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Securities Industry and
Financial Markets Association

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ECONOMIC OUTLOOK

The Economic Outlook: What Next?

Members of the Securities Industry and Financial Markets Association's Economic Advisory Roundtable believe U.S. economic growth will turn positive in the third quarter, although remain at a subpar pace until next spring.[1] Stresses resulting from the current U.S. recession dominate all responses in the economic survey. The perfect storm of financial market meltdown, credit market freeze and economic contraction seems to be passing, but the U.S. economy remains afloat, albeit battered. The continuing housing sector weakness, tight credit markets, and widespread economic contraction have been countered with aggressive and unconventional central bank actions and fiscal stimulus; these provide the backdrop for the cautious optimism reflected in this economic outlook.

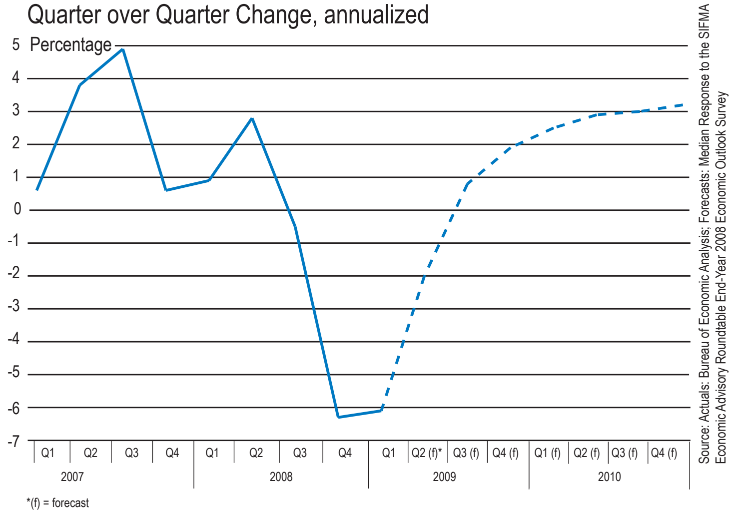
Forecast Highlights

MONETARY POLICY The Roundtable was unanimous in its opinion that the Federal Open Market Committee (FOMC) would not change its current 0.0 to 0.25 percent target federal funds rate at the upcoming June 23-24 meeting. Regarding FOMC's assessment of risks to growth and inflation, panelists did not expect significant changes; approximately half expected no change at all. Of the remainder who foresee change, panelists expect a slightly greater emphasis on hopeful economic signs or at least a reduction in the concern about downside risks. Looking into the future, nearly half of respondents expect the FOMC to begin raising rates by mid-2010, while more than three-quarters expect a rate hike by the end of 2010.[2]

THE ECONOMY The median forecast calls for gross domestic product (GDP) to fall 2.7 percent in 2009 on a year-over-year basis (-1.4% on a fourth quarter-to-fourth quarter basis). By individual quarter, respondents expect GDP to fall 2.0 percent in the second quarter on an annualized basis before recovering and growing at 0.8 and 1.9 percent annualized, respectively, in the third and fourth quarters.[3] The economy is forecast to grow 2.1% on a year-over-year basis in 2010 GDP (2.9% on a fourth-quarter-to-fourth quarter basis), but this growth is not rapid enough to prevent unemployment from rising still higher.[4]

Real GDP Growth Rate

Quarter over Quarter Change, annualized



The depth of the current recession is illustrated by job loss projections. So far in 2009, nonfarm payroll employment has fallen by 2.9 million jobs; survey respondents predicted job losses will rise to 4.7 million by year-end, even though GDP growth is expected to turn positive by mid-year.[5] Job

1 The survey was conducted from May 27 - June 12, 2009. The forecasts discussed in the text and appearing in the accompanying data table are the median values of the individual member firms' submissions, unless otherwise specified.

2 The forecast for when the FOMC would raise rates ranged from fourth quarter 2009 to first quarter 2012.

3 The full-year 2009 GDP growth forecasts ranged from negative 3.1 percent to negative 1.8 percent, in second quarter from negative 3.8 percent to 0.5 percent, third quarter from negative 0.4 percent to 3.5 percent, and fourth quarter from 1.0 percent to 3.5 percent. Nearly all respondents expect the contraction to end in the third quarter 2009.

4 The full-year 2010 GDP growth forecasts ranged from 1.2 percent to 3.7 percent, with annualized quarterly growth rising from 2.5 percent in first quarter 2010 to 3.2 percent in fourth quarter 2010.

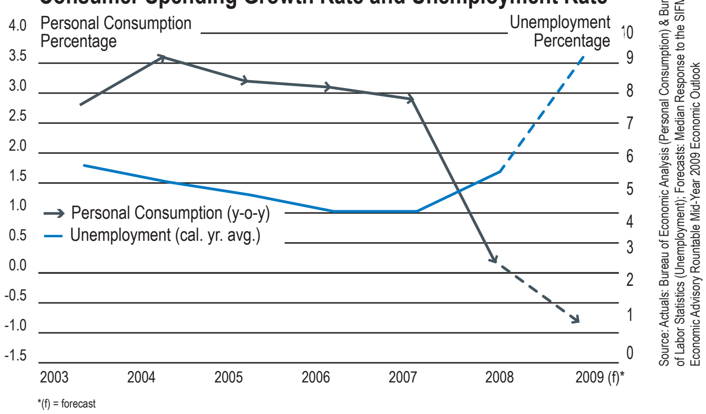
5 The full-year 2009 payroll employment forecasts ranged from a loss of 3.5 million jobs to a loss of 6 million jobs.

recovery estimates for 2010 ranged widely, with the median expectation for a restrained growth of 600,000 jobs.[6] Survey respondents expect the full-year average unemployment rate to reach 9.3 percent in 2009 and 9.8 percent in 2010.[7]

Unsurprisingly, the median consumer spending forecast calls for a drop of 0.8 percent for full-year 2009, with a mild recovery of 1.6 percent in full-year 2010.[8]

Business capital investment growth is expected to fall by 19.1 percent in full-year 2009, with a milder decline of 2.9 percent in full-year 2010.[9] State and local government spending is expected to remain largely steady with a slight drop of 0.2 percent forecast for 2009 and increase of 1.7 percent expected in 2010.[10]

Consumer Spending Growth Rate and Unemployment Rate

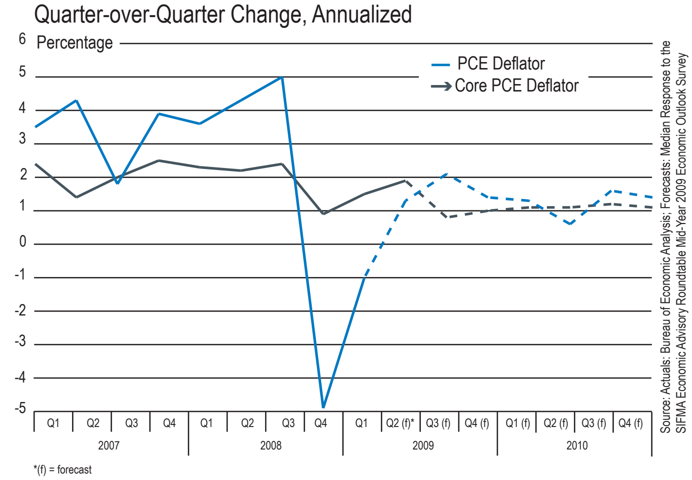


The inflation outlook has taken on a new dimension recently as "green shoots" reports of economic activity revival have emerged against the backdrop of record-setting fiscal deficits and the Fed's balance sheet expansion. Disinflation and even deflation were, until recently, leading concerns by media and popular commenters; inflation - or inflationary expectations - have instead become of concern. While a small majority of respondents reported that the expanded Fed balance sheet posed a potential future risk, none considered it a near term risk.

The median forecast for "headline" inflation, measured by the personal consumption expenditures (PCE) chain price index, was 0.3 percent for full-year 2009, rising to 1.4 percent in full-year 2010.[11] The median forecast for the core PCE chain price index was 1.5 percent for full-year 2009 and 1.0 percent for full-year 2010.[12] Nearly all of the panelists identified the level of economic slack as important or very important to their inflation outlooks; less than half cited the Fed's recent explicit long-term forecast as important or very important.[13]

INTEREST RATES As noted, the Roundtable expects that the Federal Reserve will maintain its 0.0 to 0.25 percent target federal funds rate at the upcoming meeting and for some time to come. While short-term and long-term rates have come down significantly, long-term rates have been rising of late. As of June 17, the end of the survey period, the 10-year U.S. Treasury yield was 3.62 percent, up 45 basis points (bps) from a month earlier and up 154 bps from the November 19 low yield of 2.08 percent. The median forecast for the June 2009 average 10-year Treasury note yield was 3.7 percent, rising to 3.9 percent in December and to 4.0 percent at mid-year 2010.[14] The easing of the "flight to quality" phenomenon that drove rates down sharply at the end of 2008 and growing

PCE Deflator & Core PCE Deflator
Quarter-over-Quarter Change, Annualized



6 The full-year 2010 payroll employment forecasts ranged from a loss of 1.2 million jobs to a gain of 2 million jobs.

7 The full-year 2009 average unemployment rate forecasts ranged from 9.0 percent to 9.6 percent and for 2010 ranged from 9.5 percent to 10.6 percent.

8 The full-year 2009 consumer spending growth forecasts ranged from negative 1.4 percent to positive 0.1 percent and in 2010 ranged from growth of 0.9 percent to 3.6 percent.

9 The full-year 2009 business fixed investment forecasts ranged from negative 21.0 percent to negative 17.0 percent and for 2010 ranged from negative 8.5 percent to positive 2.5 percent.

10 The full-year 2009 real state and local government spending forecasts ranged from negative 1.6 percent to positive 1.4 percent and for 2010 from negative 2.0 percent to 7.7%.

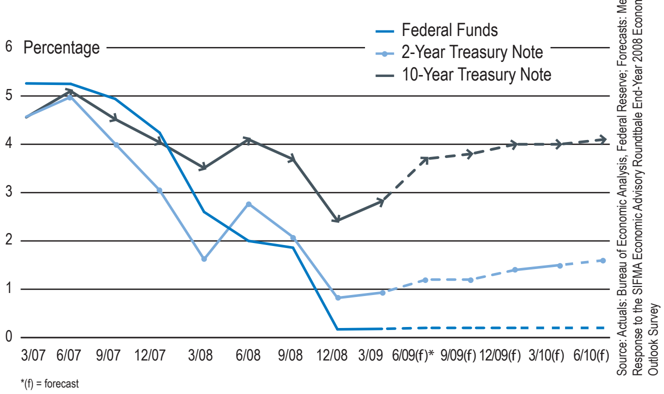
11 The full-year 2009 PCE deflator forecasts ranged from negative 0.7 percent to 1.5 percent and for 2010, from positive 0.3 percent to positive 2.3 percent.

12 The full-year 2009 core PCE deflator forecasts ranged from 0.9 percent to 1.7 percent and for 2010, from 0.2 percent to 2.0 percent.

13 See longer run projections in the Summary of Economic Projections beginning with the Minutes of the January 27-28, 2009 FOMC meeting at www.federalreserve.gov/monetarypolicy/fomcminutes20090128ep.htm

14 The average 10-year Treasury yield forecasts ranged from 3.2 percent to 3.9 percent for June 2009; from 2.9 percent to 4.0 percent for December 2009; and from 3.0 percent to 5.0 percent for June 2010.

Federal Funds Target Rate and Treasury Note Yields



optimism about the economic outlook were cited as two of the most important drivers of the recent rise in long-term Treasury yields, while inflation, inflationary expectations, and budget deficit trends were also identified as important influences. Over the intermediate term, global capital flows were also expected to have a significant impact.

Nearly half of the survey respondents expect the Treasury yield curve to steepen between now and the end of the year, with approximately 30 percent expecting it to remain about the same and the remainder forecasting flattening. The TED spread (Treasury bill less Libor rate) is expected to narrow in the next six months according to 75 percent of respondents, with the remainder expecting it to remain unchanged.

Over 85 percent of respondents expect investment-grade credit spreads to narrow over the remainder of the year, while the balance of respondents expect spreads to stay roughly the same; 94 percent of respondents predict high-yield spreads to narrow further over the course of 2009. A similar consensus was reached regarding the future of credit spreads: most predicted that credit spreads will settle at wider levels compared with pre-crisis levels, which they label "the new normal." Respondents commented that the lows reached in credit spreads during 2006-2007 were a result of complacency about risk, excessive leverage, and weak market discipline. Respondents anticipate that investors will demand greater compensation for risk, boosting the cost of capital for intermediaries without counterbalancing policy rates by the Fed.

Monetary Policy Easing; Unconventional Policies; What Next?

The survey also asked questions about unconventional policy initiatives such as the Fed's securities purchase programs for Treasury, agency and agency mortgage-backed securities. Approximately half of respondents expect the Fed will not expand, increase or prolong the purchase programs; the other half believes otherwise, especially if rates "misbehave." Regardless of the Fed's decision, all, however, believe that the Fed will maintain its expanded balance sheet for some time; several believe this may last well into 2010 to assure a well-grounded recovery. Over 90 percent of respondents commented that Fed purchases of agency mortgage-backed securities were the most effective in easing credit constraints, followed by agency debt (60 percent of respondents) and finally, Treasuries.

Asked whether they agreed with Federal Reserve Board Chairman Bernanke's statement distinguishing between quantitative easing and credit easing, and emphasizing that the Fed is engaged in credit easing, 72 percent agreed, but prefaced this agreement with several qualifications. One answered, "Easing is easing, and it still has to be undone as the markets return to normal." Another stated, "Both credit easing and quantitative easing have the potential to be inflationary if the monetary authorities are asleep at the switch."

When asked whether the expansion of the Fed's balance sheet poses an inflationary risk, most commentators once again agreed with qualifications: most believed inflation to be a potential risk, but also acknowledged major counterbalancing trends such as significant economic slack and financial deleveraging. In addition, many also had confidence that the Fed would be able to remove accommodation in a timely fashion; one commentator noted with some surprise that relatively few seemed worried about a relapse caused by a premature removal of accommodation. The majority believed that the concerns about near-term inflation risks were misplaced.

Housing and Employment Dominant Risks to U.S. Economic Growth

The housing market and employment/income growth were seen by over 85 percent of respondents as having a negative or very negative influence on the economy. The drag posed by the housing market is expected to lessen over time by several respondents. Credit market conditions were also seen as a drag on economic growth with 73 percent perceiving this to be a negative or very negative influence. Fiscal policy was the only factor cited as a plus, with 80 percent expecting it to be a positive or very positive influence on economic growth. One respondent commented, "[W]ithout fiscal stimulus, there would be no recovery. The biggest risk in 2010 is the consumer's ability to start taking the weight of the economy off the government."

Fiscal Policy: A Bright Spot Among Dark Clouds

The panelists generally saw the $789 billion stimulus package as the one positive influence on the economy, although they also believe its impact will be short-lived. Of the many provisions in the package, respondents most often cited targeted tax cuts and extended unemployment benefits and similar assistance as having the greatest impact in 2009; public works and infrastructure projects were seen as having the greatest impact in 2010. Direct aid to state and local governments were also seen as having a limited impact in 2009, but having a slightly greater impact in 2010, as some of the other positive influences fade.

Although Sunsetting Tax Cuts Will Not Help

On the other side of the fiscal policy coin is the sunset of the 2001 and 2003 personal tax cuts, which the administration has proposed should sunset as currently scheduled for singles earning more than $200,000 and couples earning more than $250,000; this proposal was characterized by nearly 80 percent of respondents as negative or very negative for the long-term growth potential of the U.S. economy. "Higher tax burdens in the long-run stifle economic activity and growth," wrote one respondent; another countered that "[p]otential growth is determined mainly by productivity trends and growth in the labor force, neither of which...is importantly affected by these changes."

Increase in Savings: Cyclical or Structural

The survey asked whether the increase in the personal saving rate - a reported 5.7 percent in May 2009 from 0.2 percent in 1Q'08 - and the contraction of consumer debt in the same period signifies a long-term behavioral change or a temporary effect of credit market disruptions and the adverse economic environment. Nearly 90 percent of respondents answered that they believed this to be a secular adjustment. Most commented that considering the severity of current conditions, damage to retirement funds, and the fact that homes will no longer be the savings vehicle consumers rely on, both cyclical and secular forces are at work. While some of the saving increase will reverse as the severity of the crisis lessens, there was general agreement that much of the increase will stick for some time to come.

When Will We Reach Bottom?

When asked to predict when a variety of indicators would hit bottom, respondents were in general agreement in some areas and at odds in others. Starting with home prices, while more than 60 respondents believed a bottom would be reached by mid-2010 and nearly 90 percent by the end of 2010, predictions ranged from 4Q'09 to 1Q'12. The bottom of housing sales, however, found much more consensus with over 80 percent averring that it had already been reached by mid-2009 and the remainder forecasting the low by year-end. As for housing starts, there was general agreement (81 percent) that bottom would be reached by the end of the third quarter, though a few saw no bottom until the first quarter 2011.

The employment outlook was generally seen as very bleak. A majority (59 percent) believe the unemployment rate will reach the high by first quarter 2010, while the remainder expects to cross that point later in 2010. As for the equity markets, there was complete agreement that the low was already hit in the first quarter of this year, although some noted that they expect to see some future sell-offs.

Oil Prices: Little Near-Term Chance of Dramatic Change

Panelists placed a 71 percent probability on oil prices remaining in the current range between $50 - $100 per barrel, a 15 percent chance of oil prices falling below $50 and a 14 percent chance of it rising above $100 through year-end 2009. The $100+/barrel scenario would have the estimated effect of reducing GDP growth by approximately 100 bps, while the sub-$50/barrel scenario envisions an increase of 60 bps.[15] On a probability-weighted basis, respondents estimated that oil prices would have no positive impact on GDP growth through year-end.

EESA Impact: Generally Effective

The panelists had mixed views on the impact that the myriad government programs, designed to counter the financial crisis, would have on the economy, credit markets and bank balance sheets. Current actions, such as the use of Fed balance sheet, Term Asset-Backed Securities Loan Facility (TALF) and FDIC guarantee on bank debt through its Temporary Liquidity Guarantee Program (TLGP) were ranked as most beneficial to credit availability. Unsurprisingly, equity injections and FDIC's TLGP were seen as impacting bank balance sheets positively. As for proposed programs, the expansion of TALF to additional collateral types was seen as most promising for credit availability and bank balance sheets.

Asset Purchases: Still Waiting

While the Treasury, FDIC and the Federal Reserve announced programs to deal with the removal of legacy loans and securities from bank balance sheets, the Public-Private Investment Program (PPIP) has yet to be launched. When asked about the expected impact of these programs, respondents ranked the legacy securities PPIP higher than the legacy loan PPIP in terms of credit availability and bank balance sheets, although neither were perceived as important as an expansion of TALF.

15 The estimated positive impact of lower oil prices (below $50 per barrel) on GDP growth ranged from 20 to 100 basis points, while the negative impact of higher oil prices (above $100 per barrel) ranged from 20 to 150 basis points less growth.

SIFMA Economic Advisory Roundtable Forecast

Inflation adjusted year-over-year percentage change unless otherwise specified. Forecast numbers appear in **bold**.

	2009	2010
Real GDP	**(2.7)**	**2.1**
Real GDP (4Q - 4Q)	**(1.4)**	**2.9**
CPI	**(0.6)**	**1.5**
CPI (4Q - 4Q)	**1.8**	**1.4**
Core CPI	**1.6**	**1.2**
Core CPI (4Q - 4Q)	**1.6**	**1.3**
PCE deflator	**0.3**	**1.4**
PCE deflator (4Q - 4Q)	**1.0**	**1.2**
Core PCE deflator	**1.5**	**1.0**
Core PCE deflator (4Q - 4Q)	**1.3**	**1.1**
Personal Consumption	**(0.8)**	**1.6**
Nonresidential Fixed Investment	**(19.1)**	**(2.9)**
Housing Starts (millions)	**0.5**	**0.7**
State & Local Government Spending	**(0.2)**	**1.7**
Current Account Deficit ($ billions)	**414.0**	**480.0**
New Home Sales (millions units)	**0.4**	**0.5**
Nonfarm Payroll Employment (change in millions)	**(4.6)**	**0.6**
Unemployment Rate (cal. yr. avg.)	**9.3**	**9.8**
S&P 500 Index Price (year-end)	**1,000.0**	**1,132.5**
Federal Budget (FY, $ billions)	**(1,812.5)**	**(1,325.0)**

Quarter-to-Quarter % Changes in Annual Rates

	2009			2010			
	II	III	IV	I	II	III	IV
Real GDP	**(2.0)**	**0.8**	**1.9**	**2.5**	**2.9**	**3.0**	**3.2**
CPI	**1.3**	**2.3**	**1.7**	**1.7**	**0.9**	**1.7**	**1.6**
Core CPI	**2.1**	**1.0**	**1.3**	**1.4**	**1.4**	**1.3**	**1.2**
PCE deflator	**1.3**	**2.1**	**1.4**	**1.3**	**0.6**	**1.6**	**1.4**
Core PCE deflator	**1.9**	**0.8**	**1.0**	**1.1**	**1.1**	**1.2**	**1.1**
Personal Consumption	**(0.8)**	**0.8**	**1.4**	**1.8**	**2.1**	**2.0**	**2.2**
Nonresidential Fixed Investment	**(14.9)**	**(10.5)**	**(6.0)**	**(1.0)**	**2.3**	**4.9**	**4.8**

Interest Rates (monthly average %)

	Jun. 09	Sept. 09	Dec. 09	Mar. 10	Jun. 10
Fed Funds	**0.1**	**0.1**	**0.1**	**0.1**	**0.2**
2 Year Treasury Note	**1.2**	**1.2**	**1.3**	**1.5**	**1.6**
10 Year Treasury Note	**3.7**	**3.8**	**3.9**	**4.0**	**4.0**
30 Year Fixed-Rate Home Mortgages	**5.3**	**5.3**	**5.2**	**5.3**	**5.5**

Exchange Rates (monthly average)

	Jun. 09	Sept. 09	Dec. 09	Mar. 10	Jun. 10
Yen/Dollar	**98.0**	**97.9**	**98.0**	**97.0**	**98.0**
Dollar/Euro	**1.39**	**1.38**	**1.38**	**1.35**	**1.35**

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