# Research
## Government Forecast

SIFMA
Securities Industry and Financial Markets Association

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**Contributors**

**Robert Toomey**
Staff Advisor
Government Securities Research, Analysis and Strategy Committee

**Charles M. Bartlett, Jr.**
Vice President and Director, Statistics

The Securities Industry and Financial Markets Association is pleased to report the results of its Quarterly Government Securities Issuance and Rates Forecast.[1] The forecast reflects the responses to a survey of members of the Association's Government Securities Research, Analysis and Strategy Committee.[2] The Committee is composed of trading strategists and research analysts at Association member firms who specialize in the U.S. government and agency securities markets. The survey is intended to provide market participants with the current consensus expectations and median forecasts of many of the Primary Dealers and other firms active in the U.S. government and agency securities markets.[3]

## Third Quarter Total Net Issuance Expected to Continue to Rise on Budget Deficit Projection

The median survey response forecasts total net Treasury bill, note and bond issuance to be $446.0 billion in the third quarter of 2009, compared with the net $343.0 billion issued in the second quarter and the net $527.0 billion issued in the third quarter a year ago.[4] The quarterly increase is consistent with significant third quarter borrowing needs, while last year's large issuance occured as the deficit increased with the intensification of the credit crisis.

### Coupon Issuance Rises Again

The median forecast for net new issuance of Treasury coupon securities was $384.0 billion for the third quarter, 3.8 percent above second quarter issuance and more than double the net issuance in the third quarter a year ago.[5] Based on the median forecast, the committee believes the Treasury Department will finish the quarter with a cash position of $260.0 billion, 18.2 percent below the balance of $318 billion at the end of the second quarter, and 30.0 percent lower than the $372 billion balance a year ago.[6]

The median forecast for gross nominal coupon issuance was $521.5 billion for the third quarter, lower than the $518.0 billion issued in the previous quarter and more than two and a quarter times what was issued in the third quarter a year ago. According to the survey, Treasury will issue $14.0 billion of Treasury Inflation-Protected Securities (TIPS) in the third quarter of 2009, lower than the $17.0 billion issued in the previous quarter.

The median forecast for gross combined coupon and TIPS issuance in the third quarter was $535.5 billion, slightly greater than the $535.0 billion in the second quarter and more than double the $244.0 billion in the third quarter of 2008. Of the $535.5 billion gross issuance projected for Q3'09 approximately 22 percent will be 2-year nominal notes, 20 percent will be 3-year nominal notes, 21 percent will be 5-year nominal notes, 16 percent will be 7-year nominal notes, 11 percent will be 10-year nominal notes, 7 percent will be 30-year bonds and 3 percent will be TIPS.

1 *The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.*

2 *The survey was conducted the week beginning July 9, 2009. The Committee received responses from six firms represented on the committee.*

3 *Previous survey reports may be found at www.sifma.org/research/govt-rates.shtml.*

4 *The dates and numbering of quarters are based on calendar year rather than fiscal year unless otherwise noted.*

5 *Net coupon projections for the third quarter of 2009 ranged from net issuance of $370 billion to net issuance of $425 billion.*

6 *Net cash position projections for the end of the third quarter 2009 ranged from $240 billion to $300 billion.*

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### Bill Issuance Down

The survey projected net bill issuance of $62.5 billion for the third calendar quarter of this year, compared to a net paydown of $27 billion in the second quarter and net issuance of $429.0 billion in the third quarter of last year.[7] Gross bill issuance is expected to total $1,319.5 billion for the third quarter, higher than the $1,280 billion in the second quarter but lower than the $1,537 billion in the same year-earlier period.

### Budget Deficit Projection: Three Fold Increase

The survey results projected a federal budget deficit of $1.525 trillion for FY 2009, more then three times the record-setting FY 2008 deficit of $455 billion. Over this survey's history, the median projected deficit forecasts have tended to be relatively conservative, i.e. higher than actual.

### U.S. Treasury Yield Outlook

The Committee's median forecast projects the benchmark Treasury yield movement to be mixed by the end of the third quarter compared to those prevalent at the time the survey was taken.[8]

### Interest Rate and Yield Curve Forecast

The median forecast was for a 10-year Treasury yield of 3.70 percent at the end of the third quarter and 3.90 percent at the end of the fourth quarter of 2009. Third quarter 10 year yield projections ranged from 3.30 percent to 3.85 percent. The median forecast projects the 30-year bond yield to be 4.50 percent at the end of the third quarter and 4.63 percent at the end of the fourth quarter. End third quarter 30 year projections ranged from 4.10 percent to 4.60 percent. The 2-year Treasury was forecast to yield 1.05 percent at the end of the third quarter and 1.23 percent at the end of December. End third quarter 2 year yield projections ranged from 1.00 percent to 1.40 percent.

The survey also projects a slight steepening of the yield curve over the next few quarters as measured by the 2-year to 10-year Treasury yield spread. Over the past few months, there has been a slight flattening of the yield curve, with the 2-year to 10-year Treasury yield spread decreasing to 242 basis points in early July from 254 basis points at the end of the fourth quarter. Based on the median projection, the 2-year to 10-year Treasury yield spread will be 265 basis points at the end of the third quarter and 267 basis points at the end of the fourth quarter of 2009.

### Economic Rebound and Fed's Treasury Program Remain Rate Upside Risks; Further Real Estate Declines and Economic Relapse are Downside Risks

The survey asked participants about risks to their forecasts or events that could cause interest rates to move higher or lower than forecasted. The three dominant risks identified on the upside are the stalling of Fed purchases; a faster-than-expected economic recovery and declining demand for Treasuries. Another upside risk is additional fiscal stimulus, which would also increase the budget deficit. The two most dominant risks identified on the downside are continued real estate price declines, which would impair asset values and the economy slipping back into further declines as fiscal stimulus fails to catalyze private sector investment and consumption.

### Federal Agency Issuance Looking Up

The survey forecasted total gross note issuance of $333 billion in the third quarter by the four largest Federal agencies, compared to $120 billion in the second quarter.[9] Nearly 40 percent of the issuance volume is expected to come from the Federal Home Loan Banks (FHLBs), reflecting their continued importance as a source of bank liquidity during current credit market conditions.

### Agency-to-Treasury Spreads; LIBOR

The respondents expect agency yield spreads to Treasuries to remain the same during the period.

At the end of the first quarter 2009, 3-month LIBOR stood at 0.60 percent and is expected to decrease over the next three months and than remain relatively unchanged for the remainder of the year. The median projection for 3-month LIBOR by end-September and end-December is 0.50 percent and 0.53 percent, respectively.

### Survey Respondents Mixed Recommendations on Weightings

The survey asked for model portfolio allocation recommendations, compared to the current portfolio weighting, across the maturity spectrum of the U.S. Treasury yield curve. The Committee consensus showed a slight preference for underweighting intermediate durations, neutral-to-overweighting for short-term and under-to-a-strong underweighting of the long term durations.

Approximately 66 percent of the survey respondents favored a neutral-to overweight position in the 0- to 3-year sec-

[7] *Net bill issuance projections for the third quarter ranged from redemption of $5 billion to an issuance of $120 billion. A negative net issuance number may be interpreted as a net paydown of outstanding Treasury debt.*

[8] *The 2-year note yield was 0.99 percent and 10-year yield was 3.61 percent and 30 year yield 4.31 percent at the end of the survey period, July 21.*

[9] *Includes Fannie Mae, Freddie Mac, the Federal Home Loan Banks and the Federal Farm Credit Banks Funding Corporation.*

tor, while 33 percent recommend being underweighted. For the intermediate duration, the 3- to 7-year sector, 83 percent recommended neutral to underweighting, while 17 percent had an overweighting recommendation. In the 7- to 10-year sector, 66 percent recommend a under to strong underweighting, with 17 percent recommending neutral, and 17 percent recommending overweight. In the 10- to 30 year sector 17 percent recommend overweight with 50 percent in the underweight and 33 percent in the strong under weighted opinion.

## SIFMA's Government Securities Research Committee Forecast

*Forecast numbers appear in bold*

| Issuance Projections | $ Billions | |
|---|---|---|
| | 2009:Q2 | **2009:Q3** |
| **U.S. Treasury Borrowing[1]** | | |
| Net Coupon Issuance | 370 | **384** |
| Net Bill Issuance | (27) | **63** |
| Quarter end cash balance | 318 | **260** |
| **U.S. Treasury Quarterly Gross New Issuance** | | |
| 4 week Bill | 430 | **407** |
| 13 week Bill | 392 | **416** |
| 26 week Bill | 376 | **396** |
| 52 week Bill | 77 | **102** |
| 2 year Treasury Note | 124 | **120** |
| 3 year Treasury Note | 112 | **106** |
| 5 year Treasury Note | 111 | **114** |
| 7 year Treasury Note | 82 | **86** |
| 10 year Treasury Note | 63 | **60** |
| 30 year Treasury Bond | 26 | **36** |
| Treasury Inflation-Protected Securities | 17 | **14** |
| **Federal Agency: Projected Total Gross Coupon Debt Issuance[2]** | | |
| Fannie Mae | 0 | **85** |
| Freddie Mac | 0 | **90** |
| Federal Home Loan Bank System - Office of Finance | 97 | **128** |
| Federal Farm Credit Banks Funding Corporation | 23 | **30** |
| Federal Budget Deficit Estimate - FY | 455 (FY08) | **1,525 (FY09)** |

| Rates & Spreads Outlook | Jun. 2009 | % Yields<br>Sept. 2009 | Dec. 2009 |
|---|---|---|---|
| **Interest Rates (End of Quarter in % Yield)** | | | |
| 2 Year Treasury Note | 1.11 | **1.05** | **1.23** |
| 5 Year Treasury Note | 2.54 | **2.50** | **2.70** |
| 10 Year Treasury Note | 3.53 | **3.70** | **3.90** |
| 30 Year Treasury Bond | 4.32 | **4.50** | **4.63** |
| 3 Month LIBOR | 0.60 | **0.50** | **0.52** |
| 2 Year Agency Benchmark/Reference Notes[3] | 19 | **10** | **14** |
| 5 Year Agency Benchmark/Reference Notes[3] | 44 | **30** | **30** |
| 10 Year Agency Benchmark/Reference Notes[3] | 47 | **35** | **35** |
| 2 Year SWAP Spreads | 43 | **38** | **34** |
| 5 Year SWAP Spreads | 42 | **41** | **39** |
| 10 Year SWAP Spreads | 22 | **20** | **19** |

[1] *Excluding Federal Reserve's purchases*
[2] *Including all callable coupon issuance and excluding all discount notes*
[3] *Indicate Agency spreads to Treasury yield in basis points*