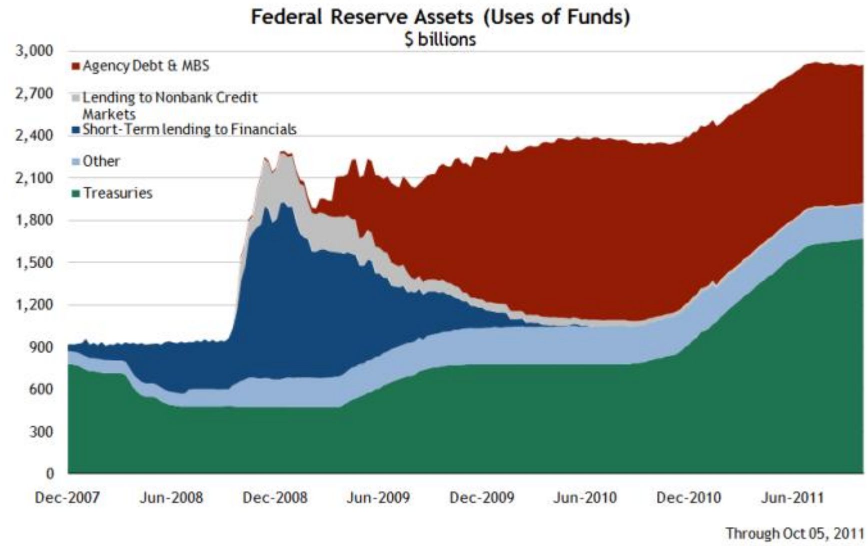
October 12, 2011

Financial Highlights

Federal Reserve

Summary

Between September 28 and October 5, the balance sheet increased by $8.4 billion, remaining essentially unchanged at $2.9 trillion.

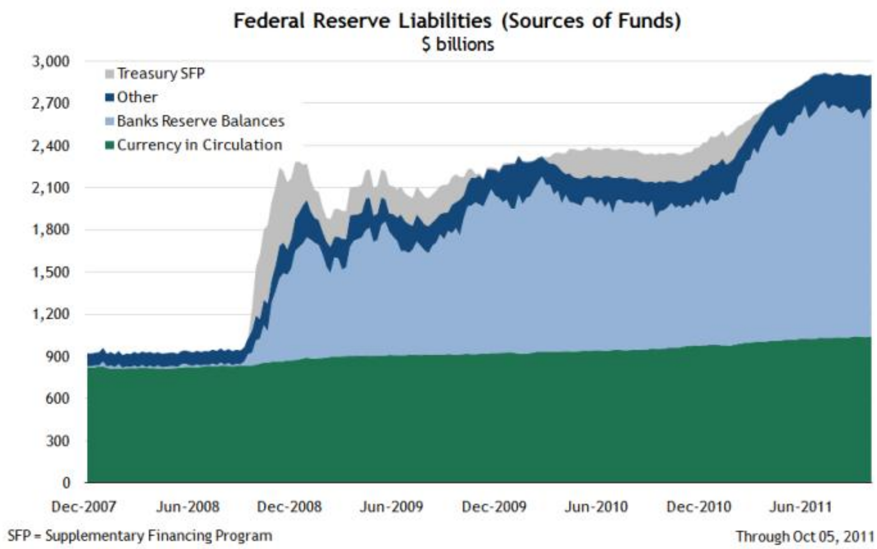


Source: Federal Reserve Board

- Treasuries increased $7.1 billion while agency debt and MBS were unchanged.
- According to the New York Fed's tentative outright Treasury operation schedule, and in line with the newly announced maturity extension program, the desk plans to purchase approximately $44 billion in Treasury securities with remaining maturities of six to 30 years and sell approximately $44 billion in Treasury securities with remaining maturities of three years or less over the month of October.

Bank reserve balances with the Federal Reserve increased $17.6 billion. Offsetting much of the increase was a decrease in the Treasury's general account with the Federal Reserve of $13.3 billion.

As of October 5, 2011, bank reserve balances are $1.6 trillion.



Source: Federal Reserve Board

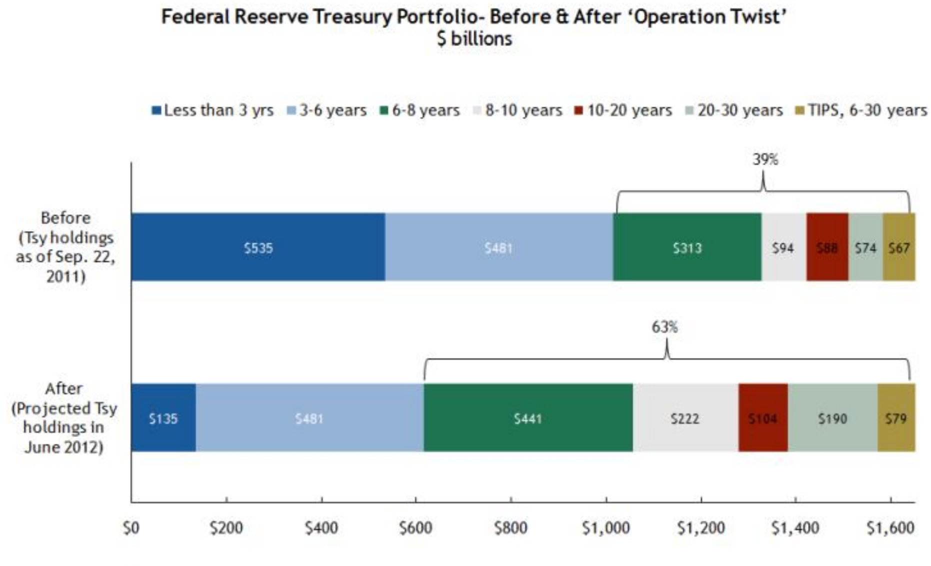
Assets: Lending to nonbanks—TALF, CPFF, AMLF, and MMIFF; Short-term lending to financials—discount window, TAF, currency swaps, PDCF, and repos; Misc.—Maiden Lanes I, II, and III, credit to AIG, and other Fed assets. **Liabilities**: Other—Reverse repos, Treasury cash holdings, and deposits with Federal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

Federal Reserve

Summary

According to the maturity extension program, the Desk plans to purchase $400 billion in par value of Treasury securities with remaining maturities of from six to 30 years and sell $400 billion with remaining maturities of three years or less by June 2012.

The result will be a Treasury portfolio of the same size but longer average maturity.



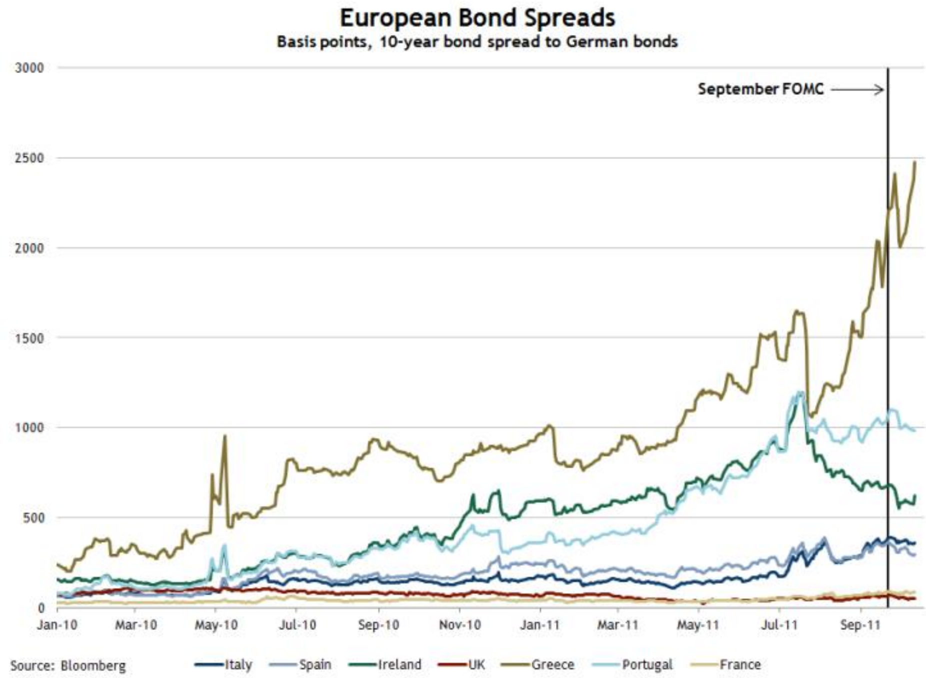
Source: New York Fed

- As of September 22, 2011 39 percent of Treasury securities held by the Federal Reserve had maturities of six years or longer. After the maturity extension program concludes in June 2012, 63 percent are expected to have maturities of six years or longer.
- Increasing demand for longer-term securities through this program is expected to drive down the interest rate on longer-term Treasury Bonds. If the interest rate on longer-term Treasury Bonds falls, the cost of long-term borrowing more generally could also fall, encouraging investment by consumers and businesses.

Europe

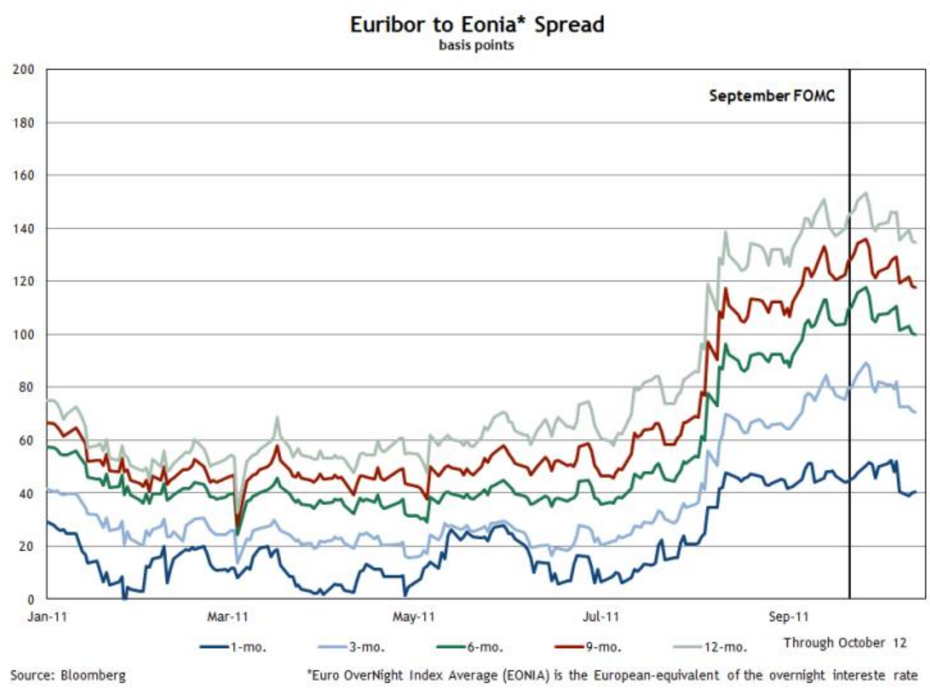
Summary

European bond spreads have narrowed over the past week for most sovereigns, except for Greece, which has seen its spread reach a record high.



- Since the September FOMC meeting, the 10-year yield spread between Greek and German bonds has widened by 267 basis points (bps) and is 472 bps higher since September 30. The yield spreads for Portugal and Ireland have both tightened, by 83 bps and 52 bps, respectively. Spanish and Italian spreads are also down, by 52 bps and 31 bps, respectively.

The euro-based Euribor-to-Eonia spread has narrowed over the past week after rising steadily since late July. Since October 5, the spread has narrowed by 8 basis points (bps) to 14 bps, depending on the tenor, and is still elevated compared to July levels.

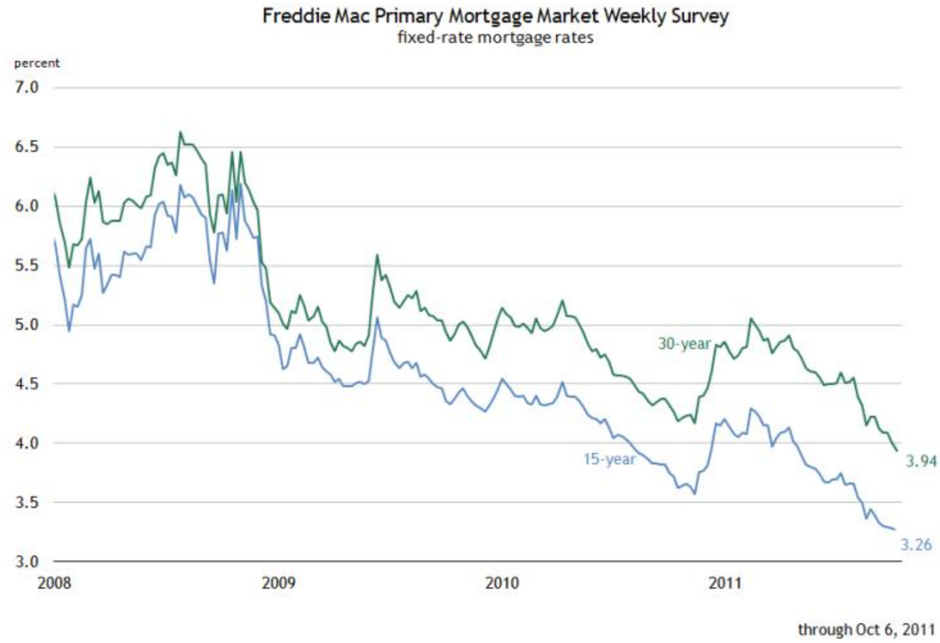


- The Euribor rates are offered interbank lending rates, denominated in euros and for a set of given maturities. The Euribor rate is determined by surveying 44 banks with the highest volume of business in the euro area, including four non-European banks. Eonia is the Euro Overnight Index Average swap rate on unsecured interbank lending in the euro area.

Mortgage Markets

Summary

The 30-year fixed rate fell below 4 percent for the first time in history. The 15-year fixed rate also fell to its lowest level for the sixth consecutive week.



Source: Federal Home Loan Mortgage Corporation/Haver Analytics

- The 30-year fixed rate averaged 3.94 percent, down from 4.01 percent a week ago. At this time last year the 30-year fixed rate averaged 4.27 percent.
- The 15-year fixed rate averaged 3.26 percent, down from 3.28 percent a week ago. At this time last year the 15-year fixed rate mortgage averaged 3.72 percent.

Despite historically low mortgage rates, the Mortgage Bankers Association announced in its latest forecast that it expects mortgage originations will decrease in 2012 from 2011. The organization expects a significant drop in refinances with only a slight increase in purchase originations.

The Purchase Index and Refinance Index are measures of loan application volume reported in the MBA's Weekly Application Survey. The survey has been conducted weekly since 1990 and covers more than 50 percent of all U.S. retail residential mortgage applications.

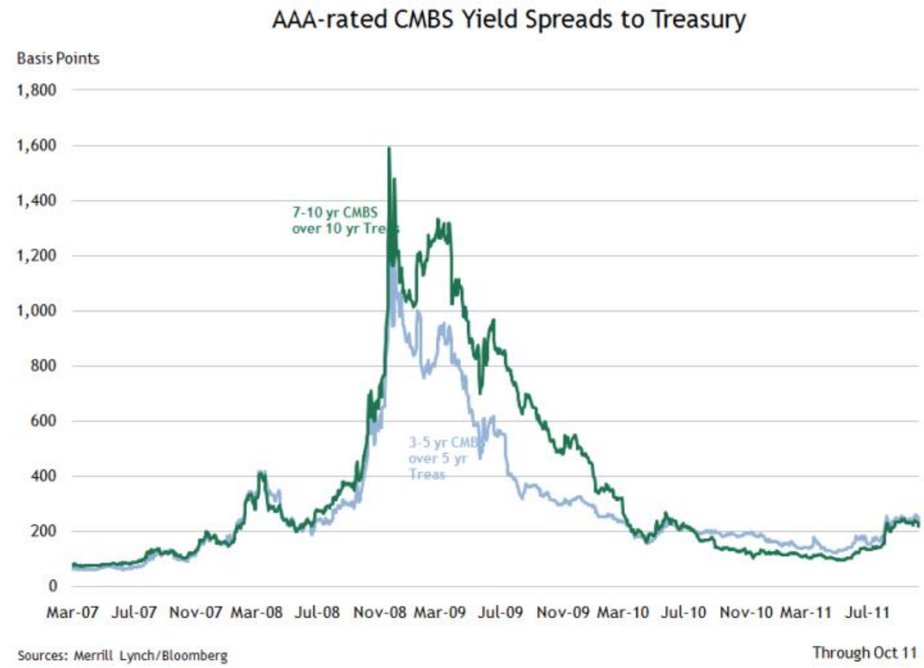
Source: Mortgage Bankers Association/Haver Analytics

- Purchase applications increased 1.2 percent, and refinance applications were up 1.3 percent for the week ending October 7.
- The refinance share of mortgage activity remained unchanged at 79.1 percent.

CMBS

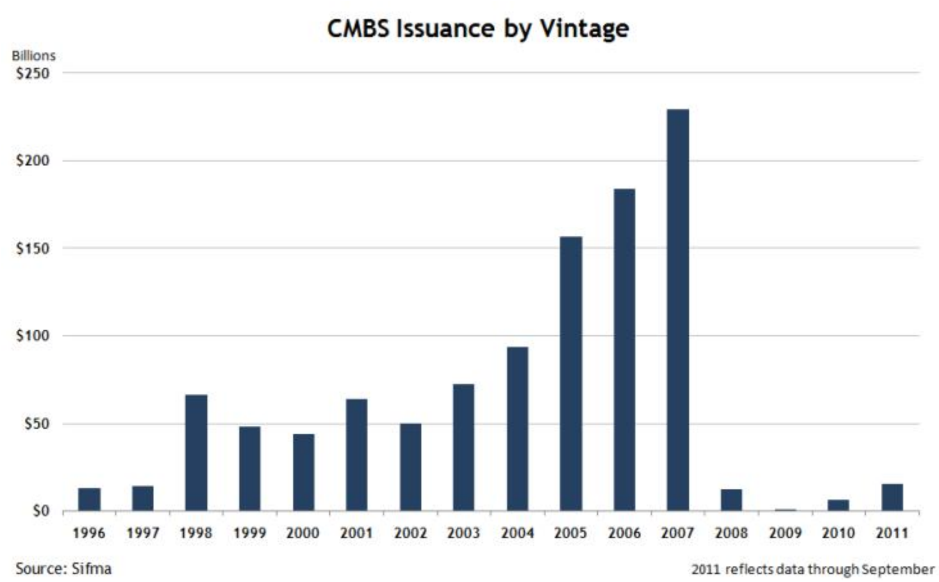
Summary

Top-rated CMBS yield spreads have risen over the past three months.



- Since July 14, 2011, three-to-five year commercial mortgage backed securities yields have increased 43 bps while the five-year treasury yield has declined 37 bps, resulting in an 80 bp increase in the spread.
- Over the same period, seven-to-ten year CMBS yields have increased just one basis point, while the yield on ten-year Treasuries has declined 80 bps, resulting in a an increase in the spread of 81 bps.

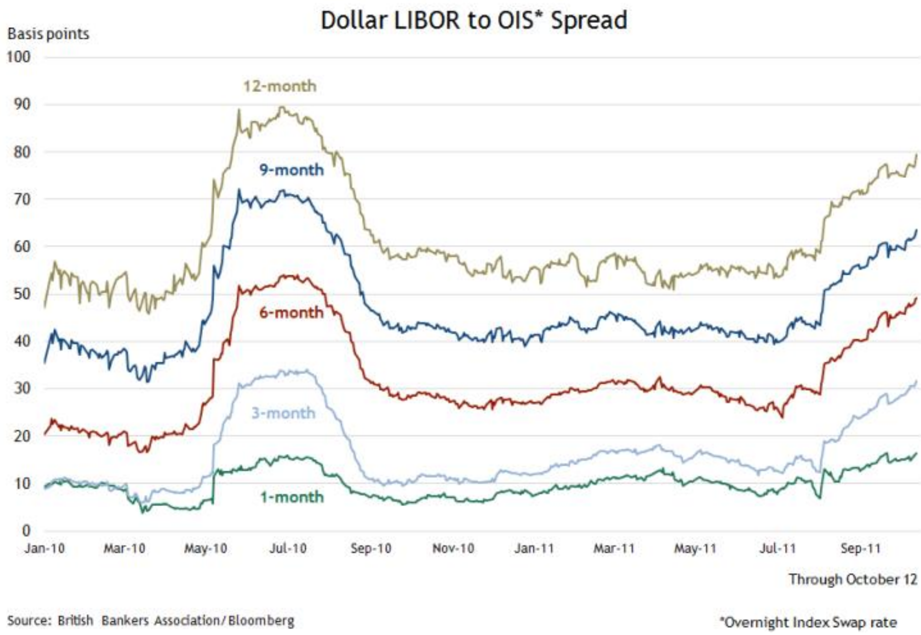
Non-agency CMBS issuance year-to-date is already higher than issuance in all of 2010 but remains very far below peak issuance in 2007.



Broad Financial Market Indicators

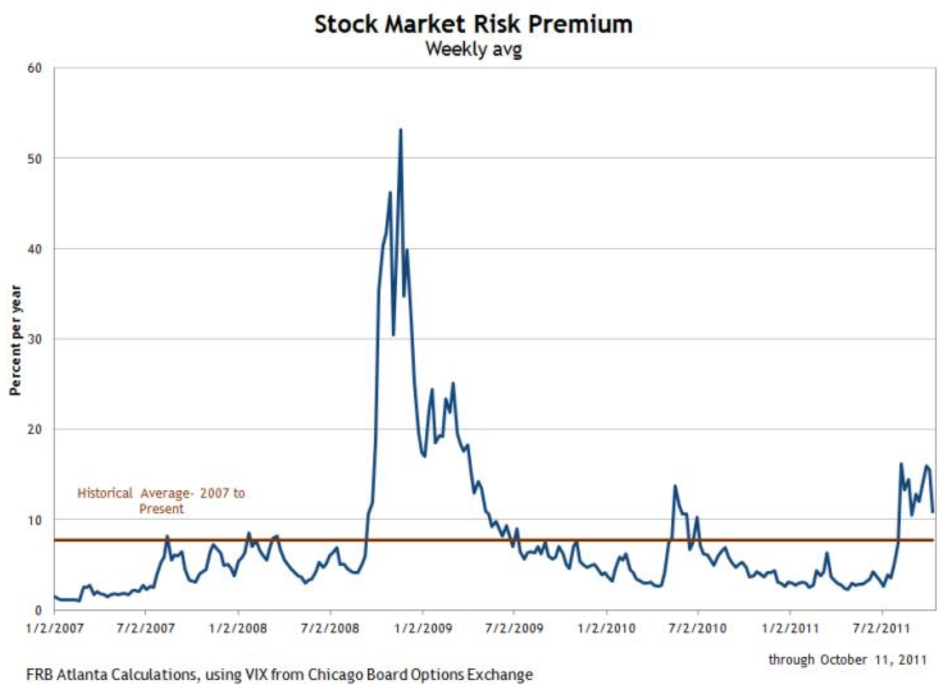
Summary

LIBOR to OIS spreads for all tenors have been widening since late August. Since the last FOMC meeting, spreads are nearly 4 bps to 6 bps higher for the three- to 12-month tenors and about 1.7 bps higher for the one-month tenor.



- The LIBOR-OIS series shown above is denominated in U.S. dollars and reflects the spread between interbank lending rates offered and the overnight index swap rate (OIS). The LIBOR panel used to create the rate is made up of 19 large international banks based in the United States, Europe, and elsewhere. The OIS rate is a proxy measure for the expected effective rate on federal funds held over a given maturity.

The premium investors have demanded in order to invest in stocks has been very volatile recently, declining over the past week.

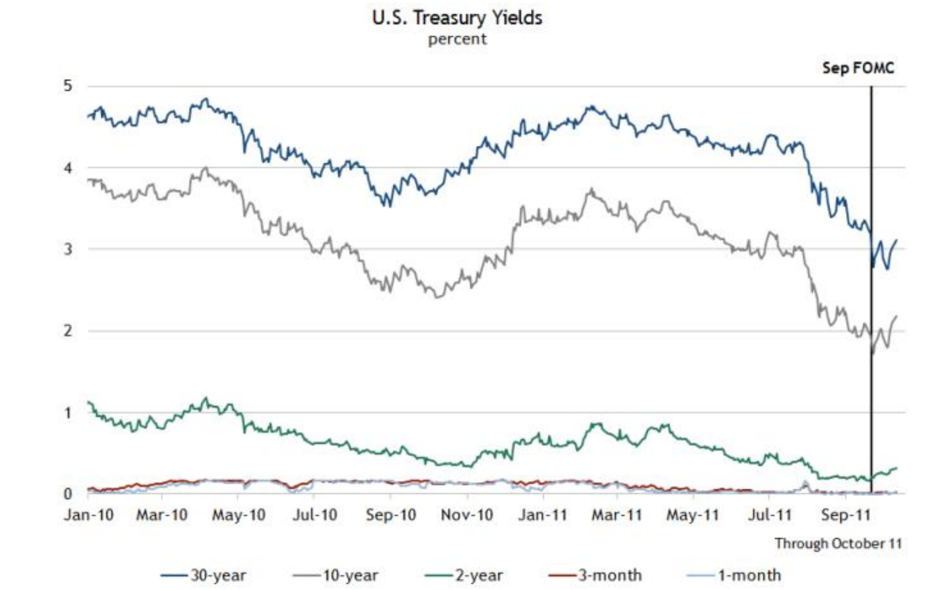


- In the most recent weekly average, the premium has declined to 10.85 percent per year, a decline from the previous weekly average of 15.45 percent but well above the average over four and a half years of 7.77 percent.

Broad Financial Market Indicators

Summary

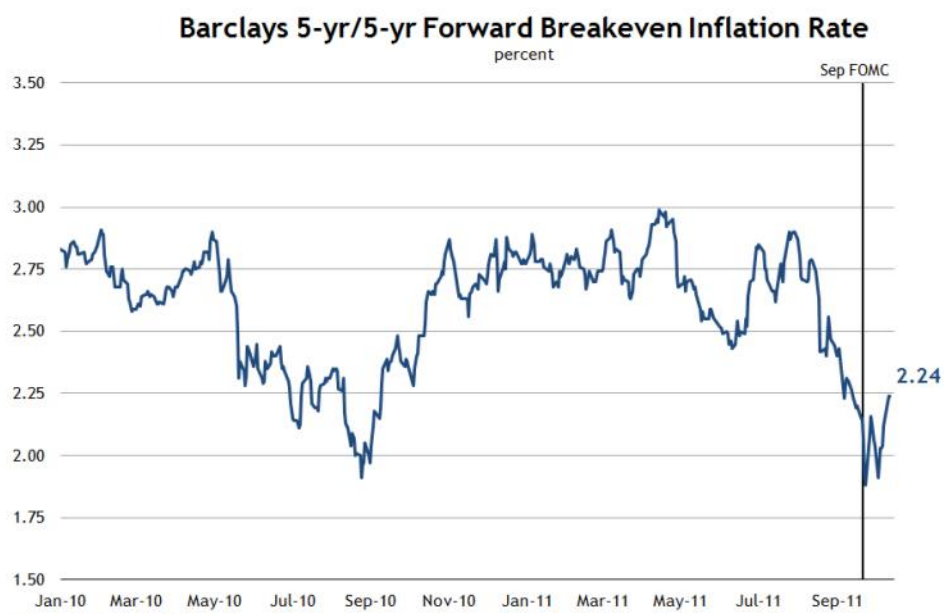
Since the September FOMC meeting, longer-dated Treasury yields have increased.



Source: Federal Reserve Board/Haver Analytics

- Since September 21, the 30-year Treasury bond yield is up 8 bps to 3.11 percent, the 10-year is 30 bps higher to 2.18 percent, and the two-year is up 11 bps to 0.32 percent. The three- and one-month T-bill rates are both little changed at 0.02 percent and 0.01 percent, respectively.

Breakeven inflation rates have been very volatile lately. After declining to a recent low of 1.88 percent on September 23, they have risen to 2.24 percent through October 12.



Source: Barclays Capital

- Looking at one measure calculated by Barclays suggests investors see CPI inflation five to 10 years out as averaging about 2.24 percent as of October 12, 2011, which is about 21 bps higher over the week and 18 bps higher since the September FOMC meeting.