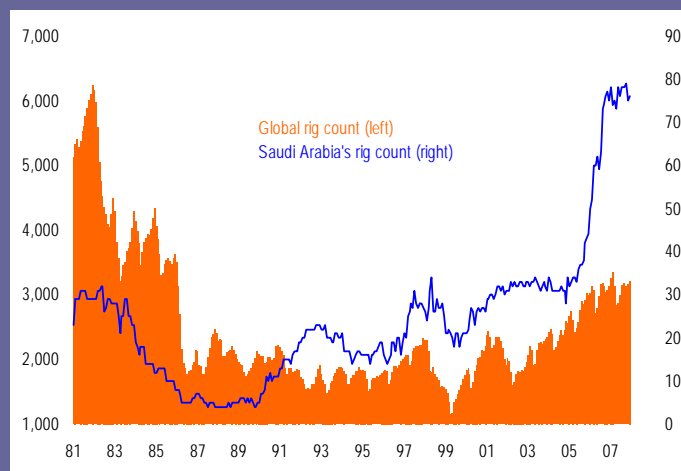
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## ... and it takes time to realign supply

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Oil exploration rig count



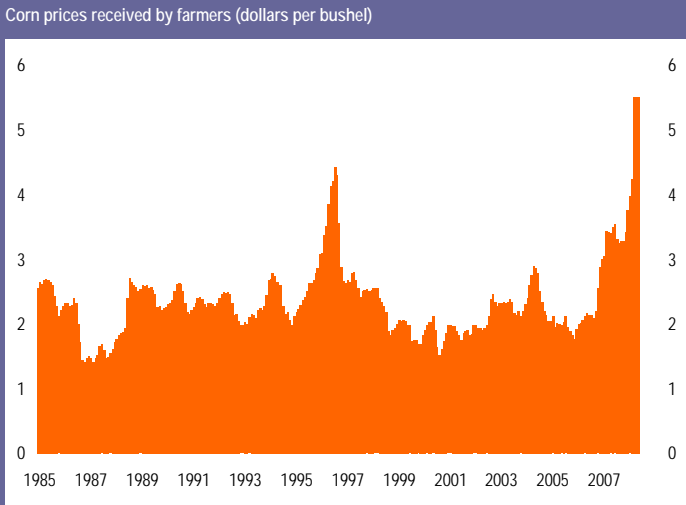
Source: Baker Hughes

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# And an ill-conceived energy initiative ...

# Corn's price spike ... no Fed-monetary story ...



Source: US Department of Agriculture

## The Energy Independence and Security Act of 2007 ... not

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Renewable fuels requirements (billions of gallons annually)

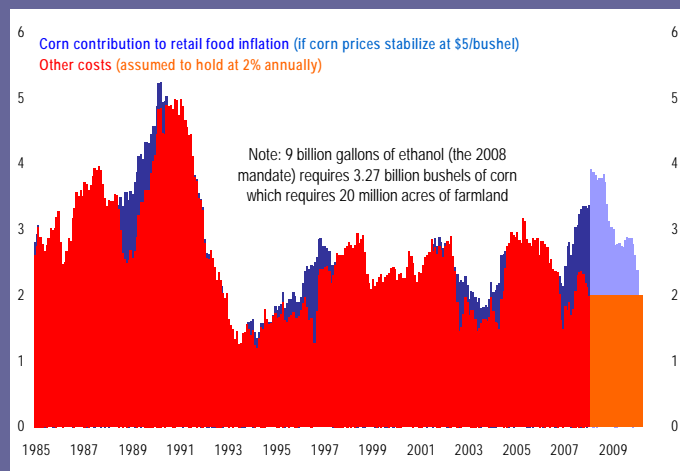
	Previous <u>Law</u>	Current <u>Law</u>
2006	4.0	
2007	4.7	
2008	5.4	9.0
2009	6.1	11.1
2010	6.8	13.0
2011	7.4	14.0
2012	7.5	15.2
2013		16.6
2014		18.2
2015		20.5
2016		22.5
2017		24.0
2018		26.0
2019		28.0
2020		30.0
2021		33.0
2022		36.0

Source: United States Senate

## If you legislate food inflation, call it a tax, not inflation

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Retail food prices (percent change at an annual rate over the most recent two years)



Source: US Department of Commerce; US Department of Agriculture; JPMorgan Chase & Co.

All traumatizing the economy ...

The pain isn't so much in the numbers ...

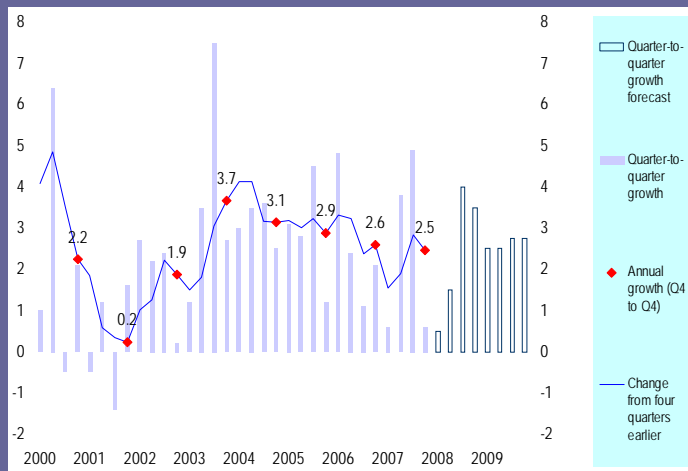
... which in print look benign ...

Real GDP growth  
% change over the four quarters of the year

	2007	2008
United States	2.5	2.4
Europe (EU-11)	1.9	2.0
Japan	1.5	1.2
Newly industrializing	8.2	6.9

... and more like a stall than a stumble

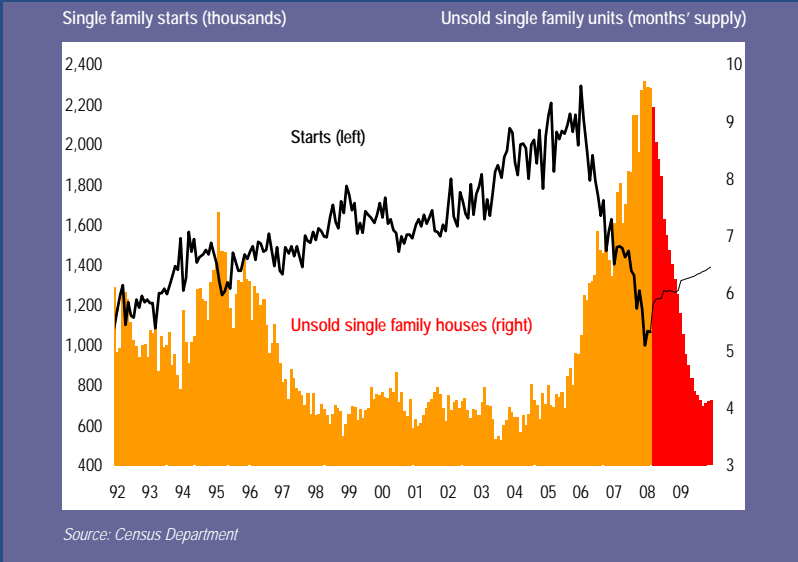
Real GDP growth in selected regions (percent change from four quarters earlier)



Source: US Department of Commerce

## Housing's in recession and will stay there in 2008 ...

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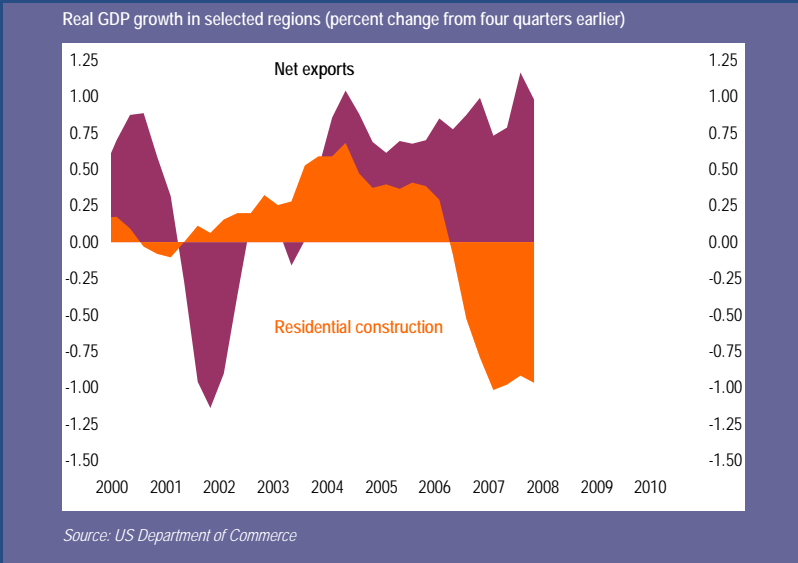


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## ... but what builders take, exporters give back

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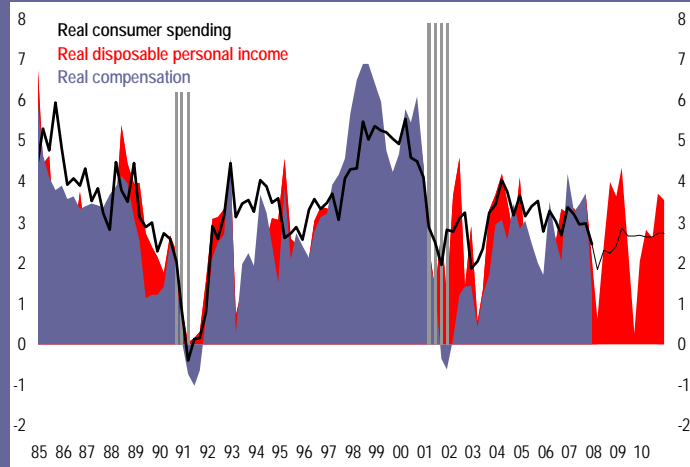
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## Consumers will be helped by \$117 billion of rebates ... soon

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Real consumer spending and selected income (percent change from four quarters earlier)



Source: US Department of Commerce

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The trauma is in the feel ...

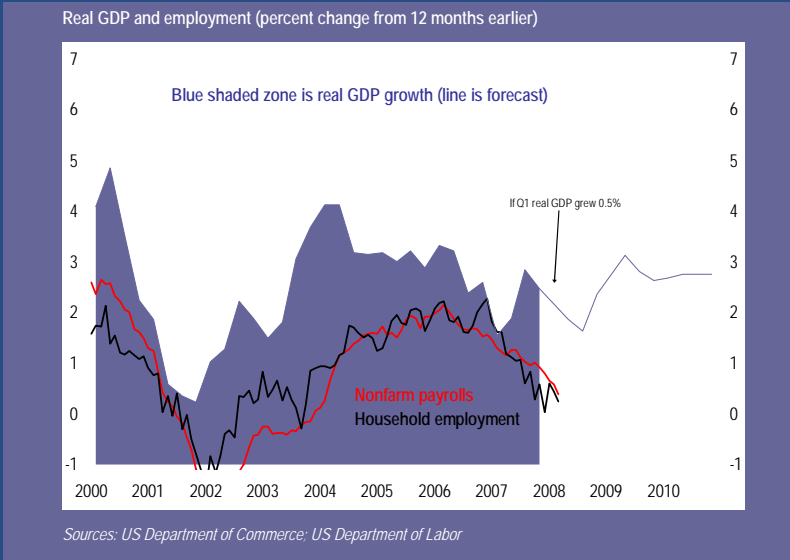
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## Slowing net job growth ...

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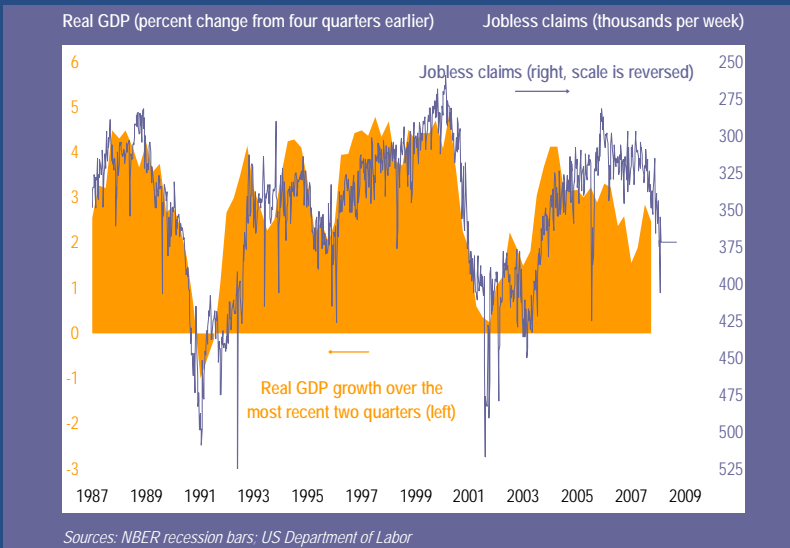


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## ... the layoffs ...

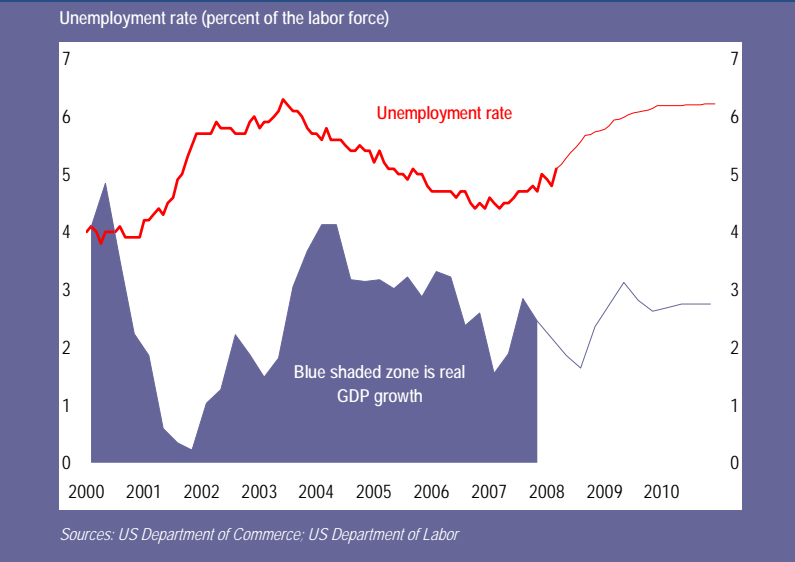
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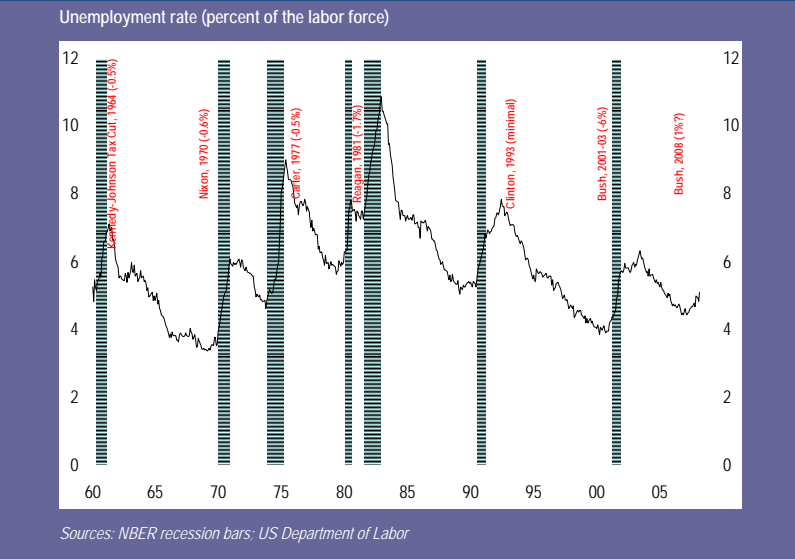
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### ... and unemployment ...

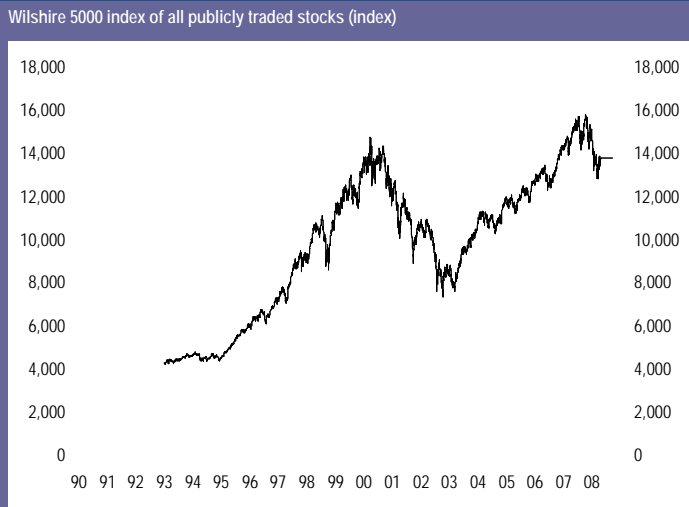


### This stumble/stall/recession now is on the map



# Over the hills ... still many thrills

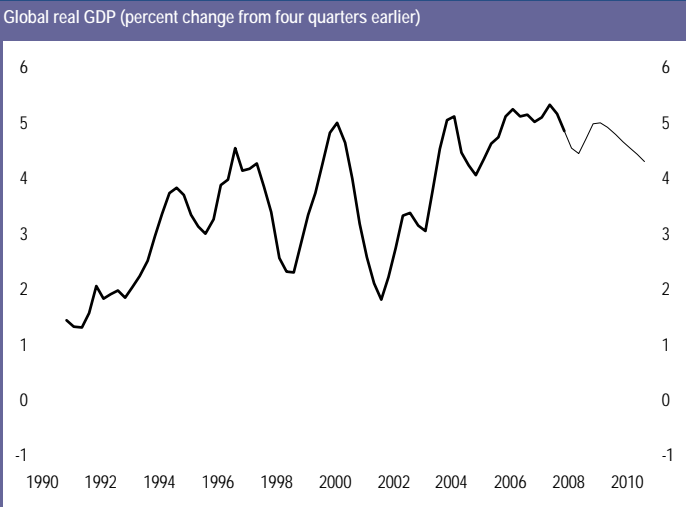
## ... where we discount eternity



Source: Bloomberg

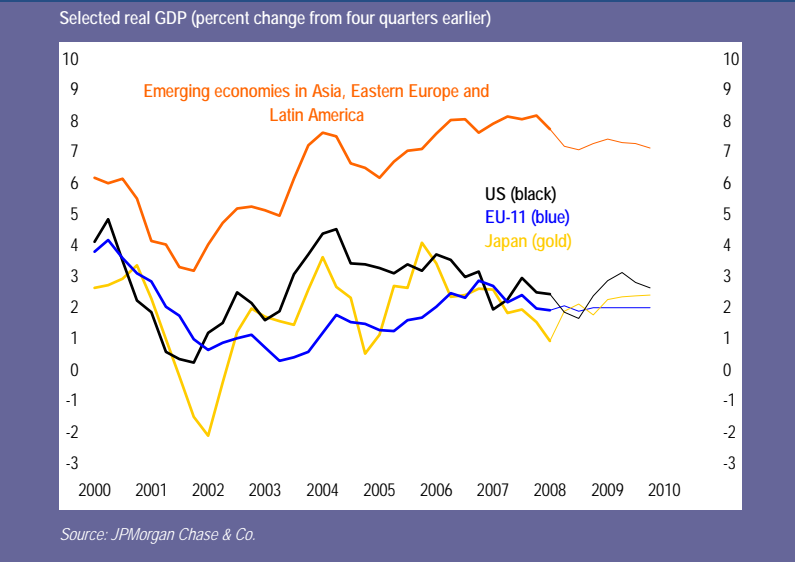
# A waking planet ...

# The lights are coming on all around us ...

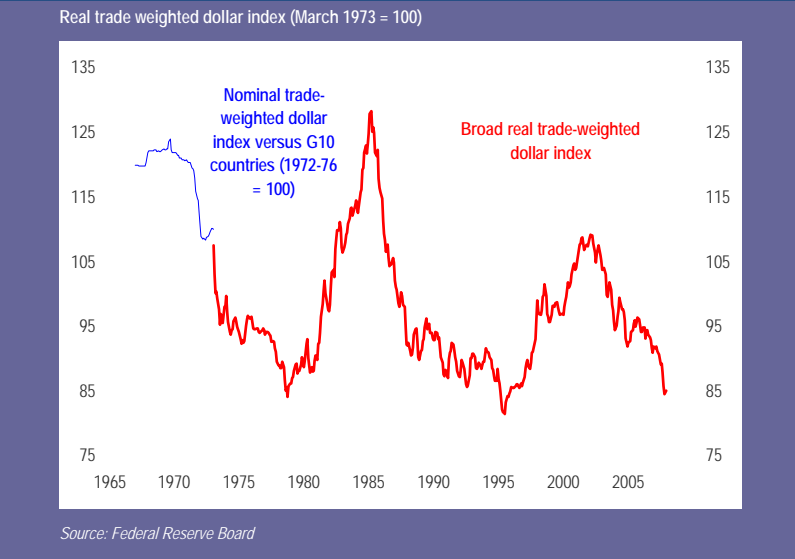


Source: JPMorgan Chase & Co.

### ... in desperately poor areas

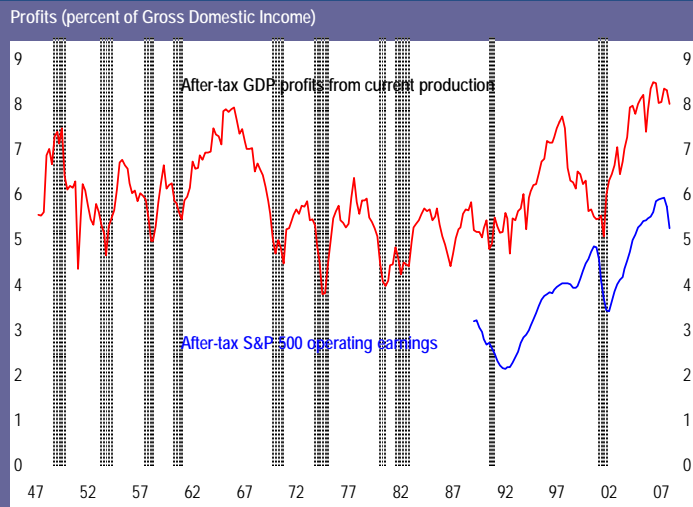


### That's partly what the dollar is "saying"



... and we're benefiting

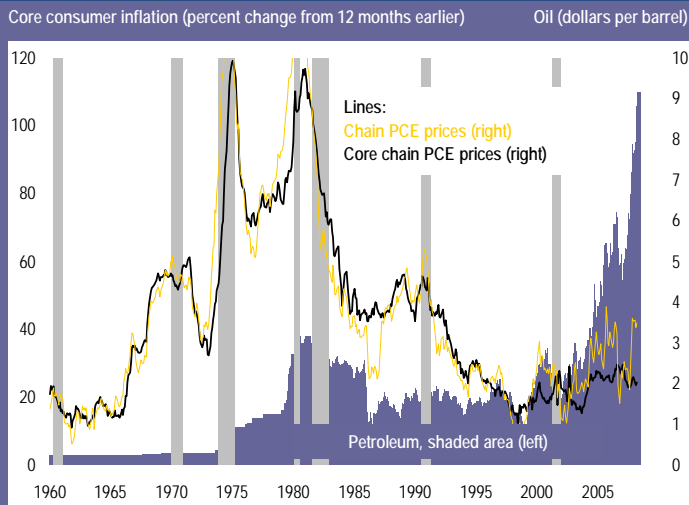
### US profits echo the global story



Sources: NBER recession bars; US Department of Commerce; Standard & Poor's

# A tolerable inflation picture ...

# ... curve the grade



Sources: NBER recession bars; US Department of Commerce; Bloomberg



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