

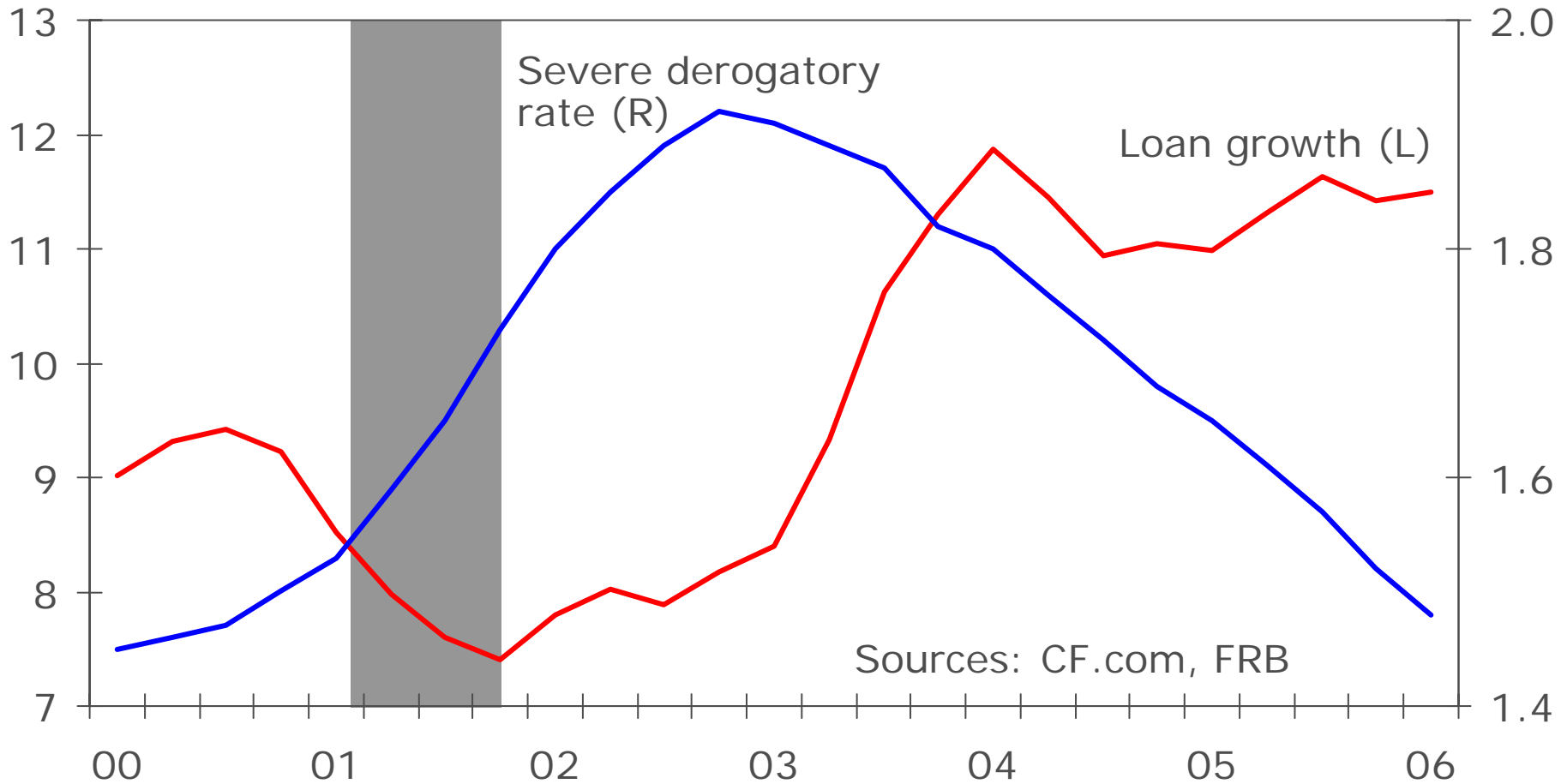
# Household Credit Outlook

Presented by:

Mark M. Zandi,  
Chief Economist

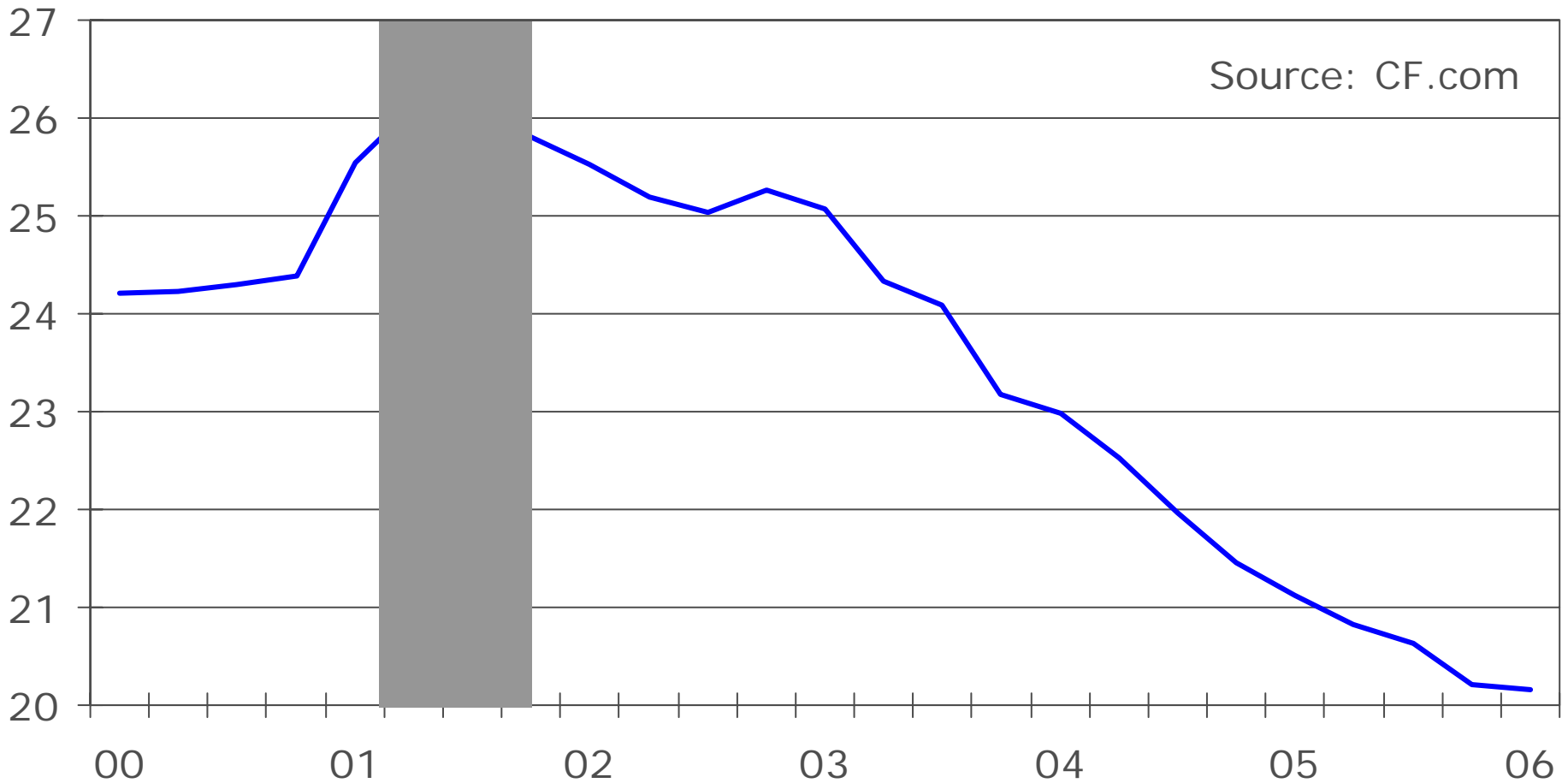
# In the Sweet Spot of the Credit Cycle...

## All household liabilities, 4-qrt MA



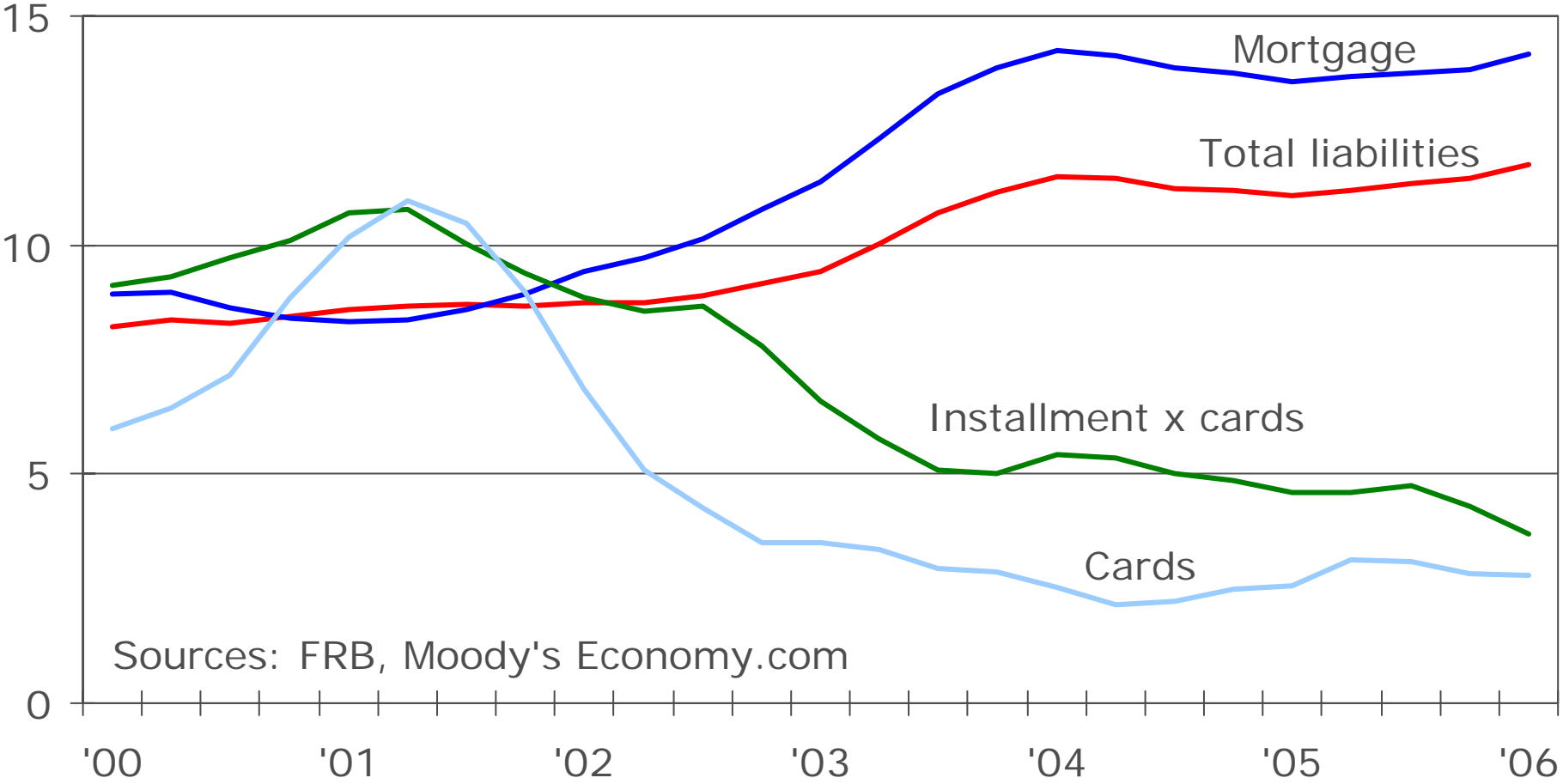
# ...the Very Sweet Spot

## Subprime share of liabilities



# Mortgage Lending Has Soared...

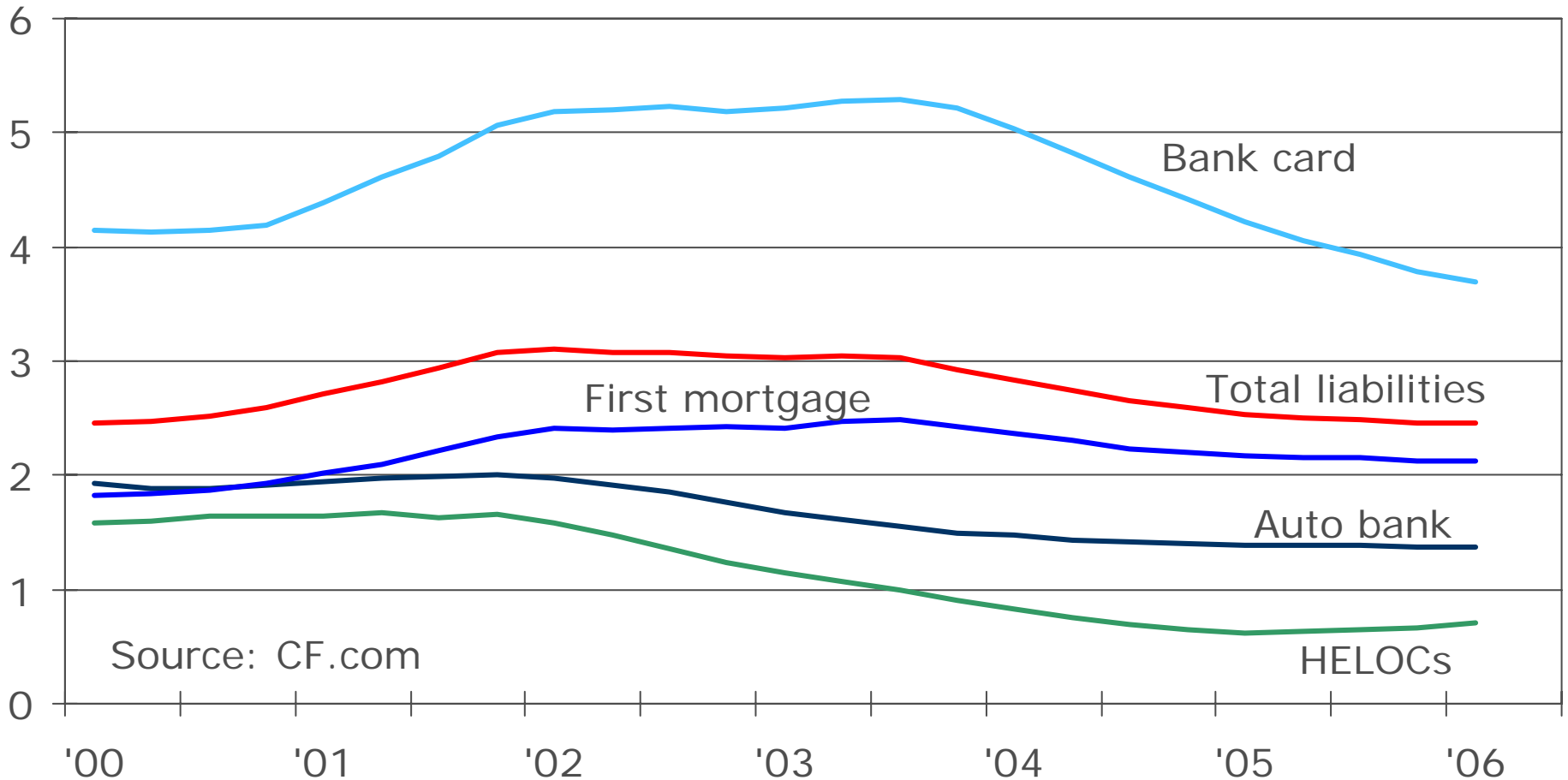
% change year ago, 4 qtr. MA



Sources: FRB, Moody's Economy.com

# ...and Quality Has Improved Across the Board

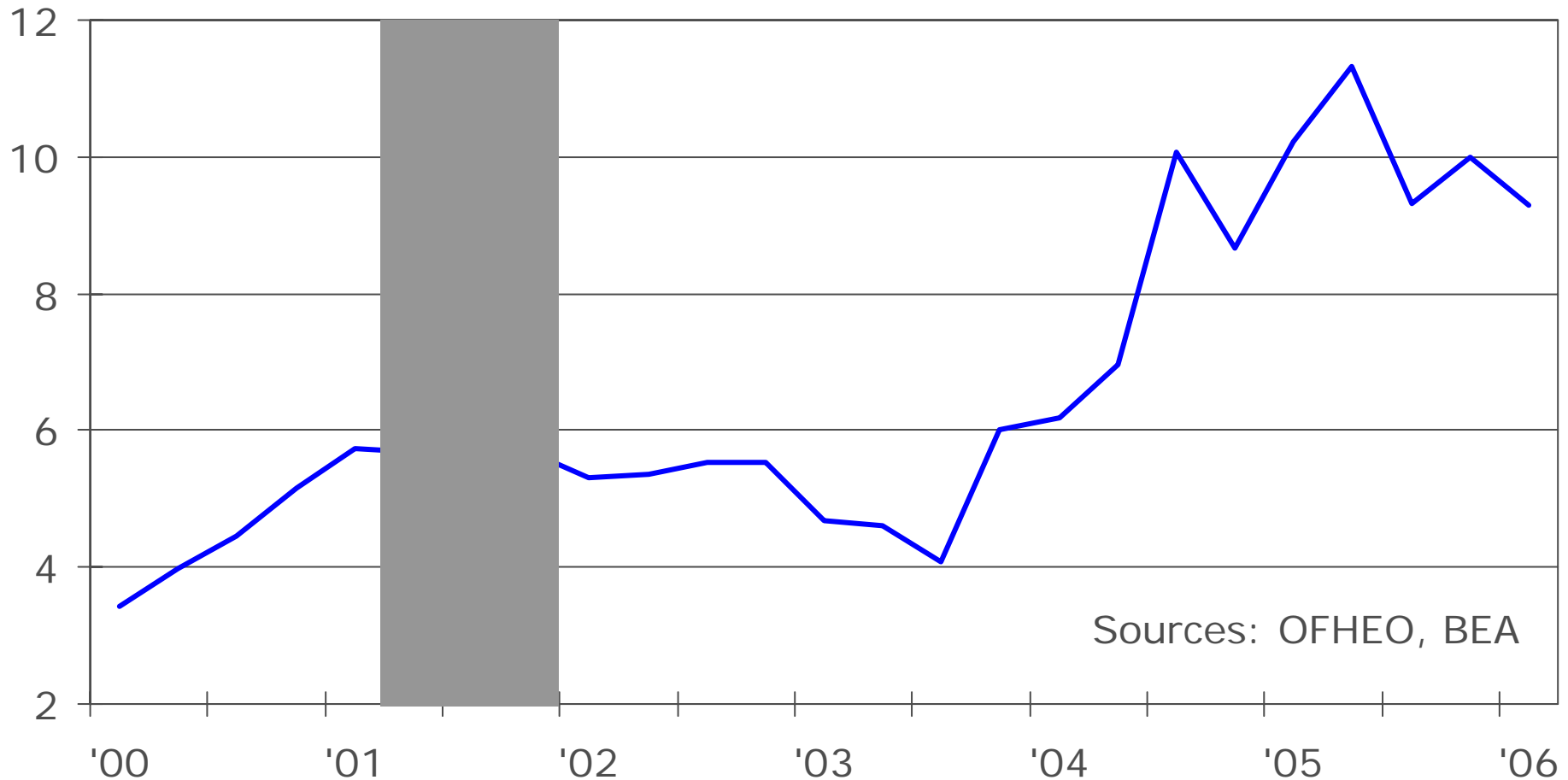
## Delinquency rate, 4 qtr. MA



Source: CF.com

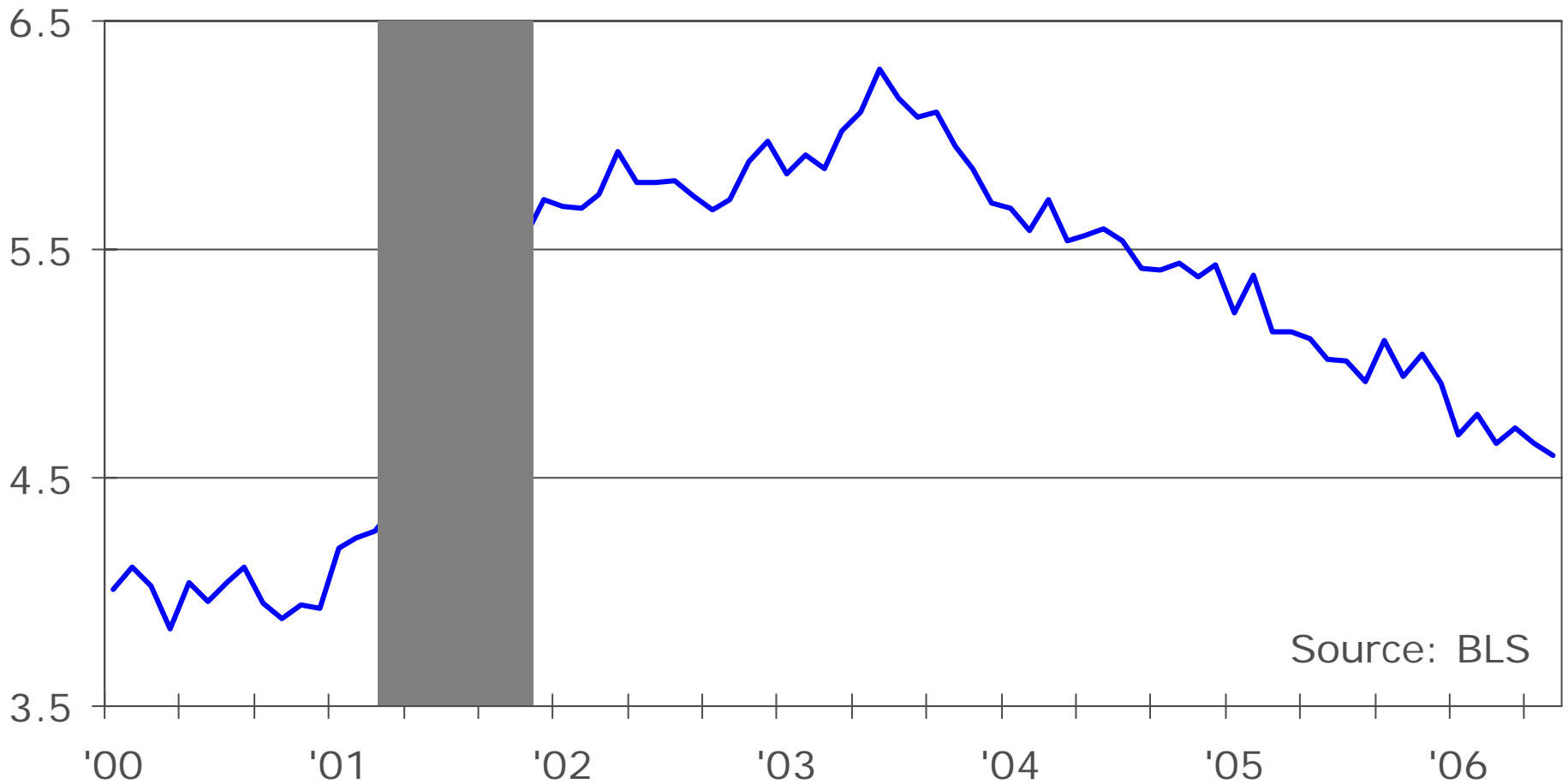
# An Unprecedented Housing Market...

## Real house price growth



## ...and Better Job Market...

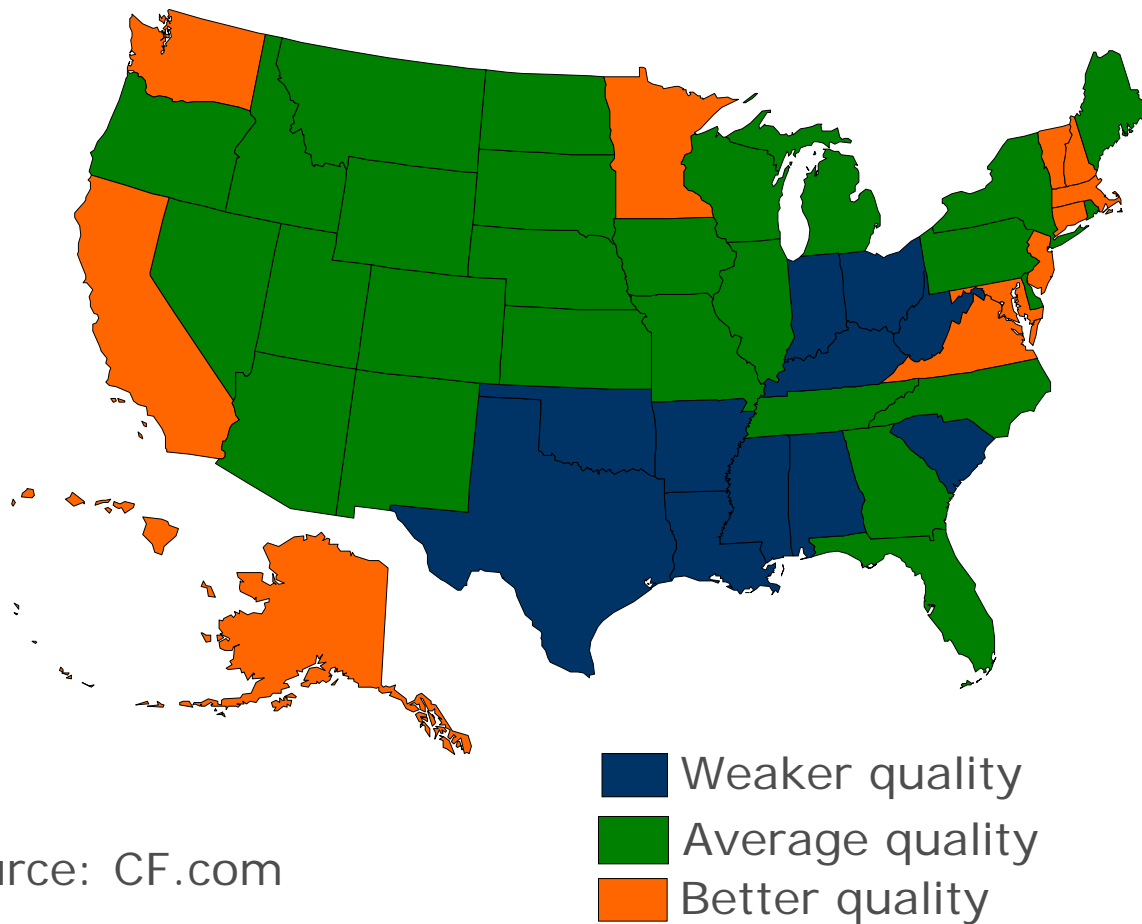
### Unemployment rate



Source: BLS

# ...is Evident Across the Country

Severe derogatory rate, all household liabilities, \$

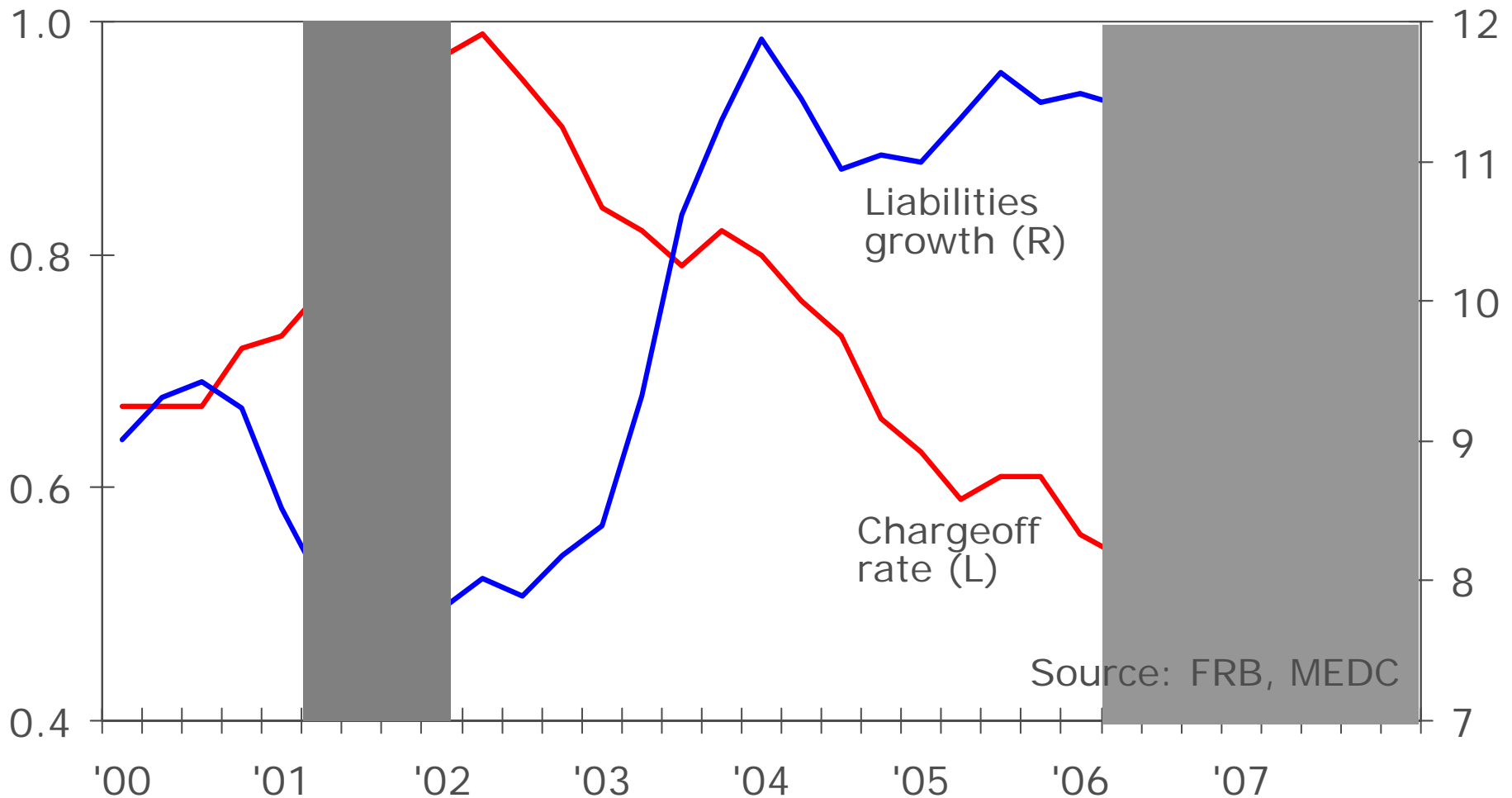


Source: CF.com



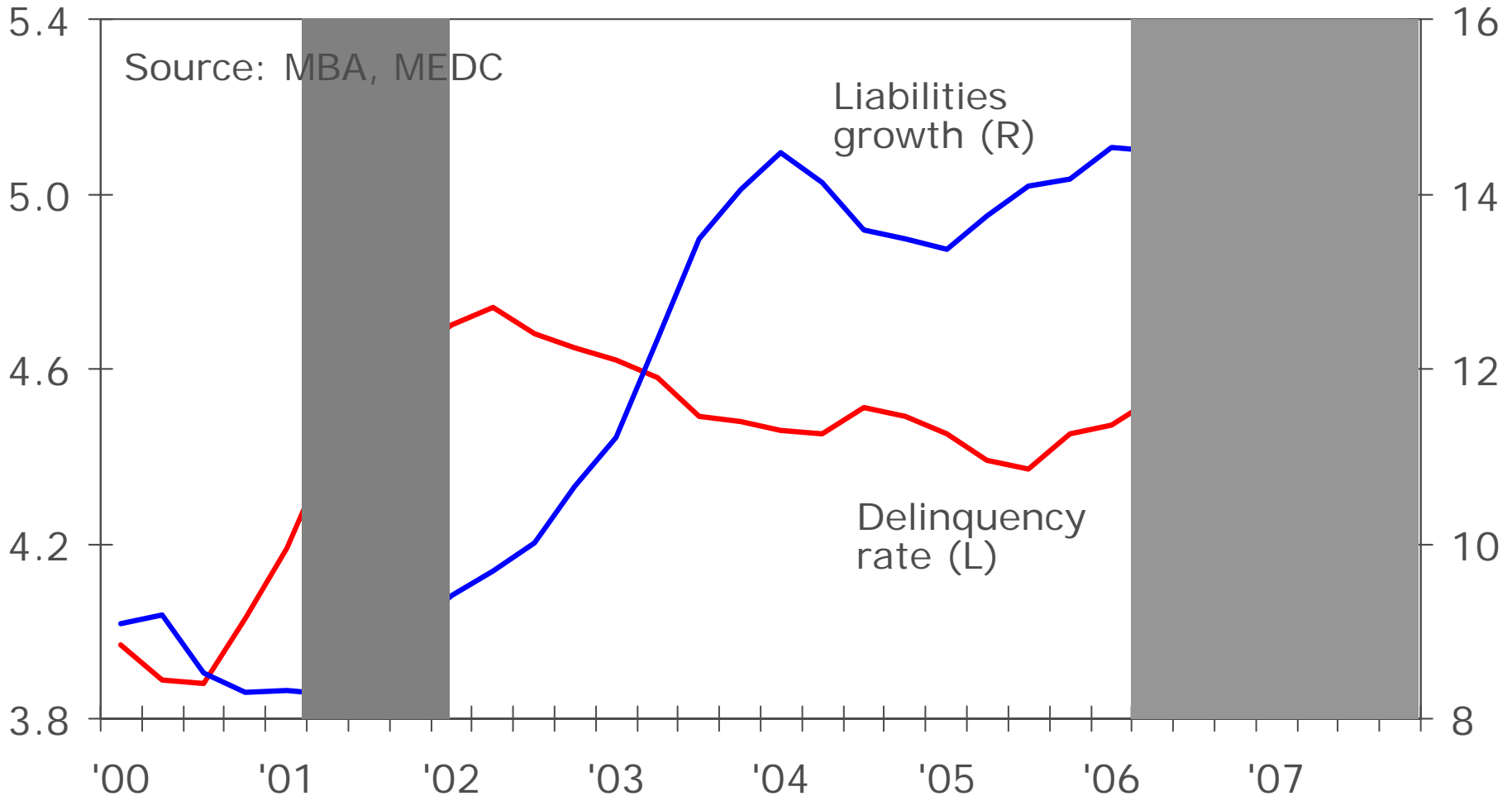
# The Credit Cycle is Set to Turn....

4-qrt MA



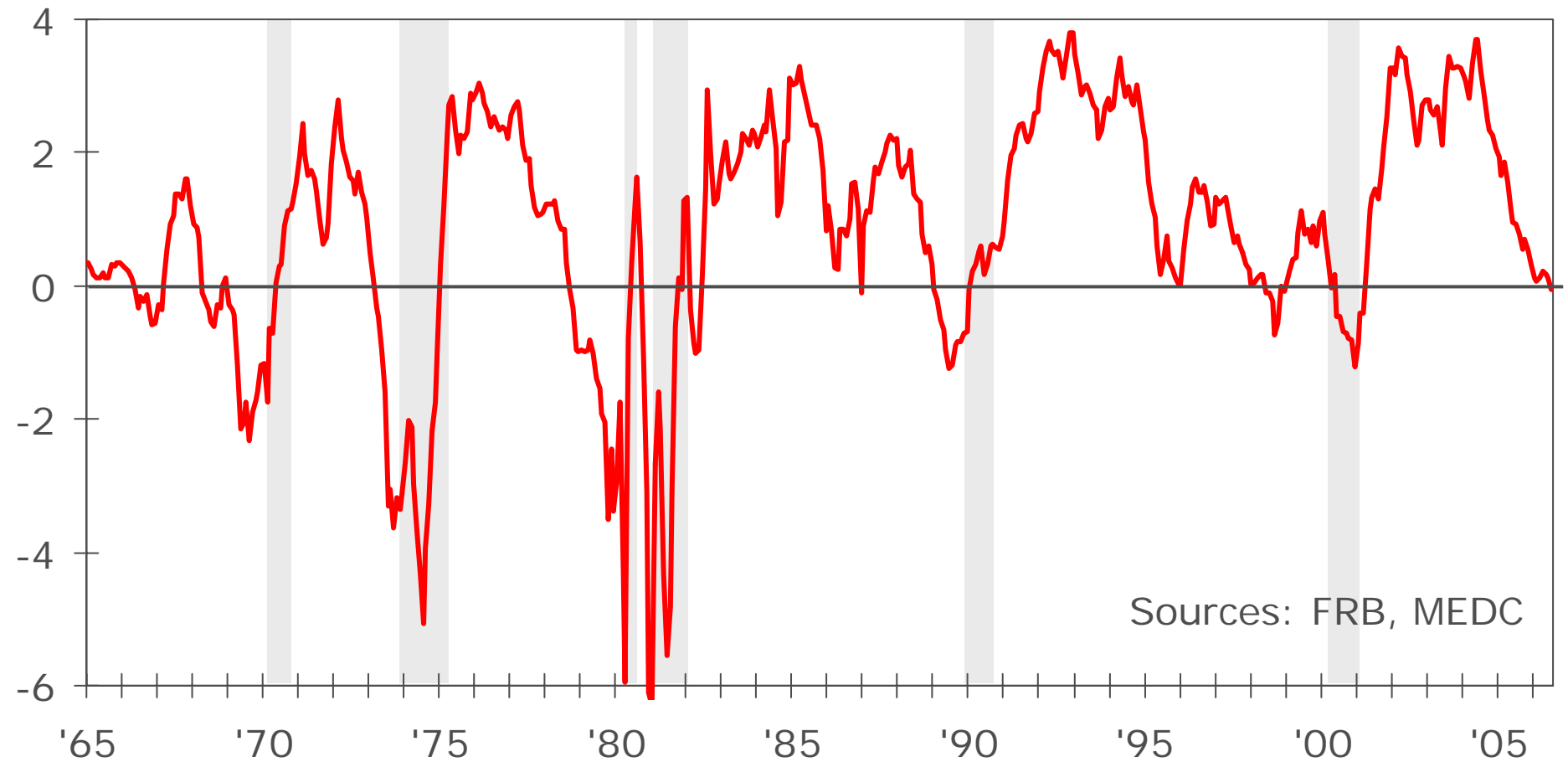
# ...Particularly for Mortgage Lenders...

## 4-qrt MA



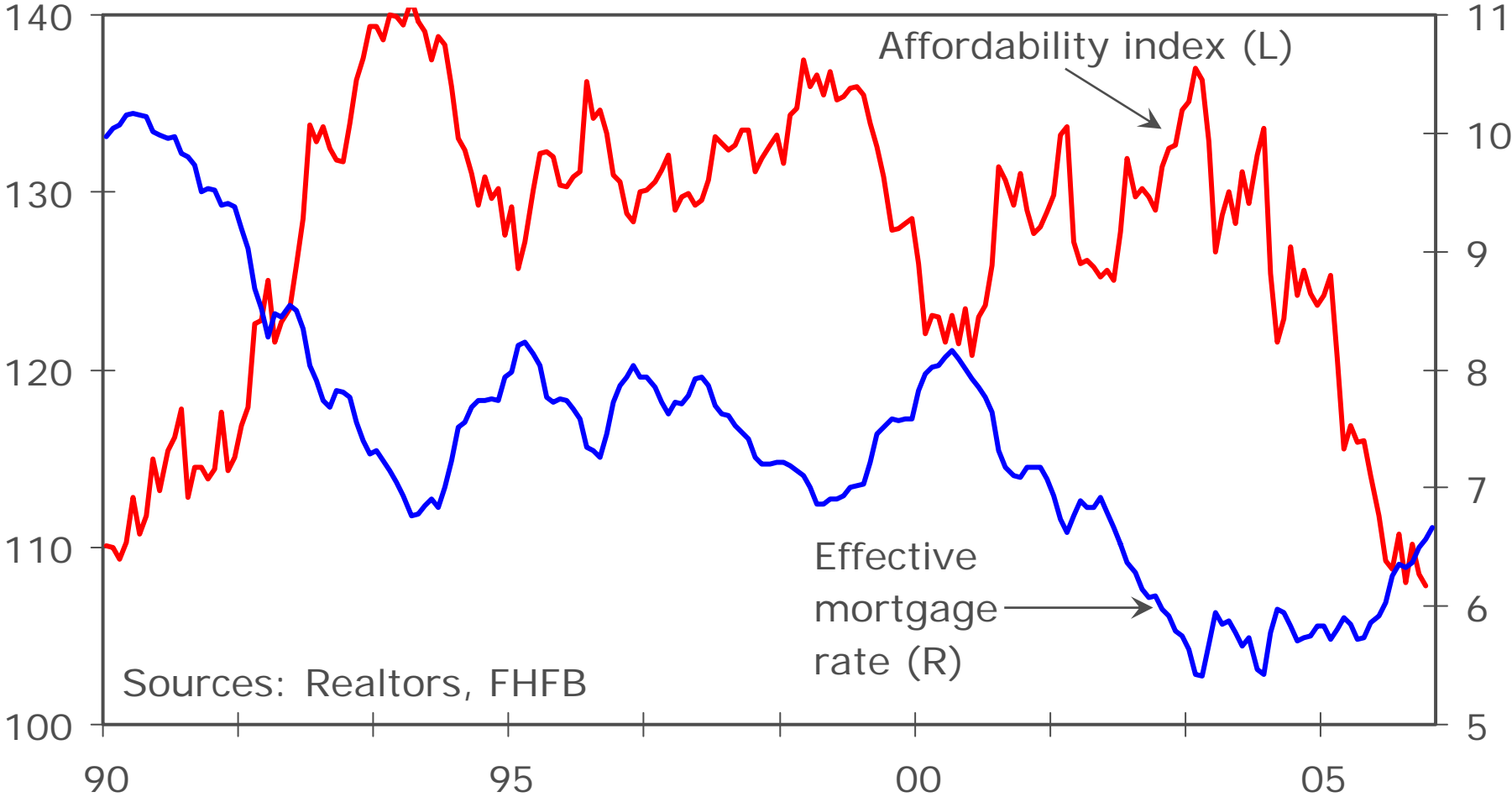
# ...as Monetary Policy Tightens

## Difference between 10 yr. T-yield and Fed Funds Rate



Sources: FRB, MEDC

# Housing Affordability is Eroding...



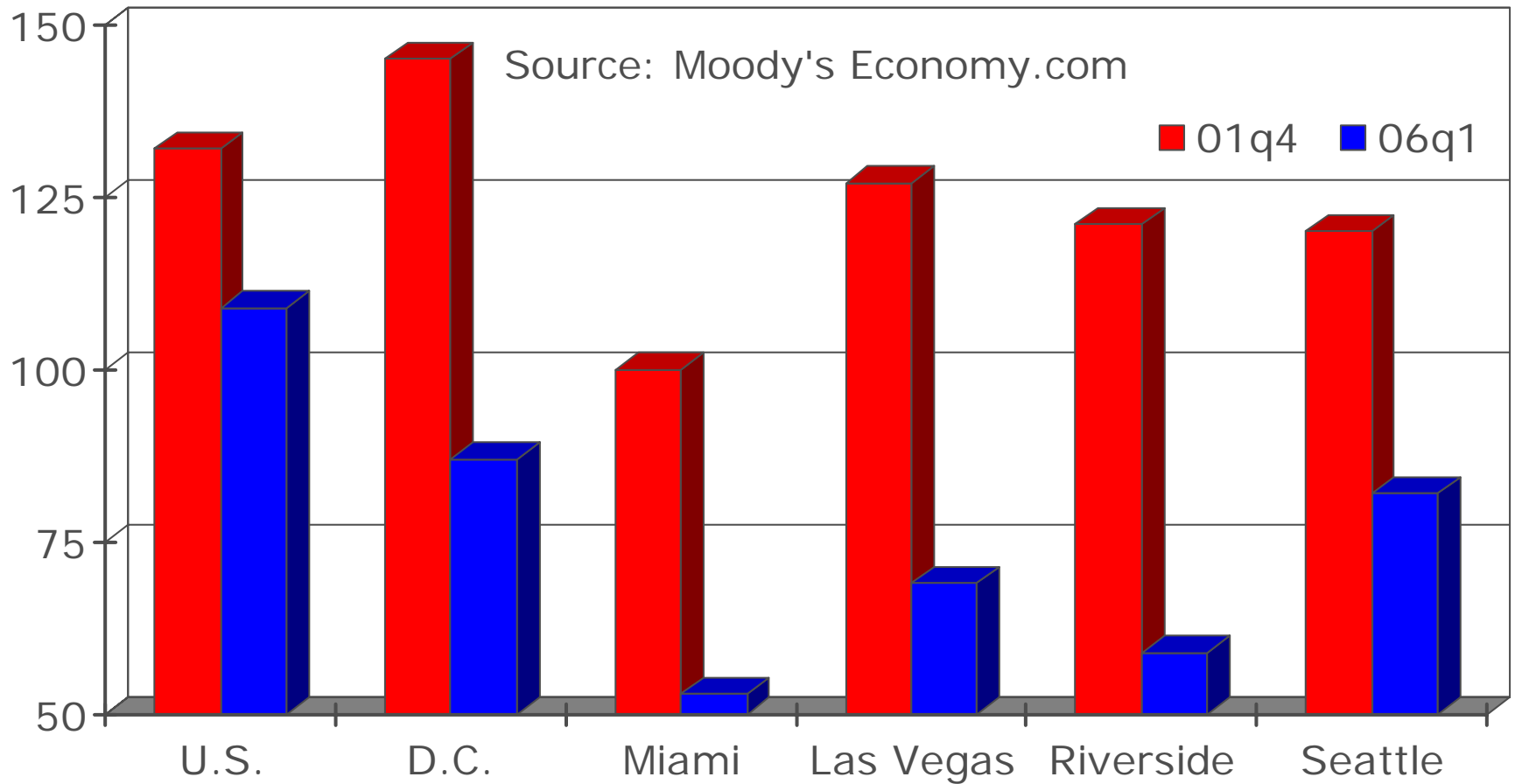
Sources: Realtors, FHFB

Effective mortgage rate (R)

Affordability index (L)

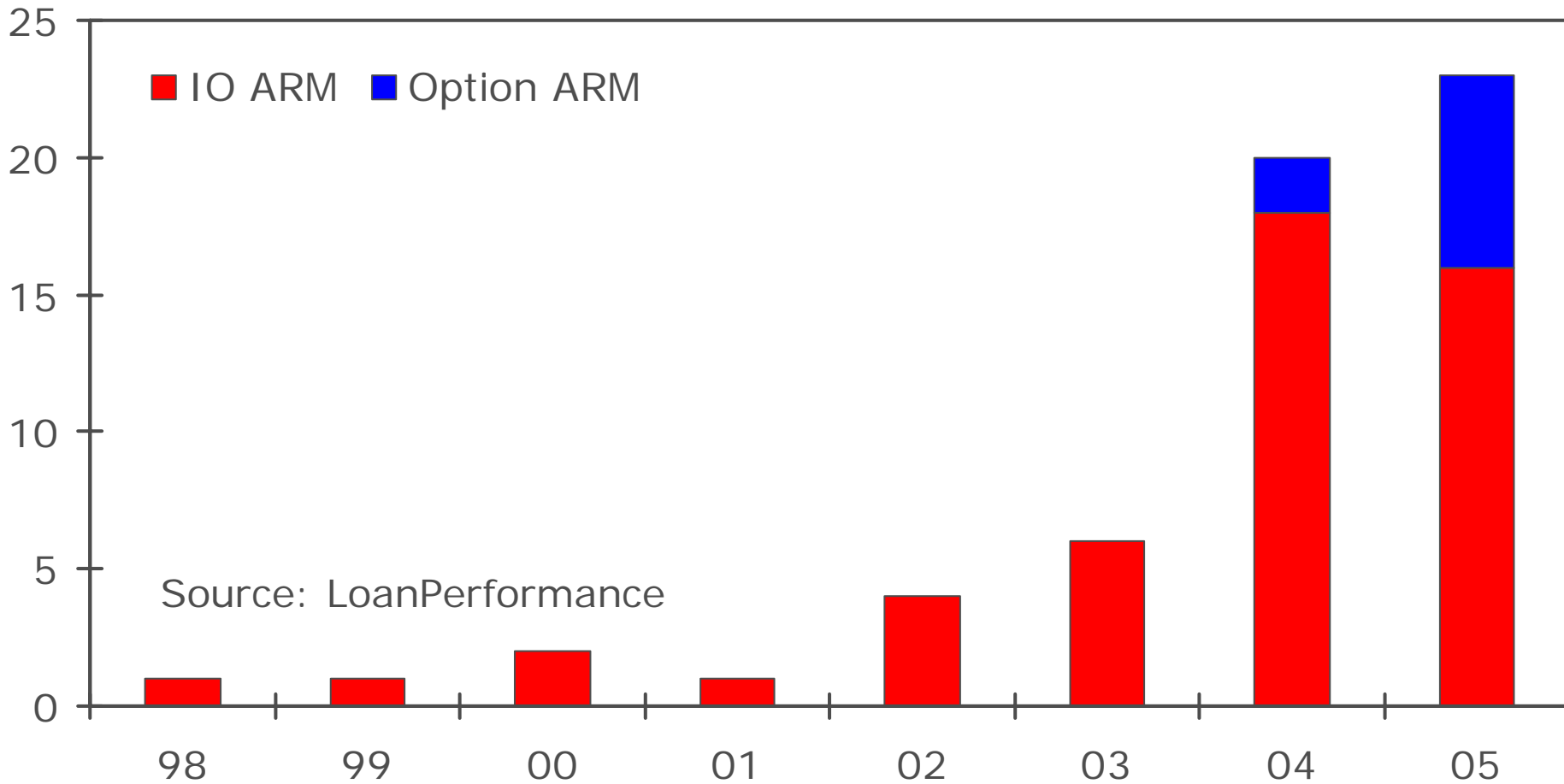
# ...in Many Parts of the Country...

## Housing affordability index



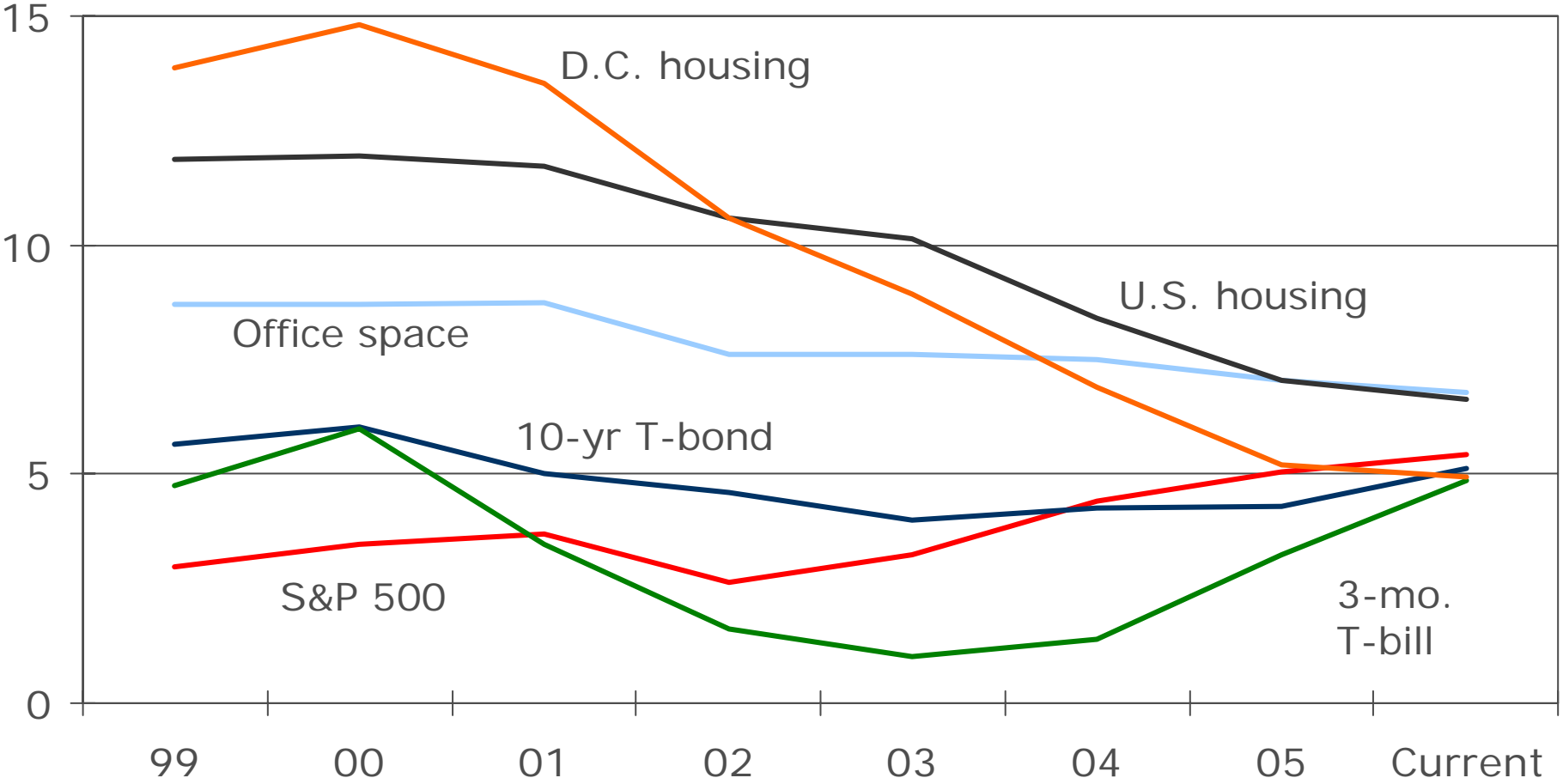
# ...Despite Very Aggressive Lending

## Share of non-conforming mortgage originations



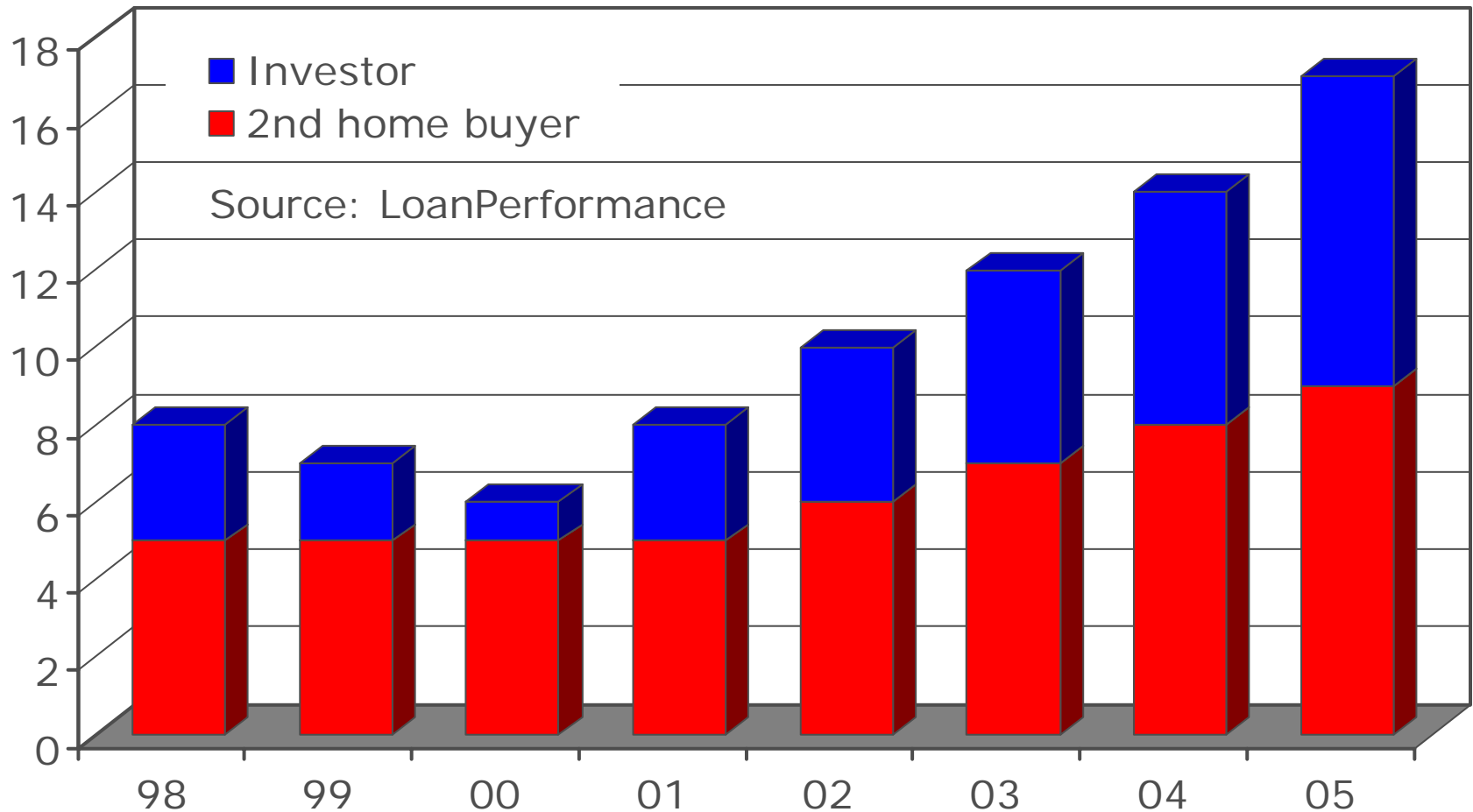
# Housing Appears Increasingly Expensive...

## Yield



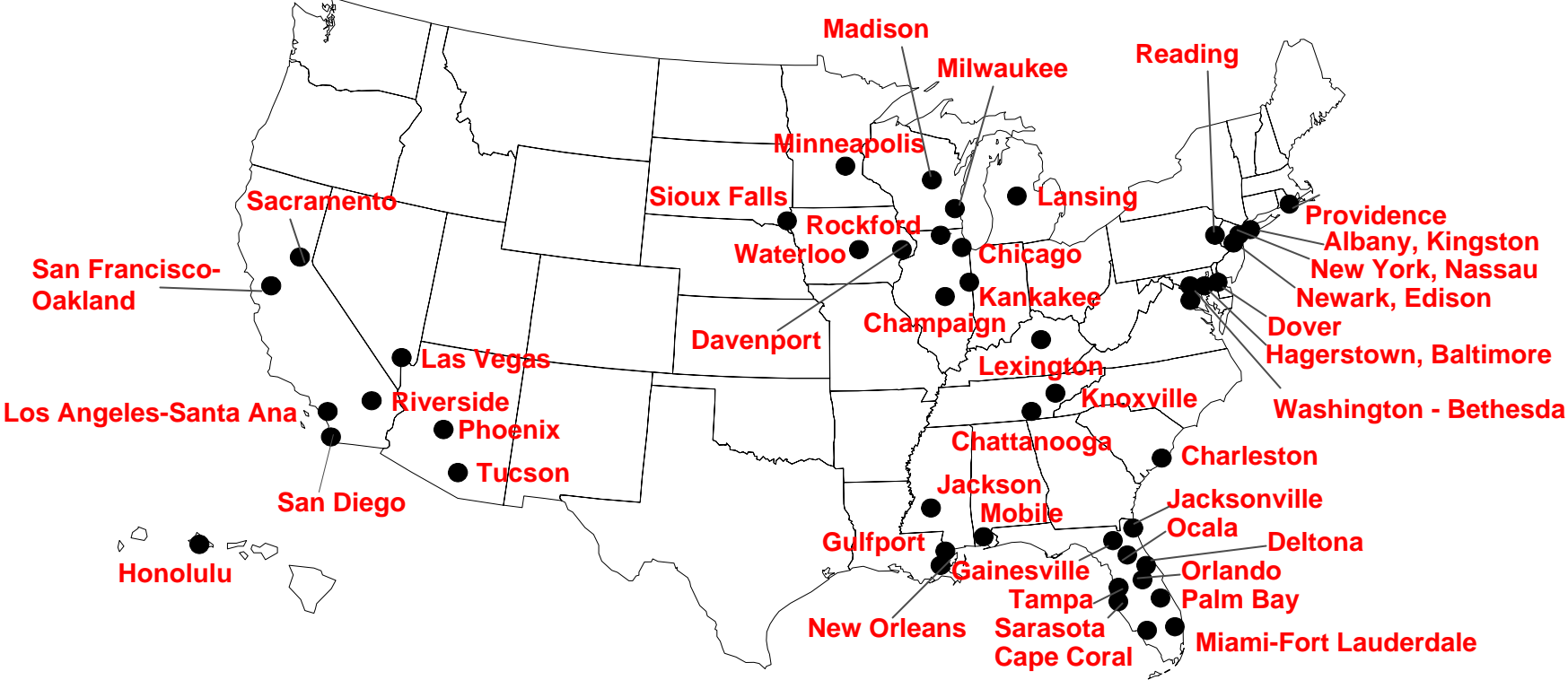
# ...Undermining Investor Demand

## Investor share of non-conforming mortgage originations





# Metro Areas at Risk



## Highly overpriced

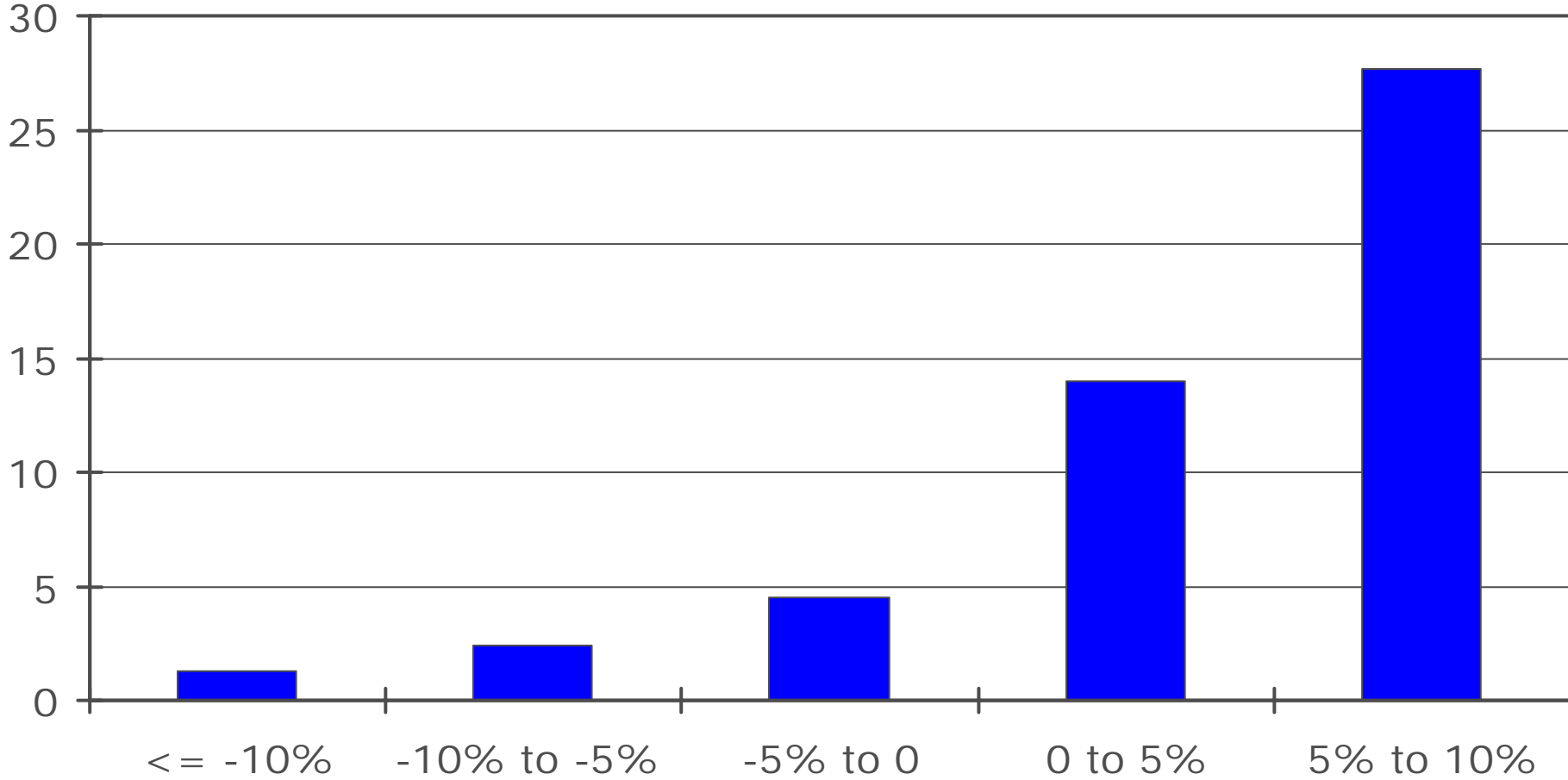
2 SD above historic average

Based on the NAR median house price, 2006Q1

Source: Moody's Economy.com, NAR

# Real Price Declines in Half of Metro Areas

% MSAs With Price Growth Below Inflation, Next 3 Yrs, OFHEO



# Metro Areas Projected to Experience Lower Prices

## 10% or more decline

Carson City, NV  
Prescott, AZ  
Reno, NV  
Las Vegas, NV  
Nassau, NY

## Between 5% to 10% decline

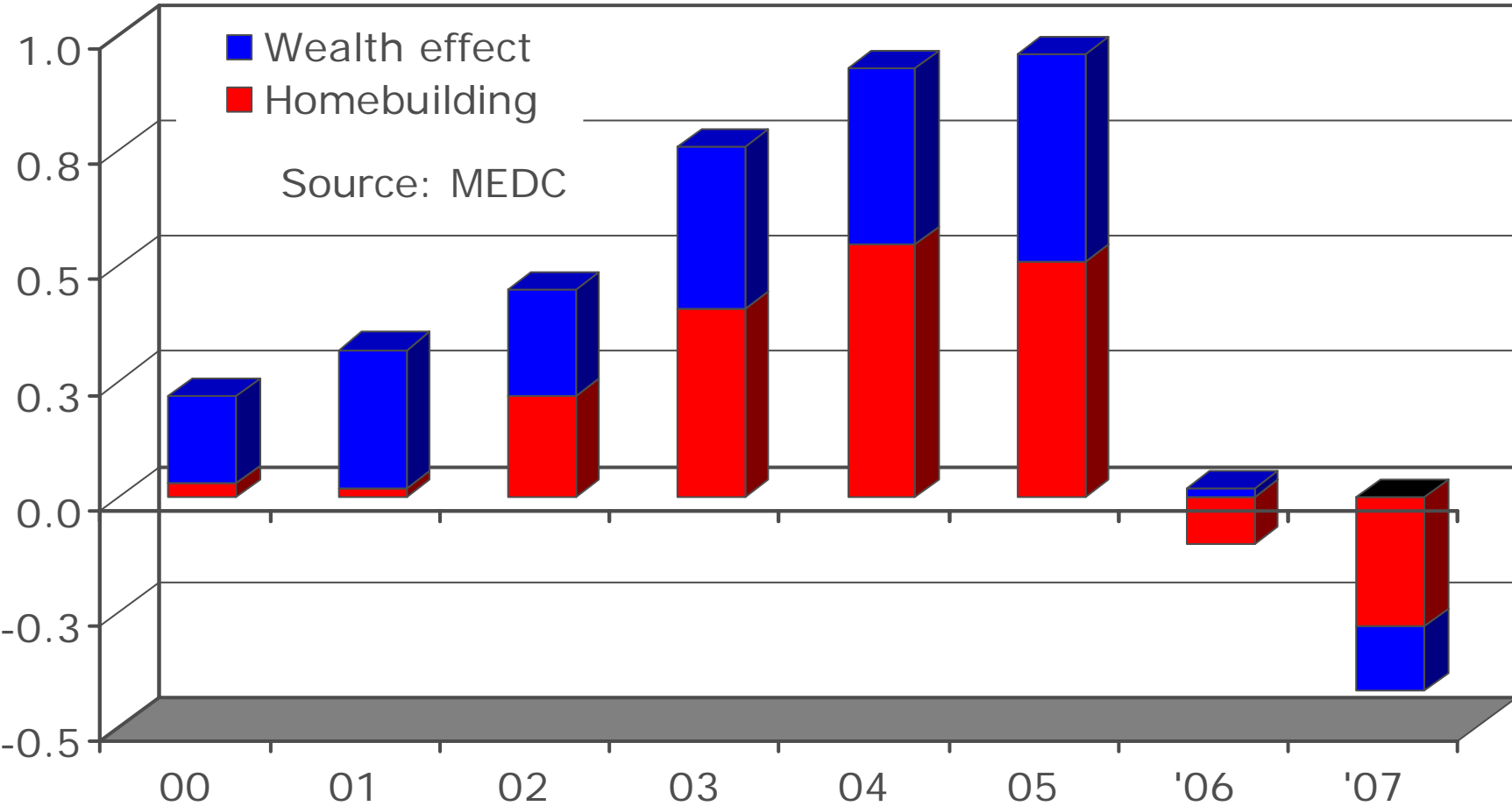
Phoenix, AZ  
Yuma, AZ  
Washington, VA  
Bethesda, MD  
Miami, FL  
Poughkeepsie, NY  
Tucson, AZ  
Santa Barbara, CA  
Stockton, CA

## Less than 5% decline

Riverside, CA  
Edison, NJ  
Essex County, MA  
St. George, UT  
Atlantic City, NJ  
Barnstable Town, MA  
Santa Ana, CA  
Boston, MA  
Salinas, CA  
Los Angeles, CA  
New York, NY  
Fort Lauderdale, FL  
Worcester, MA  
Pascagoula, MS  
Merced, CA  
Bakersfield, CA  
Gainesville, FL

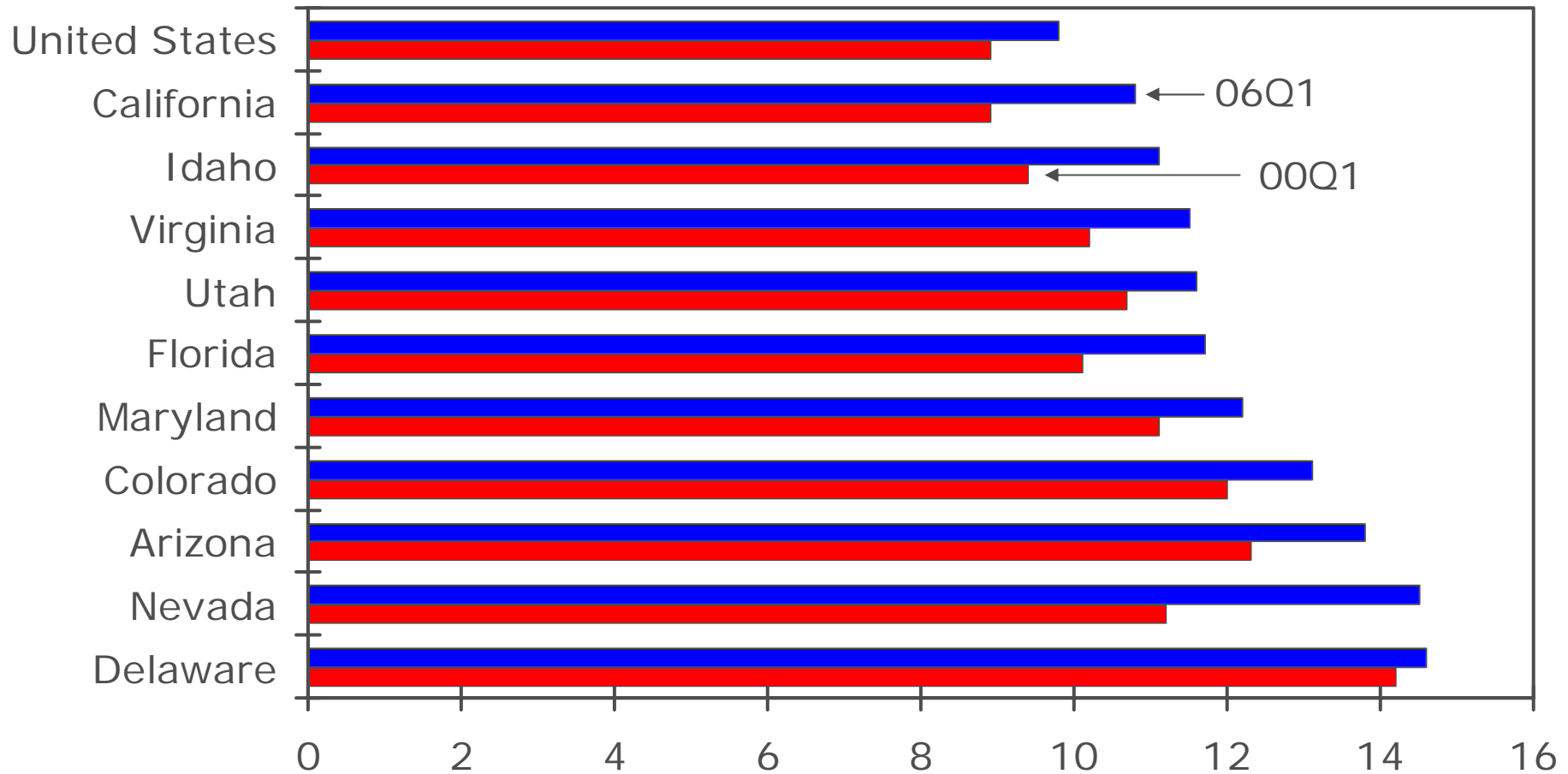
# Housing Goes From a Positive to a Negative...

## Percentage point contribution to real GDP growth

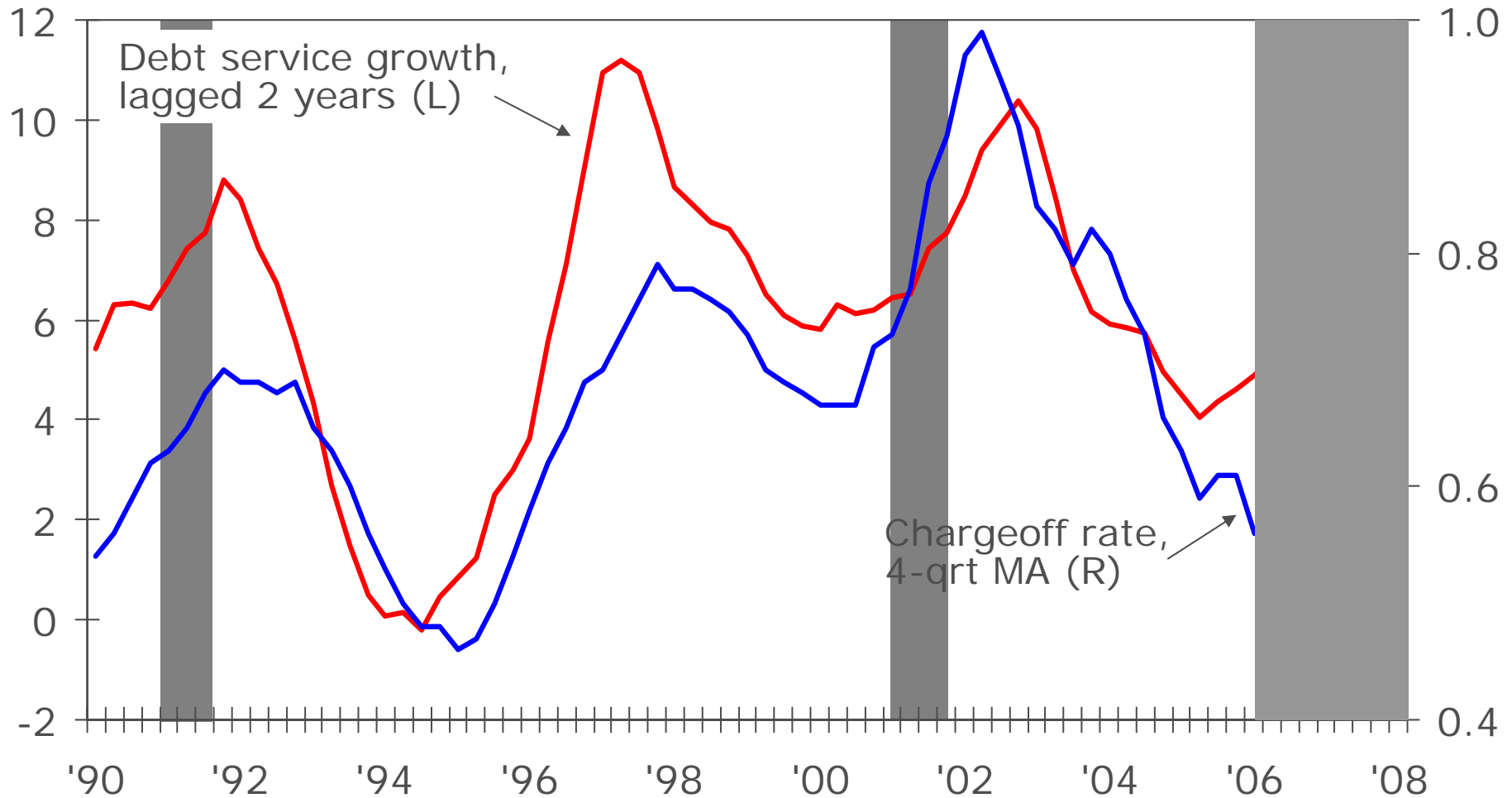


## ...Particularly in Some Areas

### Real estate-related employment as share of total, %

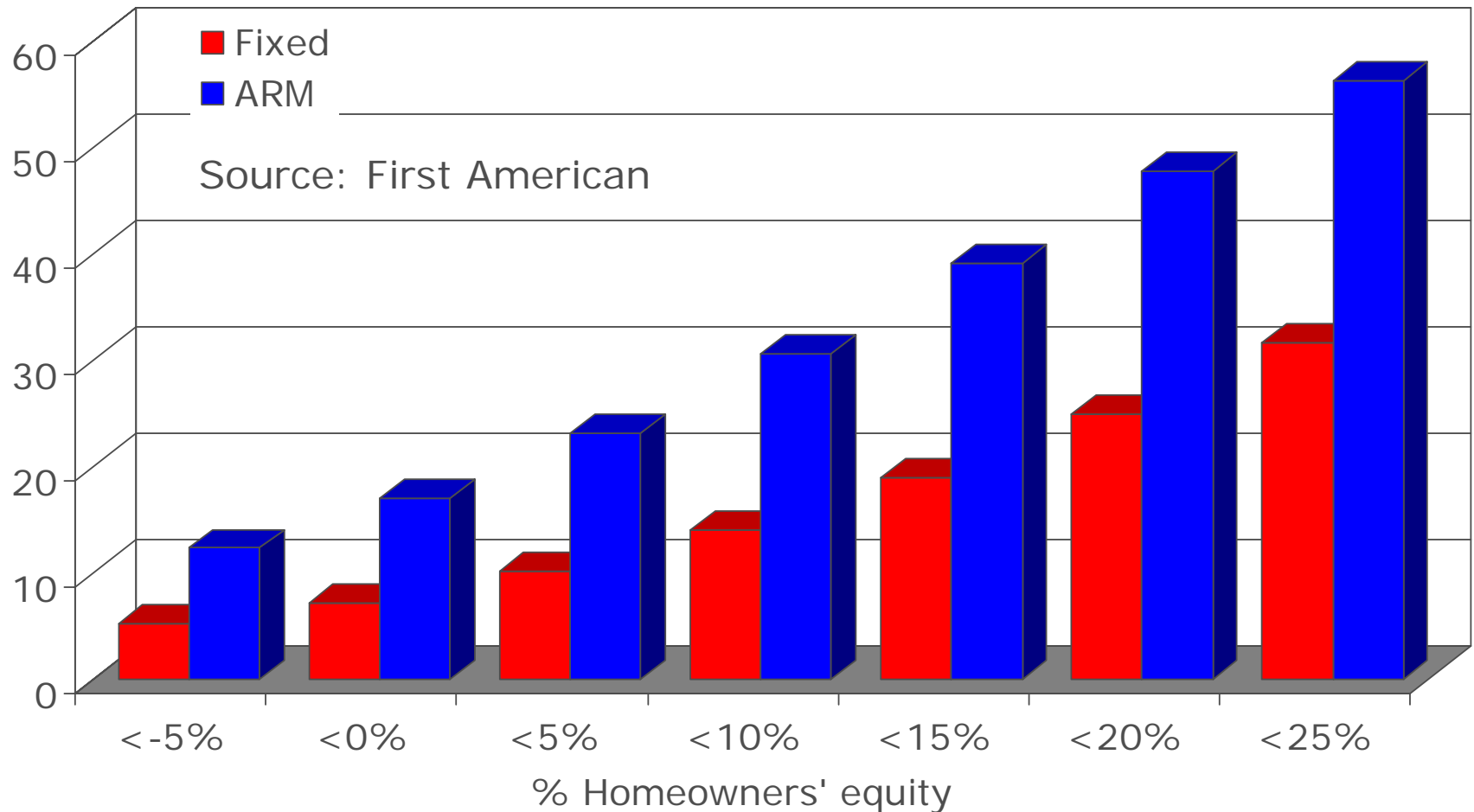


# Higher Rates, Rising Debt Service, Credit Problems



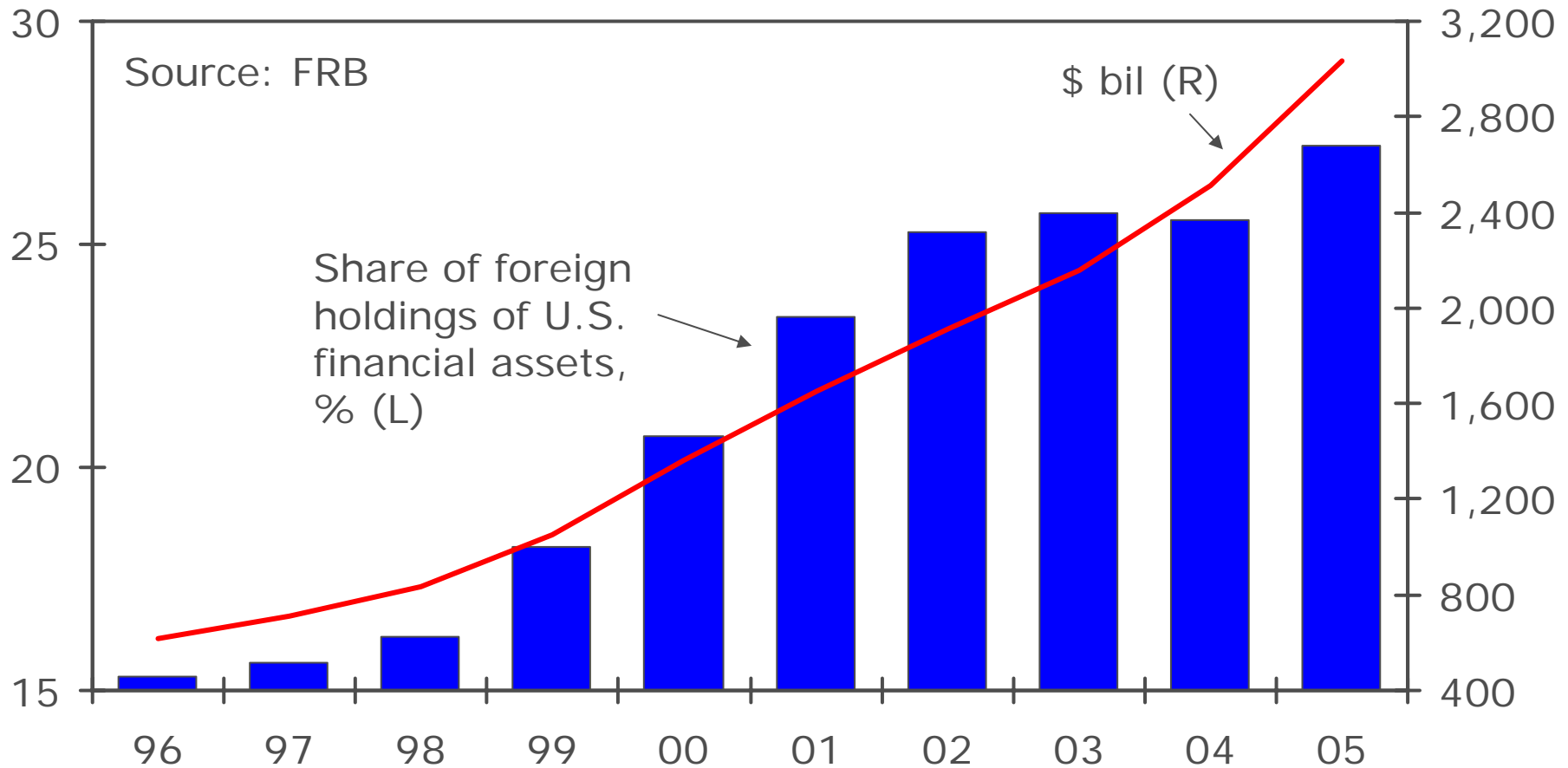
# Higher Rates Threaten New Homeowners...

## Cumulative distribution of homeowners' equity, %



# ...Which Could Spook Global Investors

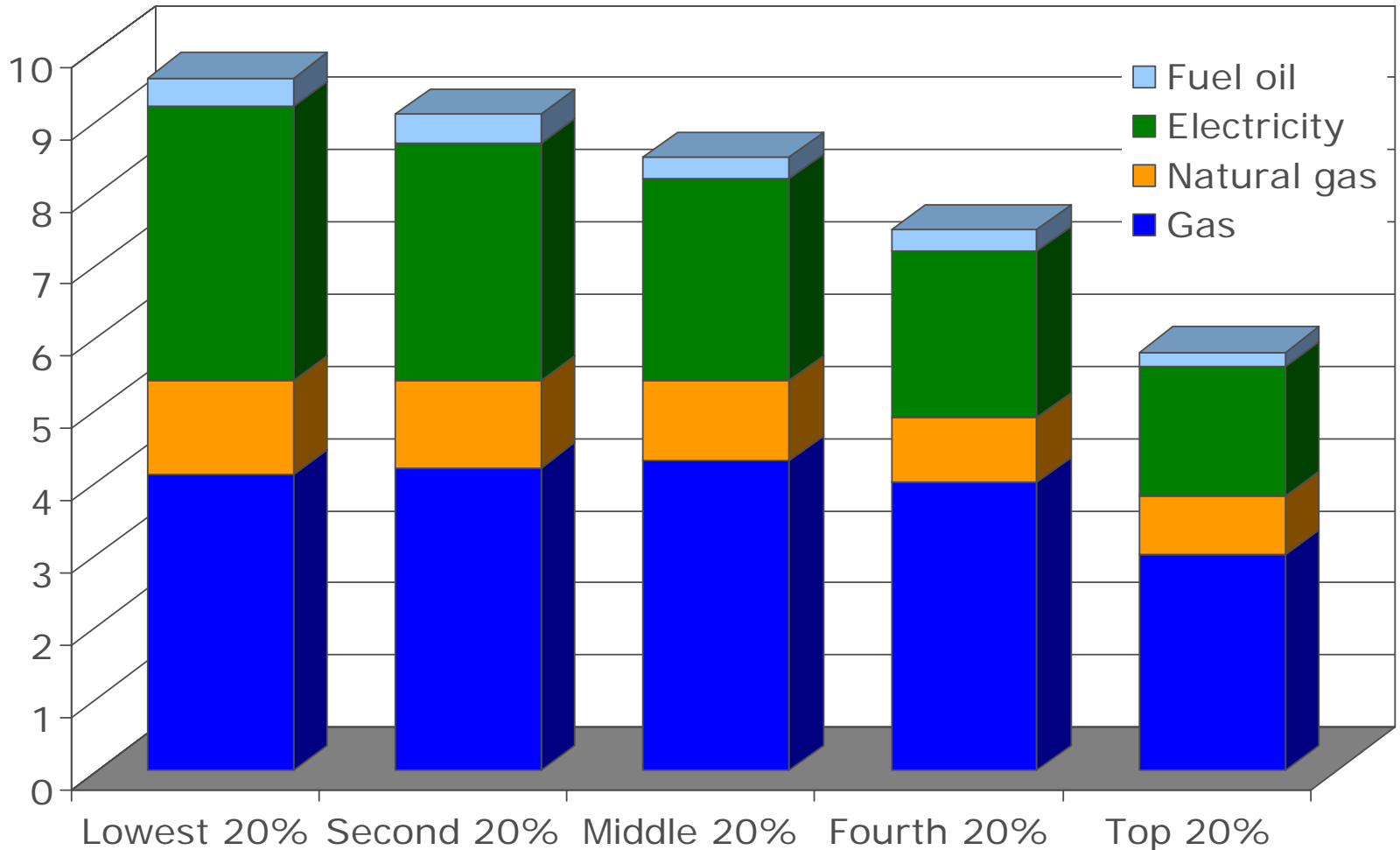
## Foreign holdings of U.S. mortgage-backed debt





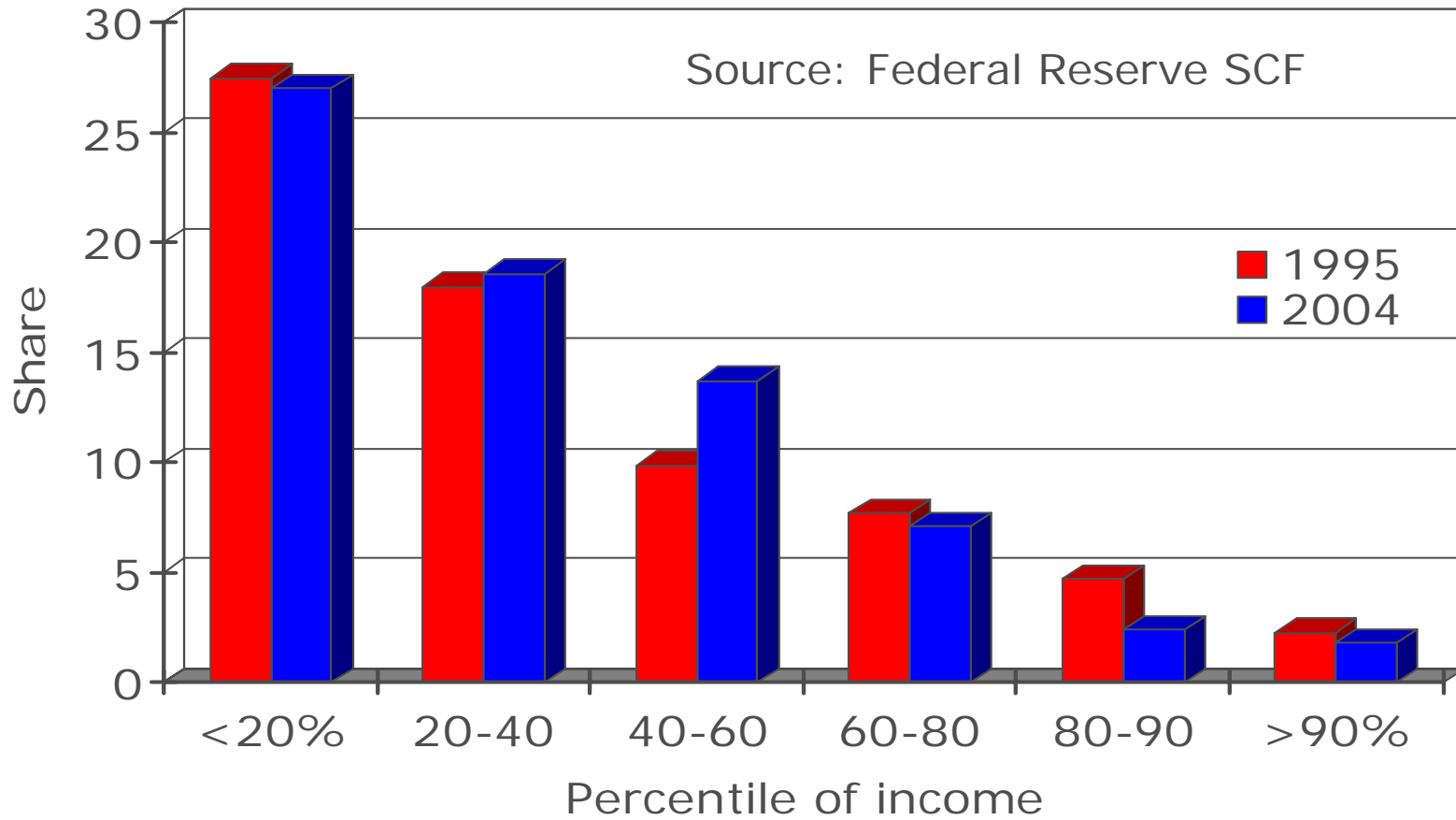
# Higher Energy Prices are a Threat...

% of consumer spending, 2004 Consumer Expenditure Survey



## ...Particularly to Lower Income Households

Share of families with debt burdens greater than 40%



# Outlook Summary

- The credit cycle is at its sweet spot. Loan growth is robust and loan quality is pristine. Behind the stellar conditions are the heretofore roaring housing market and strong job market.
- The credit cycle is set to turn with the tightening in monetary policy.
- Housing and mortgage markets are weakening. Home sales are falling, unsold inventory is surging, and house prices have gone flat. New construction remains strong, however.
- House prices will decline by as much as 10% peak-to-trough throughout much of the Southwest, Florida, and parts of the Northeast. Half dozen markets will experience a crash.
- Matters of concern include the job market's reliance on housing, negative wealth effect, confident builders, even higher rates.
- The most substantial threat is that weakening mortgage credit quality will trigger a financial market event, resulting in a more serious decline in housing and economic activity.
- Even higher energy prices also remains a threat.