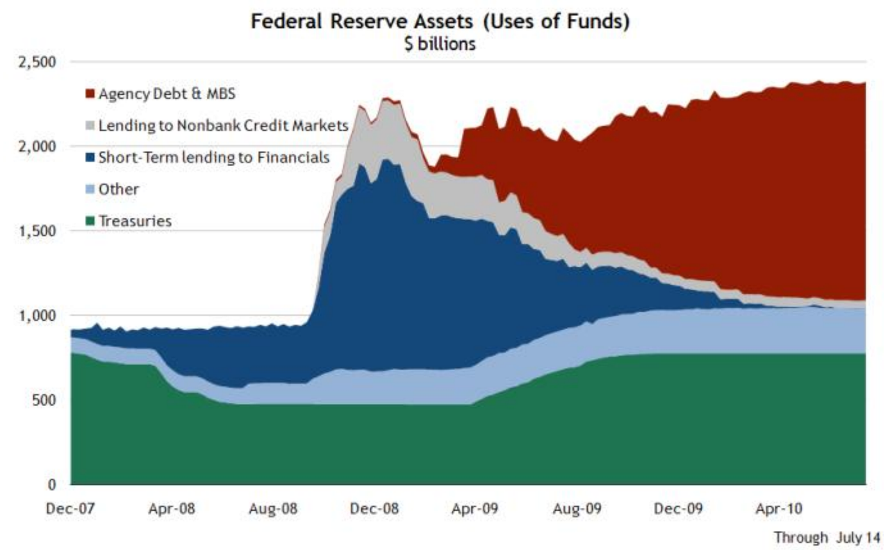
July 21, 2010

Financial Highlights

Federal Reserve

Summary

The balance sheet remained essentially unchanged, increasing by $9.7 billion for the week ending July 14.

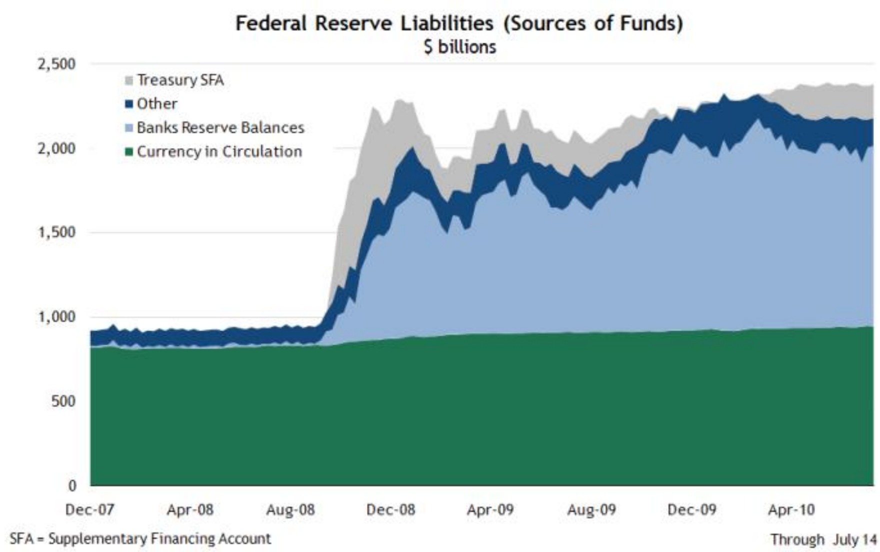


Source: Federal Reserve Board

- MBS on the balance sheet grew $10.3 billion.

Bank reserve balances increased $12 billion while U.S. Treasury deposits with Federal Reserve banks, part of "Other," decreased by $8.6 billion.

Term deposits, a potential reserve-draining tool, remained unchanged.



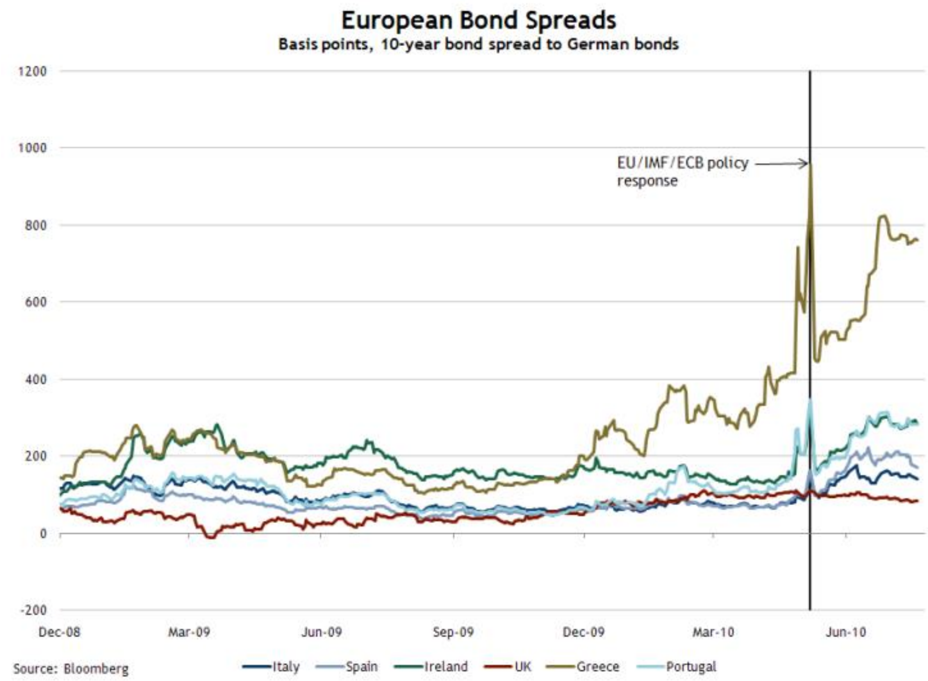
Source: Federal Reserve Board

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.

European Debt

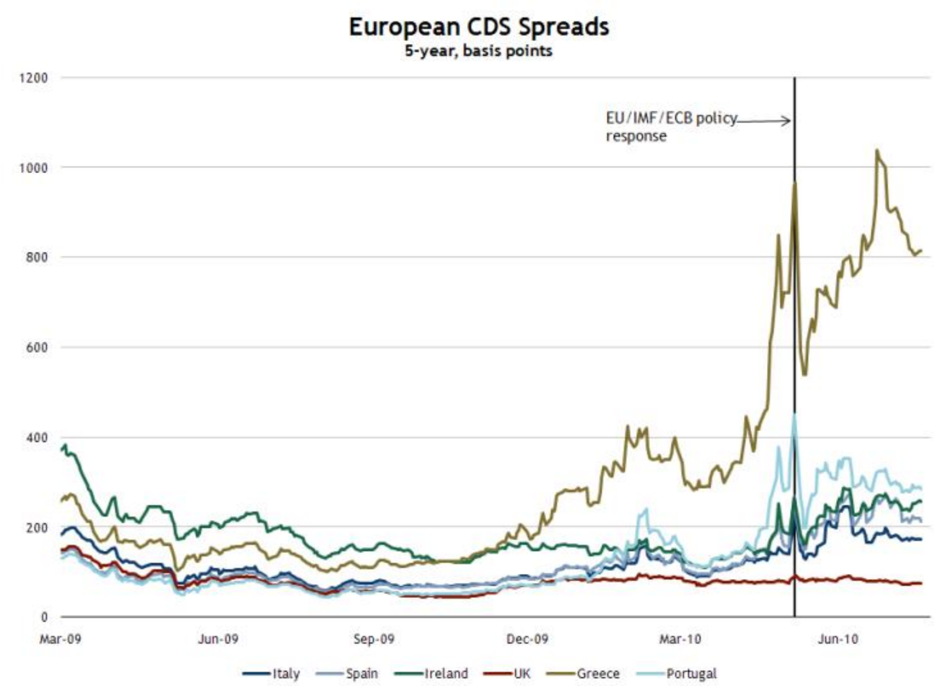
Summary

Peripheral European bond spreads (over German bonds) have declined from recent highs but remain extremely elevated.



- Since the June FOMC meeting, the 10-year Greece-to-German bond spread has narrowed by nearly 40 basis points (bps) (from 8.01% to 7.62%) through July 20. Other European peripherals' spreads have also narrowed, with Portugal lower by 25 bps over the period and Spain 24 bps lower.

Similarly, CDS spreads have declined but remain relatively wide.

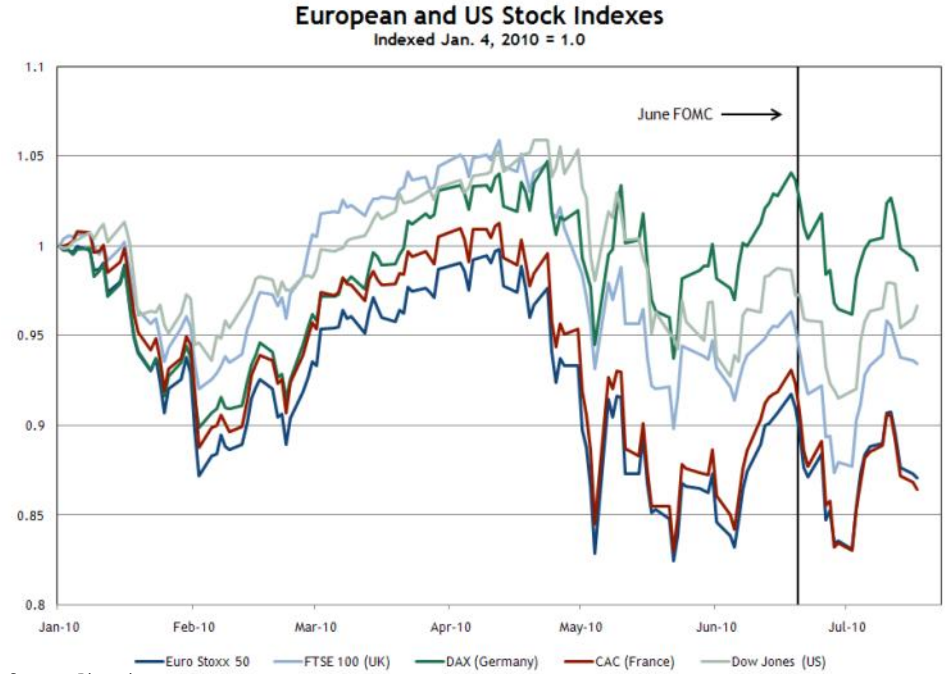


Source: Bloomberg

Bond and Equity Markets

Summary

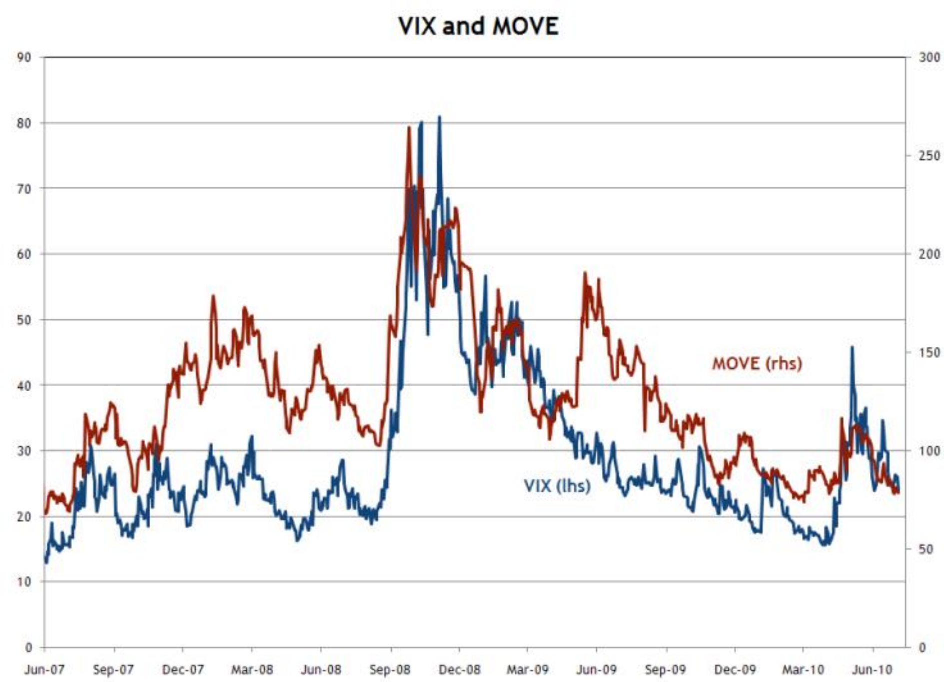
Equity markets in Europe and the United States are lower since the June FOMC meeting, as well as for the year to date (with the exception of the FTSE 100).



Source: Bloomberg

- Since the June 23 FOMC meeting and through July 21, most stock indexes in Europe and the United States are lower, with the CAC down 4.1%, the DAX lower by 3.5%, the Euro Stoxx 50 by 2.4%, and the Dow Jones by 2%. The FTSE 100 is up 0.7%.
- Year to date, all indexes are down, with the DAX the best performing (-1.0%); the Dow Jones and FTSE 100 are down about 5%, and the CAC and Euro Stoxx 50 are down around 13%.

Volatility in the equity and bond markets has declined during the same period.



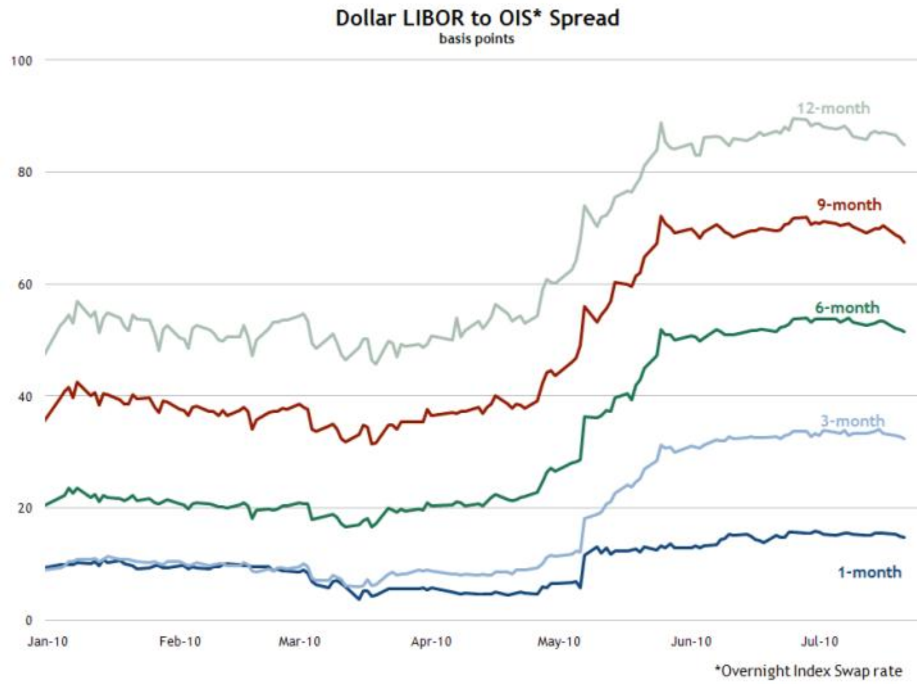
Source: Merrill Lynch, Chicago Board Options Exchange

- According to the VIX “fear index” from the Chicago Board Options Exchange, equity market volatility has decreased 11% since the June 23 FOMC meeting. During the same period, the Merrill Lynch MOVE index showed bond market volatility also declined, down 7.6%.

Broad Financial Market Indicators

Summary

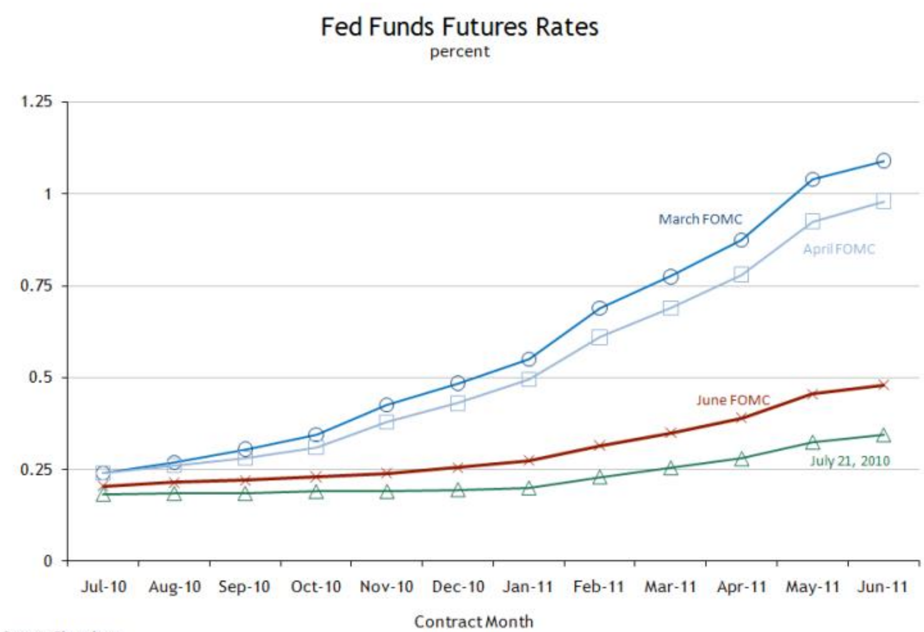
LIBOR to OIS spreads have narrowed slightly, especially on the long end, since the last FOMC meeting, though they remain elevated relative to levels seen earlier this year.



Source: Bloomberg/British Bankers' Association

- Since the last FOMC meeting on June 23, dollar LIBOR to OIS spreads narrowed slightly across all tenors, but more so farther out on the curve. The one-, three-, and six-month spreads declined less than 1 bp while the nine- and 12-month spreads were lower by more than 3 bps.

The curve of expected rates from the fed funds futures market has flattened further since the June FOMC meeting, pushing back the expectation of the first Fed rate increase to the second half of 2011.



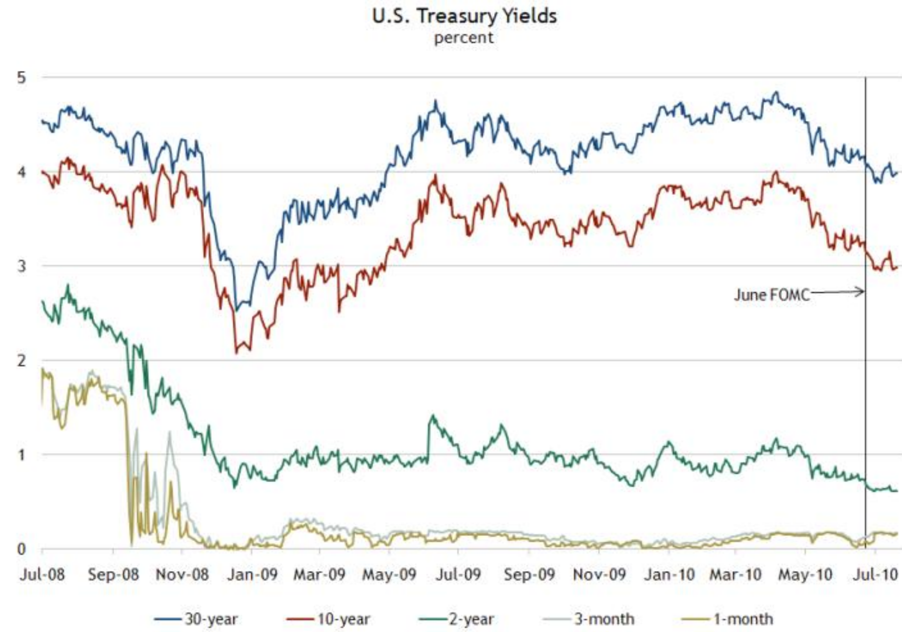
Source: Bloomberg

- Since the June FOMC meeting, the fed funds futures markets has pushed backed its expectation of a rate increase to late 2011.
- As of July 21, the futures market for fed funds indicates an implied rate of about 34 bps for the June 2011 contract.

Broad Financial Market Indicators

Summary

Longer-dated Treasury yields have declined since the June FOMC meeting.



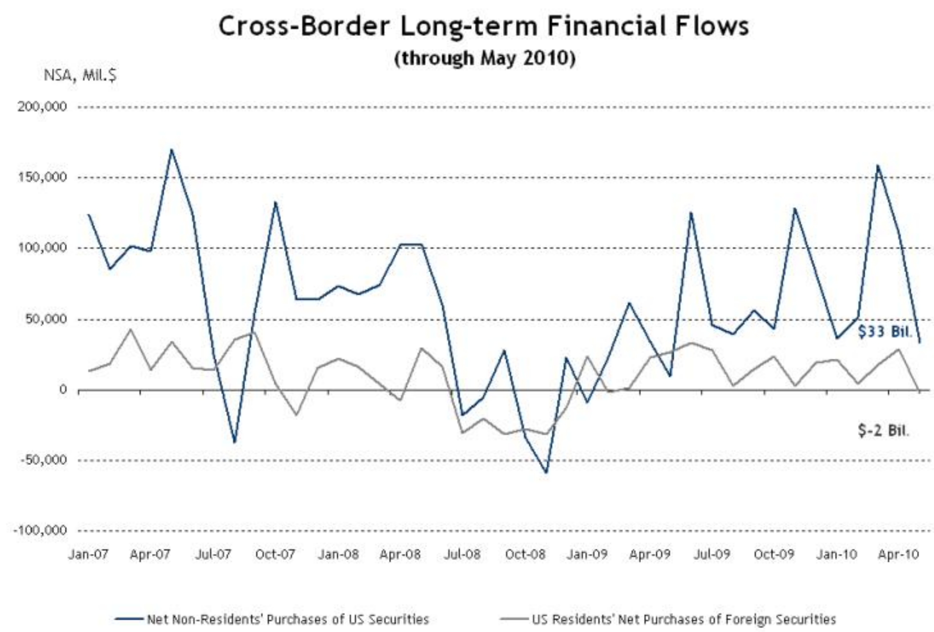
Source: Federal Reserve Board

- Since the June FOMC meeting, longer-dated Treasury yields have moved lower across the two-to-30-year curve: Through July 20, the 30-year bond is down 6 bps to 3.99%, the 10-year bond is 15 bps lower at 2.98%, and the two-year note declined 5 bps to 0.61%.
- T-bill rates, however, have risen over this period. The three– and one-month bills are higher by 3 bps and 9 bps, respectively, with both yielding 0.16% through July 20.

Broad Financial Market Indicators

Summary

Nonresidents' net purchases of long-term U.S. securities declined to $33 billion in May. On net, U.S. residents repatriated $2 billion, reflecting $10 billion in net sales of foreign bonds.



Source: U.S. Treasury/Haver Analytics

- On net, nonresidents bought $33 billion in long-term U.S. securities in May. Most foreign private capital in May was directed into U.S. government agency bonds. Nonresident private investors on net bought $24 billion in agency bonds, the highest amount since February 2008.
- On net, U.S. residents sold about $2 billion in foreign securities in May, consistent with increased risk aversion in financial markets as a result of the intensification of the European sovereign debt stress. This sell-off is the first one of long-term foreign financial assets by U.S. residents since February 2009. Sales of foreign assets imply a higher supply of capital for the U.S. economy.
- After two months of net buying, China reduced its holdings of U.S. Treasury securities in May to $868 billion. China accounts for a third of all U.S. Treasury securities holdings by foreign official institutions and about a fifth of total foreign holdings. At the end of the first quarter of 2010, nonresidents held 50% of marketable U.S. government debt.