July 29, 2009

Financial Highlights

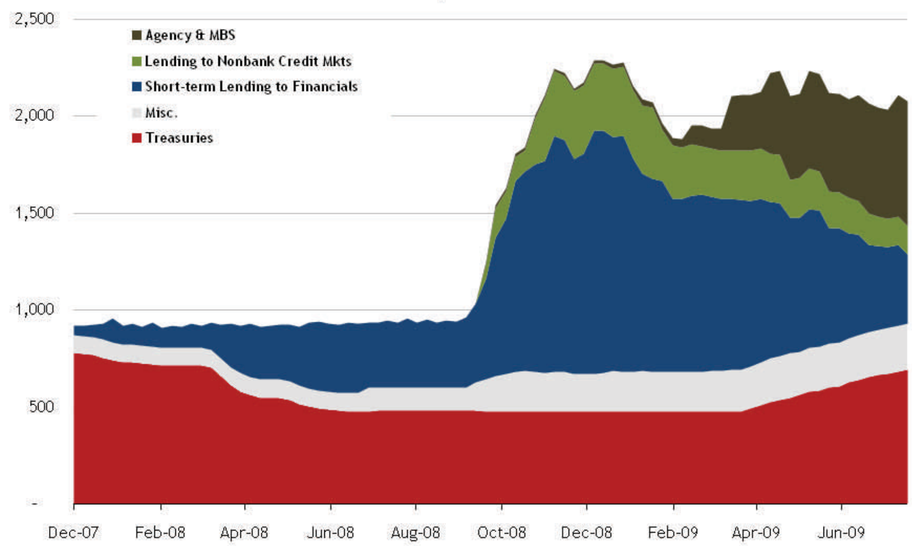
Federal Reserve

Summary

The size of the Fed's balance sheet has largely been flat since March, remaining within a range of $2 trillion to $2.2 trillion.

Federal Reserve Assets (Uses of Funds)

$ billions



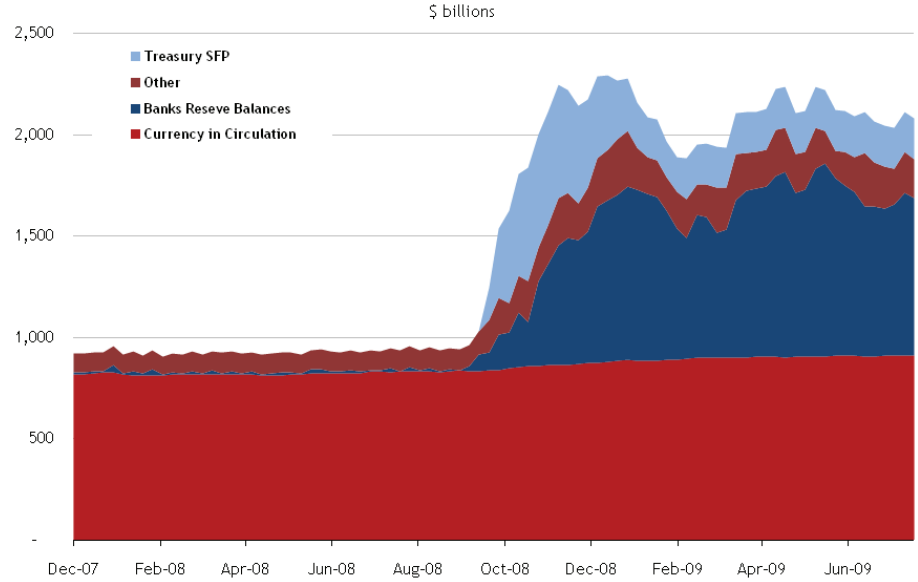
Source: Federal Reserve Board

- The overall size of the Fed's balance sheet has been steady over the past few months and the broad trends remain little changed. That is, the sizeable declines in short-term lending to financials and nonbank credit markets have largely been offset by increases in holdings of Treasury securities, mortgage-backed securities, and agency debt.
- Lending to nonbank credit markets had accounted for nearly 18% of the balance sheet in January but has since fallen to under 7%. Similarly, short-term lending to financial firms had accounted for just over one-half of the balance sheet at the beginning of the year, but it has declined to just over 17%. Treasuries now make up one-third of the balance sheet after reaching a low of about 21% in December 2008.

On the liabilities side, bank reserve balances continue to make up a large portion of the balance sheet. So far this year, reserves have made up an average of about 38% of liabilities.

Federal Reserve Liabilities (Sources of Funds)

$ billions



SFP = Supplementary Financing Program

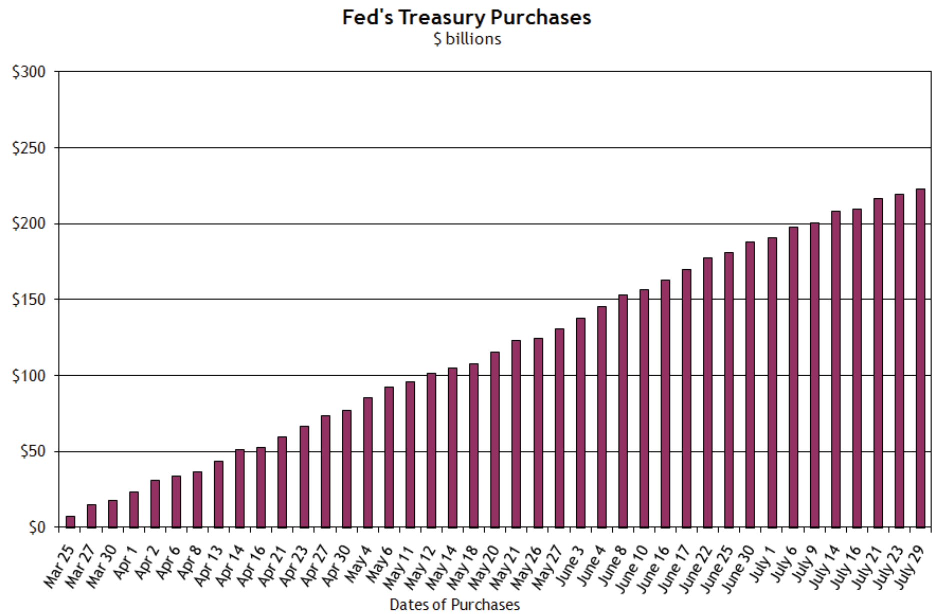
Source: Federal Reserve Board

Assets: Lending to nonbanks: TALF, CPFF, AMLF, and MMIFF; Short-term lending to financials: discount window, TAF, currency swaps, PDCF, and repos; Misc: Maiden Lanes I, II, and III, credit to AIG, and other Fed assets. **Liabilities**: Other: Reverse repos, Treasury cash holdings, and deposits with Federal Reserve Banks other than reserve balances and excluding the Supplemental Financing Program.

Federal Reserve

Summary

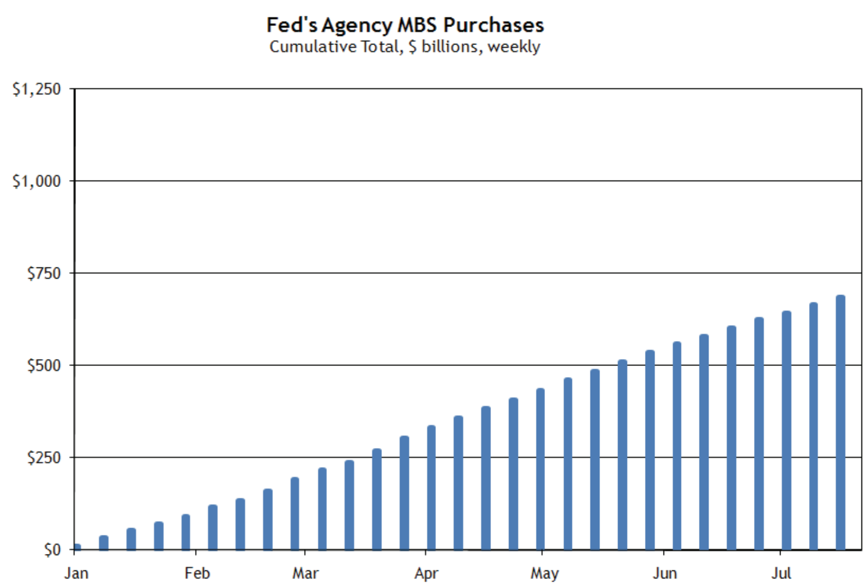
The Fed made two purchases of Treasury securities during the past week, totaling $6 billion.



Source: NY Fed

- The Fed purchased $3 billion in Treasury securities on July 23, focused in the 17– to 30-year sector, and another $2.999 billion on July 29 in the same maturity buckets.
- To date, the Fed has purchased $223 billion of Treasuries and will purchase up to $300 billion by autumn.

The Fed purchased $21.1 billion of MBS.



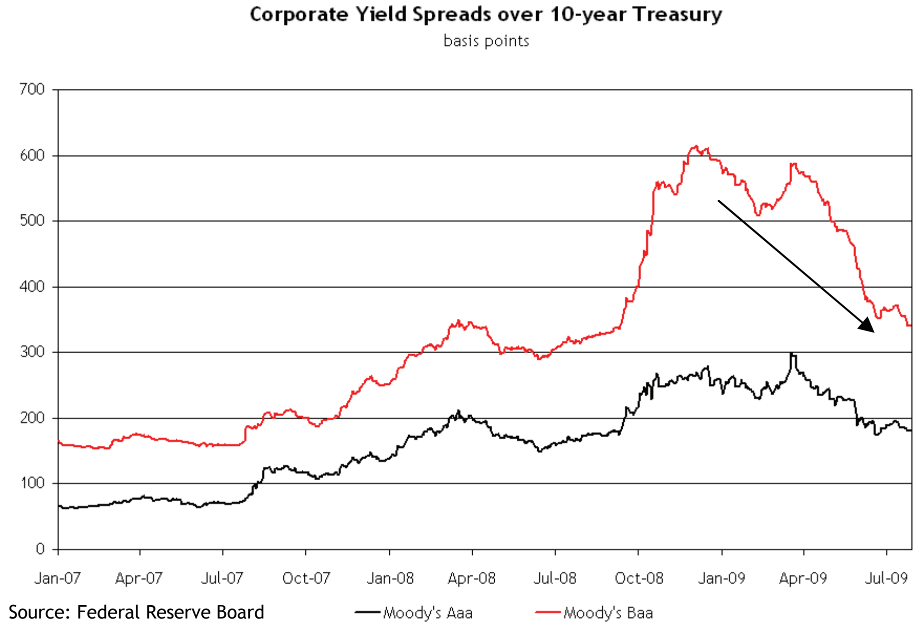
Source: NY Fed

- The Fed purchased a net total of $21.1 billion of agency-backed MBS between July 16 and 22, bringing its total purchases up to $686 billion, and by year-end the Fed will purchase up to $1.25 trillion.

Corporate Bonds

Summary

Investment grade corporate bond spreads have fallen sharply this year, consistent with improvement in perceived credit quality and/or a reduction in the credit risk premium demand by investors.



Source: Federal Reserve Board

- Corporate bond yield spreads over comparable Treasuries reflect multiple factors including credit risk (uncertainty of the obligor with respect to meeting its obligations), liquidity risk (uncertainty of being able to easily trade a security), and the risk premium market participants demand in order to take on these risks.
- After peaking at just over 600 basis points (bps) in December, the Baa spreads have declined sharply this year, falling by about 275 bps. Similarly, the Aaa spreads have declined from their recent peak of about 300 bps to about 180 bps. Spreads are now at their lowest levels in almost a year.
- The decline in spreads may reflect improvement in investors' perception of credit quality of the obligors. The decline in spreads is also noteworthy when taken in the context of the robust amount of bond issuance seen this year (next page).

The CDX has trended downward since March, consistent with improvement in perceived default risk among investment-grade borrowers.

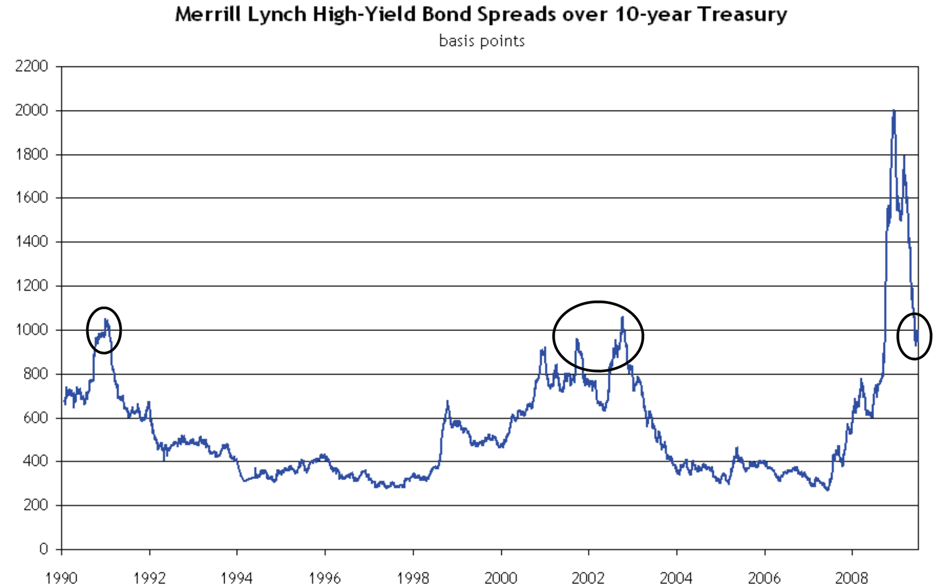
Source: Markit Group Limited/Haver Analytics

Corporate Bonds

Summary

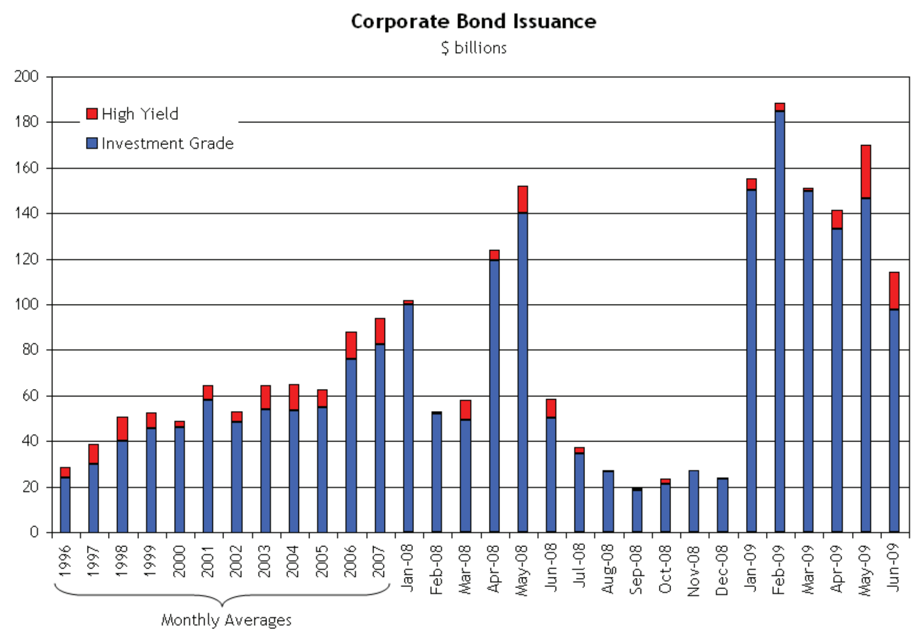
Risk spreads for high-yield borrowers has been cut in half, declining from about 20% in December to about 8.5% currently.

The high-yield spreads have now declined to levels comparable to the peaks seen in the last two credit cycles following the 1990 -91 and 2001 recessions.



Source: Merrill Lynch and Federal Reserve Board

Following the difficulty in accessing capital markets last year, firms have been able to successfully tap funding markets by issuing bonds.



Source: SIFMA and Bloomberg

- Corporate bond issuance had slowed to a trickle in the second half of last year as investment-grade and high-yield borrowers brought an average of just $29 billion and $2.2 billion, respectively, to the market each month.
- During the first half of 2009, general market conditions have improved, investors have been increasingly willing to take on a bit more risk, and corporate bond spreads have declined. Taken together, firms have been better able to access the corporate bond market as seen in the improvement of average monthly issuance, which has increased to about $144 billion (for investment grade) and $9.9 billion (for high yield) in the first six months of 2009.

Consumer Credit

Summary

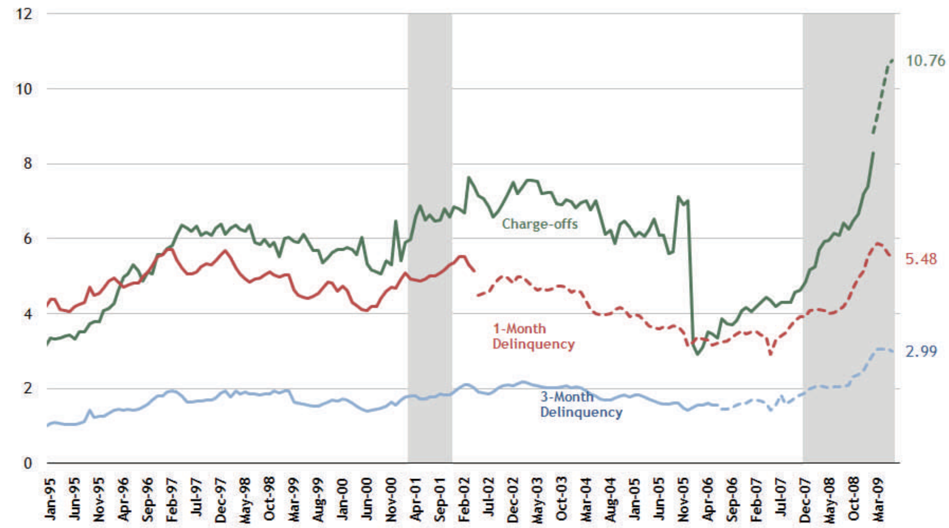
Credit card charge-off and delinquency rates, which tend to be correlated with unemployment, continue on an upward trend.

The charge-off rate, according to Moody's credit card charge-off index, reached an all-time high of 10.76% in June.

Consumer credit declined $3.3 billion dollars from April to May. The majority of the decline in May came from revolving consumer credit, which accounted for $2.9 of the $3.3 billion.

Total consumer credit outstanding was $2.5 trillion in May. Historically, consumer credit rarely shrinks; since September 2008 it has contracted $63.2 billion (or 2.4%).

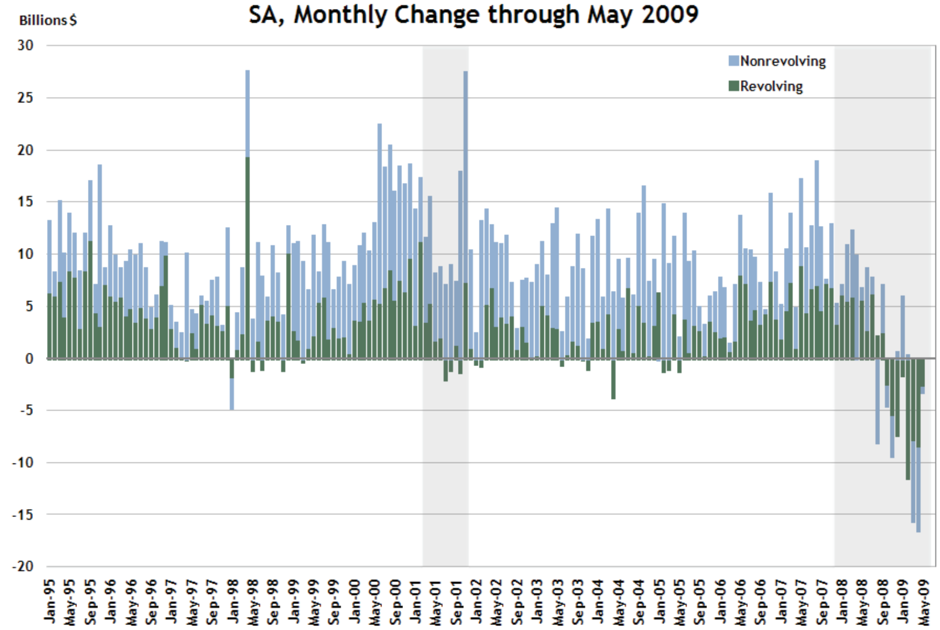
Credit Card Charge-off & Delinquency Rates
NSA, percent



Sources: S&P and Haver Analytics; Note: Dotted lines are Moody's and Bloomberg.

- Credit card charge-off rates—the percent of uncollected credit card balances written down as a loss out of average outstanding credit card balances—rose for the ninth consecutive month and have more than tripled since January 2005.
- The one-month and three-month delinquency rates have been declining slightly since March and April, but this decline is likely a seasonal factor as consumers use tax refunds to pay off debts, according to Moody's.
- Analysts at Moody's predict credit card charge-offs will peak in 2010 between 12 percent and 13 percent.

Consumer Credit Outstanding
SA, Monthly Change through May 2009



Source: Federal Reserve Board of Governors

- Consumer credit continues to contract as the savings rate increases, consumers spend less, and banks raise credit card interest rates and cut available balances.

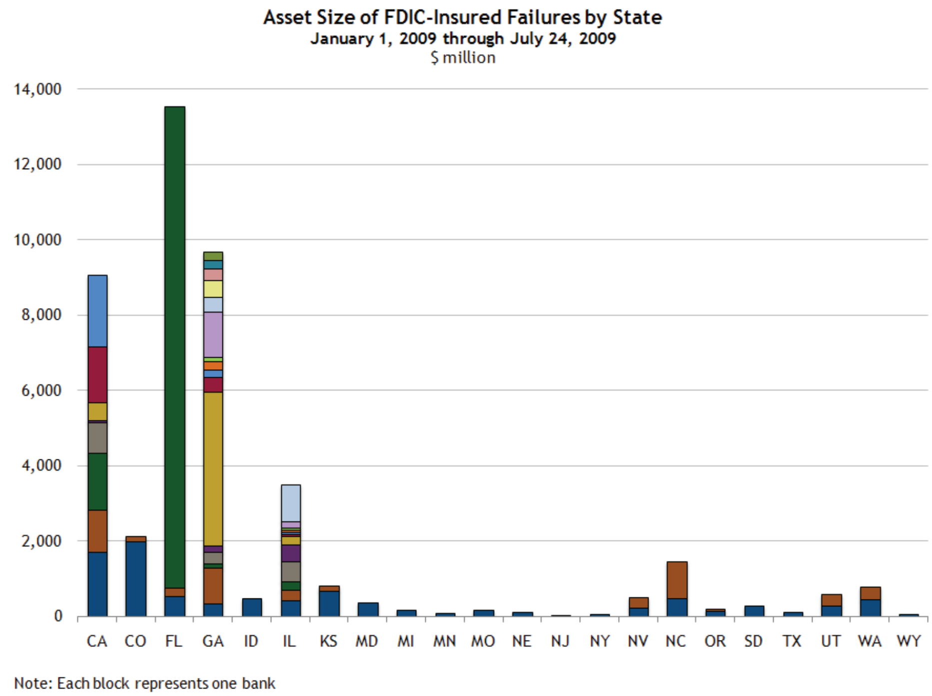
Bank Failures

Summary

Regulators closed six banks in Georgia and one in New York last week, bringing the number of FDIC-insured failures in 2009 to 64.

The six Georgia banks, all subsidiaries of Security Bank Corporation in Macon, faced heavy real estate-related losses resulting from pressures on the residential housing market.

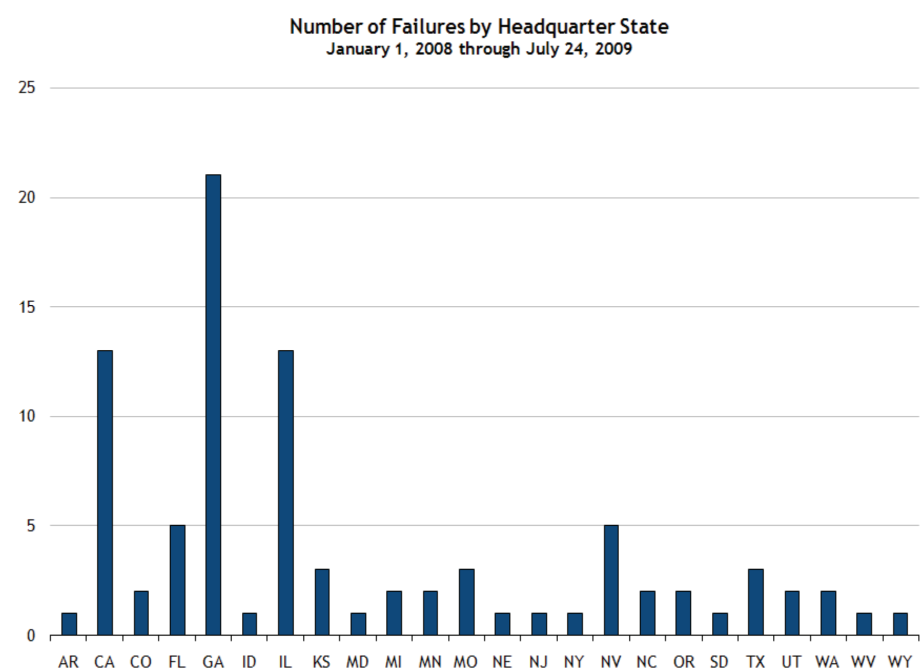
The 16 Georgia banks closed in 2009 represent one quarter of the failures this year.



Source: FDIC press releases

- Waterford Village Bank (Clarence), with $61.4 million in assets on March 31, 2009, is the first New York bank to fail since Reliance Bank (White Plains) was closed in March 2004.

A total of 89 banks have failed since the beginning of 2008. Georgia leads the nation with 21, followed by Illinois and California with 13 each and Florida and Nevada with five each.



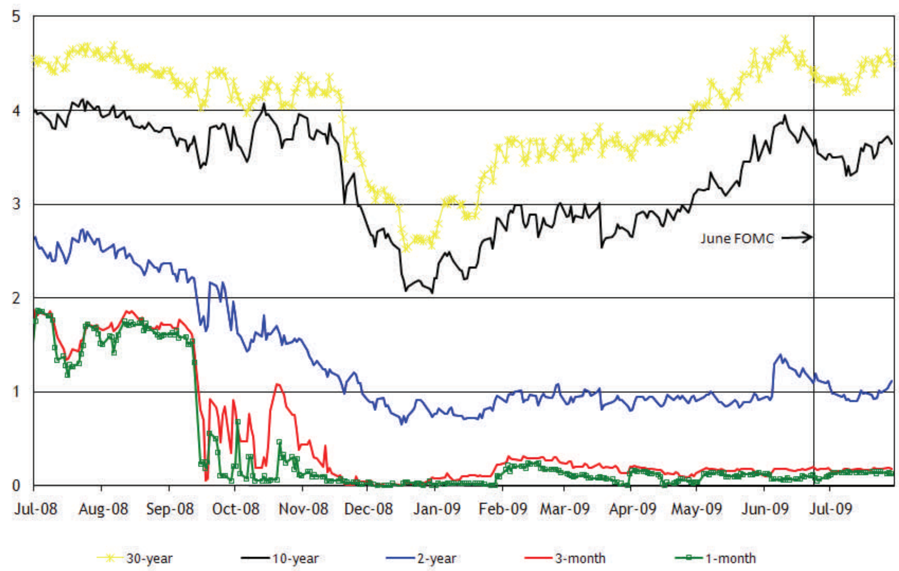
Source: FDIC press releases

Treasury Yields

Summary

Though longer-dated Treasury yields increased during the week, they have been stable since the last FOMC meeting on June 23–24.

U.S. Treasury Yields
percent

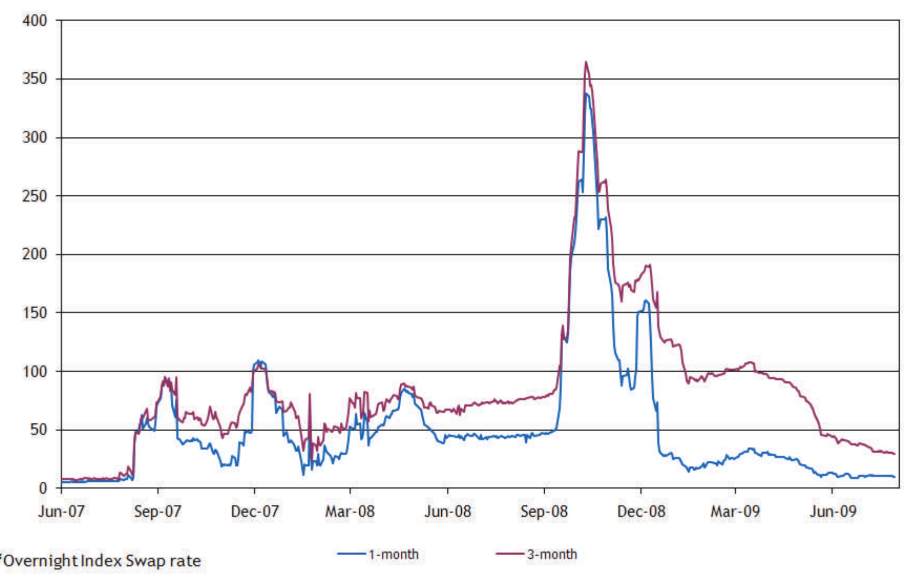


Source: Bloomberg

- Between July 22–29, longer-dated Treasury yields rose: The 30-year bond was up 5 bps to 4.50%, the 10-year note was up about 10 bps to 3.64%, and the two-year note shot up 18 bps to 1.23%. And T-bills were unchanged: The three-month yield was 0.18%, and the one-month was 0.13%.
- But since the last FOMC meeting on June 23–24, yields have dropped slightly for most Treasury securities, with the exception of the 30-year bond, which rose 7 bps.

LIBOR-to-OIS spreads are low and stable, narrowing about a basis point during the week.

Dollar LIBOR to OIS* Spread
basis points



*Overnight Index Swap rate

Source: Bloomberg and British Bankers' Association

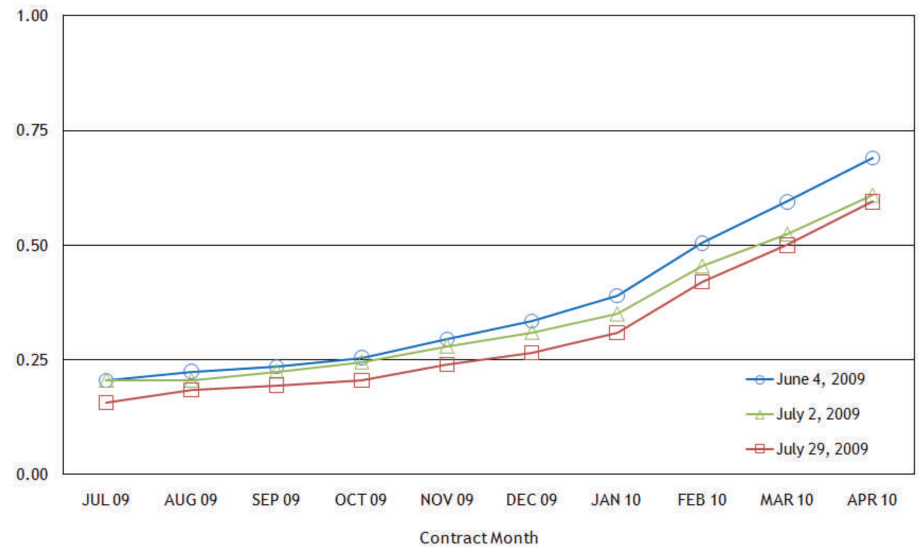
- Interbank funding spreads remain at or near the precrisis levels: the one-month dollar LIBOR-to-OIS spread was 10 bps as of July 29 and the three-month was 29 bps, both a basis point lower during the week.

Fed Funds Futures

Summary

The market for federal funds futures currently implies that market participants do not put positive probability on an increase in the fed funds rate until the first quarter of 2010.

Fed Funds Futures Rates
percent



Source: Bloomberg

- Since the last Federal Open Market Committee (FOMC) meeting on June 23–24, the futures contract for March 2010 has declined 13 bps to 0.49%. The downward shift in the entire futures curve indicates that market participants have extended their forecast for a constant fed funds rate of 25 bps.
- Since the rise in the futures-implied federal funds rate following the May employment report on June 5, futures have been trending downward and have moved below the implied rates seen just prior to that release (as denoted by the blue line).
- Like fed funds futures, Eurodollar futures have also declined, with the March 2010 contract falling 20 bps since the June FOMC meeting (and it fell 14 bps on July 2 alone, following the worse-than-expected June payroll numbers).