

NABE Economic Policy Survey®

National Association For Business Economics

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NABE Panel: Subprime and Credit Top Short-Term Threats to U.S. Economy August 2007

*The NABE Economic Policy Survey presents the consensus of a panel of 258 members of the National Association for Business Economics. Conducted semiannually, this survey was taken July 24-August 14, 2007. May be reprinted in whole or in part with credit given to NABE. View the survey results, including complete tabulations, online at www.nabe.com. This is one of three surveys conducted by NABE. The other two are the NABE Outlook and the NABE Industry Survey. **Catherine L. Mann**, Brandeis University; **Richard A. Brown**, FDIC; and **Kathleen Camilli**, Camilli Economics, conducted the analysis for this report.*

“Financial market turmoil has shifted the focus away from terrorism and toward subprime and other credit problems as the most important near-term threats to the U.S. economy,” says **Carl Tannenbaum**, NABE President and Chief Economist, La Salle Bank/ABN-AMRO. “However, these concerns appear to be somewhat transitory, as the five-year outlook for housing remains positive.”

Survey Highlights

The combined threat of subprime loan defaults and excessive indebtedness has supplanted terrorism and the Middle East as the biggest short-term threat to the U.S. economy. Just 20% of NABE members surveyed listed terrorism and the Middle East as their top concern in August, compared to 35% in March. Meanwhile, 18% of those surveyed pointed to the effects of the subprime debacle as their biggest concern, and the related issue of “excessive household and/or corporate debt” was cited by another 14%.

Short-Term Risks to the U.S. Economy (Percent of survey panelists responding)

	Survey Month				
	Sep 2005	Mar 2006	Aug 2006	Mar 2007	Aug 2007
Combined subprime default & debt*	na	na	na	na	32
*Effects of subprime loan defaults	na	na	na	na	18
*Excessive household/corporate debt	9	7	5	13	14
Defense/terrorism	20	26	34	35	20
Energy prices	30	23	29	9	13
Current account deficit	11	13	11	12	8
Inflation	5	3	12	4	6
Employment issues	1	1	1	7	5
Govt spending/ deficit	13	14	2	5	3

The most serious long-term challenges facing the U.S. economy are health care costs, cited by 24% of respondents, and an aging population, cited by 21%. These responses were similar to survey rankings from 2005 and 2006. Education and skilled labor rank close behind, with 17% seeing them as the nation’s most important long-term challenge.

Longer-Term Challenges to the U.S. Economy

(Percent of survey panelists responding)

	Survey Date				
	Sep 2005	Mar 2006	Aug 2006	Mar 2007	Aug 2007
Health care	23	22	16	25	24
Growth of elderly population/dependency ratio	18	21	17	23	21
Education system	21	16	21	15	17
Federal deficit	22	22	23	19	13
Energy issues	4	8	13	8	9
Competitiveness	7	5	4	4	6

The ranking of U.S. economic strengths remains unchanged, led by labor force flexibility (39%), technology and productivity (24%), and deep capital markets (15%).

U.S. Economic Strengths

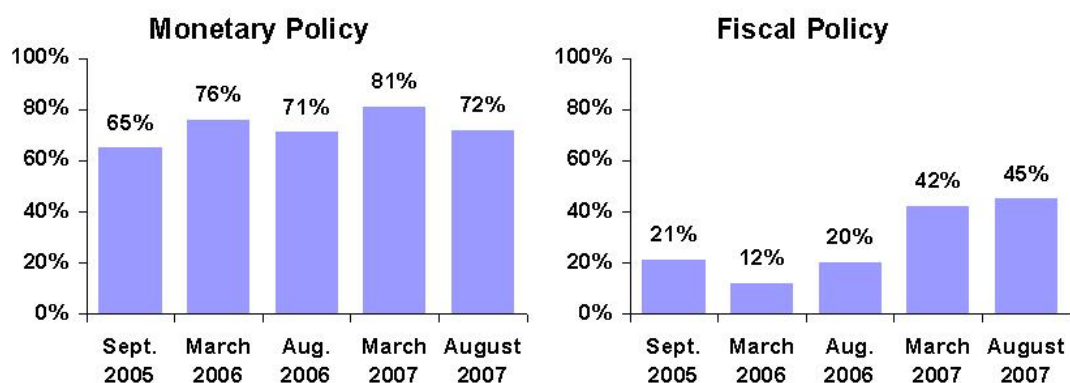
(Percent of survey panelists responding)

	Survey Date				
	Mar 2005	Sep 2005	Mar 2006	Aug 2006	Mar 2007
Flexible labor markets/economy	35	42	35	39	39
Productivity/technology	35	26	29	27	24
Deep capital markets	12	11	16	18	15

The consensus on monetary policy was beginning to fray even before the survey ended on August 14.

The percent of respondents judging monetary policy to be “about right” slipped to 72% in August from 81% in March, while those calling policy “too restrictive” almost doubled to 16%. A plurality (47%) of NABE members continue to call U.S. fiscal policy “too stimulative,” although the 45% who think it is “about right” is more than twice as large as a year ago.

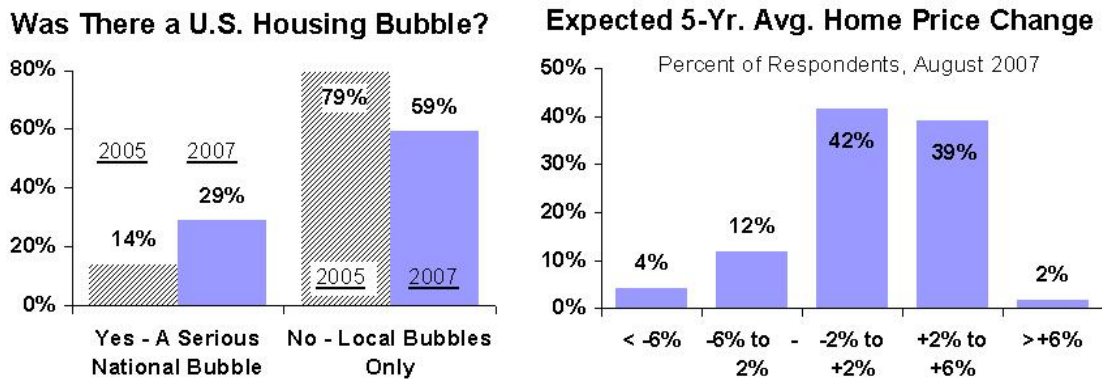
Percent of NABE Panelists Who Consider Current Policy to be “About Right”:



Interpretations of the early-2000s U.S. housing boom have shifted. Responding to a series of questions first asked in the August 2005 Policy Survey, more NABE members now view the boom as a credit-induced bubble. Just over 29% now call the boom a “serious national bubble,” compared to only 14% two years ago. Virtually all of this increase came from the group of respondents who previously ascribed the trend to “local bubbles.” The percentage citing “easier credit standards” as the number one or number two cause for the housing boom jumped to 64% from 34% in 2005. Just over 60% of NABE members polled agreed that the new mortgage lending rules issued by federal banking regulators are “necessary and appropriate;” however, among these supporters a vast majority (over 90%) also termed the action “a little late.”

The five-year housing outlook remains largely positive. A slight plurality (42%) of respondents expects U.S. home prices to be flat, on average, over the next five years. But respondents who expect home prices to rise on average over the next five years (41%) far outnumber those who expect prices to fall (16%). NABE members continue to place low odds (1 in 10) on a large drop in U.S. home prices similar to that experienced in Japan during the 1990s.

Despite Growing “Bubble” Concerns, Long-Term Housing Outlook Positive



Substantial percentages of economists report little familiarity with complex instruments and other financial innovations. Despite the prevalence of NABE members holding advanced degrees in economics and other business-related disciplines, substantial percentages admitted to having little or no familiarity with the structure, activities, and risks associated with hedge funds (45%), private equity funds (40%), asset-backed securitization (48%), credit default swaps (CDS, 68%) and collateralized debt obligations (CDOs, 51%).

The greatest threat to financial stability is thought to arise from CDOs, followed by hedge funds and CDS. In terms of regulation and reporting requirements, members were generally split between “fine as is” and “prefer more,” with the greatest need for regulatory and reporting enhancements seen for hedge funds (57%) and CDOs (48%). More than six out of ten those surveyed agreed that the “carried interest” gains earned by partners in private equity funds should be taxed as ordinary income.

NABE members are divided as to their assessment of the threat posed by man-made global warming. Some 53% of respondents accept man-made global warming due to CO₂ emissions as a “fact.” Of these, just over four-fifths also agree that the problem poses “significant risks that must be addressed immediately.” On the other side of the ledger, 45% do not yet accept man-made global warming as a fact, although two-thirds of that number state that further study of the issue is needed.

The most popular policy prescription for reducing man-made carbon emissions is higher fuel economy standards for cars and trucks. Close behind are proposals for a “carbon tax” or a system for capping emissions and trading carbon credits. A vast majority (93%) of respondents agreed that much could potentially be done to reduce man-made carbon emissions using current technologies, and 44% feel that significant gains could be made at relatively low cost.

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