U.S. GOVERNMENT FORECAST

SIFMA Quarterly Government Securities Issuance and Rates Forecast – Second Quarter 2010

Issuance Projections See Moderate Decrease as Confidence in Recovery Grows

Second Quarter Total Net Issuance to Fall on Improving Economic Conditions

The SIFMA Quarterly Issuance Survey[1] forecast total net Treasury bill, note and bond issuance to be $351.0 billion in the second quarter of 2010, compared with the net $483.2 billion issued (and $417.0 billion forecast in SIFMA's 1Q'10 issuance survey[2]) in the first quarter of 2010 and $343.2 billion issued in the second quarter of 2009 (actuals include cash management balances).[3]

The net $483.2 billion issued ($353.2 billion when excluding cash management bills) in 1Q'10 was significantly above Treasury's February marketable borrowing estimate of $392 billion, but was relatively in-line with Treasury's November 2009 estimate of $478 billion. The higher than expected issuance was partly due to the increase in the Supplementary Financing Program (SFP) to $200 billion from $5 billion (announced in late February), following a reduction in the program from $15 billion to $5 billion that was announced in late December 2009 before the debt ceiling was formally raised.

The drop to $351.0 billion projected for 2Q'10 may partly reflect an expanding economy and expectations for sustainable growth (and associated increased revenues), and attempts to curb spending and national debt levels going forward. However, issuance projections remain largely in-line with year-ago levels, indicating continued financing needs. Uncertainty and challenges in the marketplace linger, despite a recovering economy that appears on track to deliver sustainable growth, and investors will likely continue to find Treasuries attractive and as safer, long-term investment alternatives.

Net Coupon Issuance Still Greater Year Over Year; Cash Balances Expected to Rise

The median forecast for net new issuance of Treasury coupon securities (notes and bonds) is $423.5 billion for the second quarter, 2.2 percent below 1Q'10's net coupon issuance of $433.2 billion, but more than 14 percent above the net $370.3 billion issued in the second quarter of 2009.[4] In addition, survey respondents believe that Treasury will finish the second quarter with a cash position of $250 billion, 17.9 percent above the balance of $212 billion at the end of the first quarter this year, and a jump of 28.9 percent from the end-4Q'09 cash balance of $194 billion (including $5 billion for the SFP).[5] Treasury's February estimate for the end-June 2010 cash balance was $85 billion (including $5 billion for the SFP as originally stated), but this did not reflect adjustments for the SFP announcement, which occurred in late February after Treasury's estimates were originally released.

Respondents also estimated the fiscal years 2010 and 2011 federal deficits will be approximately $1.4 trillion and $1.2 trillion, respectively, compared to the $1.35 trillion and $980.1 billion estimated for the same years by the Congressional Budget Office. The Administration released their proposed FY2011 government budget in February and estimated a $1.57 trillion FY2010 deficit, which is expected to drop to $1.27 trillion for FY2011.

The second quarter 2010 forecast for gross nominal coupon issuance is $575.0 billion, 4.9 percent below the $604.7 billion issued in the first quarter but still 10.8 percent greater than the $519.1 billion issued in the same year-earlier period. Survey respondents forecast Treasury will issue $19 billion of Treasury Inflation-Protected Securities (TIPS) in 2Q'10, slightly greater than the $18.4 billion issued in 1Q'10. Treasury had previously indicated intentions to increase the frequency of TIPS auctions over time, and expectations in the future are for TIPS to make up a greater percentage of total marketable

[1] The survey was conducted beginning on April 9, 2010 and ending on April 23, 2010. A description of the participants is provided on page 5. Previous survey reports may be found at http://www.sifma.org/research/research.aspx?ID=10342.

[2] SIFMA's 1Q'10 Government Forecast Survey results can be found here.

[3] Survey results are medians and the dates and numbering of quarters are based on calendar year rather than fiscal year unless otherwise noted.

[4] Net coupon issuance projections for the second quarter of 2010 ranged from $405 billion to $443 billion.

[5] Net cash position projections for the end of the second quarter 2010 ranged from $75 billion to $275 billion.

debt. As a reminder, 20-year TIPS were eliminated in late 2009 and the 30-year TIPS were reinstated beginning on February 22.

The median forecast for gross combined coupon and TIPS issuance in the second quarter is $594.0 billion, 4.7 percent below the $623.1 billion recorded in 1Q'10, but 11.3 percent greater than the $533.5 billion in 2Q'09. Of this total, approximately 22 percent is projected to be in 2-year notes, 20 percent in 3-year notes, 21 percent in 5-year notes, 16 percent in 7-year notes, 11 percent in 10-year notes, 7 percent in 30-year bonds and 3 percent in TIPS.

Net Bill Issuance Projects $72.5 billion Paydown; Growing Momentum in Coupon Market and SFP

The survey projects net bill redemption of $72.5 billion for the second quarter in 2010, compared to net issuance of $50.0 billion in the prior quarter and a net redemption of $27.1 billion in the second quarter of 2009. The wide range of responses received[6] suggests that there remain some uncertainty in the marketplace regarding the economic recovery and Treasury's debt management plan going forward. Gross bill issuance is expected to total approximately $1.05 trillion in the second quarter, higher than the $1.03 trillion in 1Q'10 but less than the $1.28 trillion issued in 2Q'09. Overall consensus continues to be that issuance levels will decline over time. Treasury had previously indicated their intent to shift from the shorter-term bill market to the longer-term coupon market, although it will maintain short-term liquidity through use of the SFP.

U.S. Treasury Yield Outlook – Yields Expected to Rise and Curve to See Slight Flattening

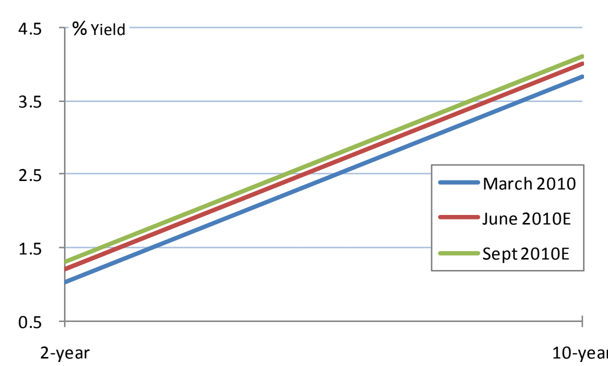
The survey forecasts benchmark Treasury yields will increase going through the second quarter of 2010, relative to levels prevalent at the time the survey was taken.[7] This trend reflects a growing confidence in the recovery's progress and a perceived increase in demand for riskier assets.

The median forecast for the 10-year Treasury yield is 4.0 percent for the second quarter of 2010 and 4.1 percent for the third quarter of 2010. Projections for 10-year yields range from 3.6 to 4.2 percent in 2Q'10 and from 3.5 to 4.4 percent in 3Q'10. The median forecasts for the 30-year bond yield are 4.9 percent for both the second and third quarters this year. There was a narrower range of responses received for second quarter 30-year projections, from 4.5 percent to 5.2 percent, than for the third quarter, which ranged from 4.3 to 5.4 percent. The 2-year Treasury note is forecast to yield 1.2 percent in the second quarter and 1.3 percent in the third quarter of 2010. The range for second quarter 2-year yield projections is between 0.9 percent and 1.3 percent, and is broader for the third quarter, between 1.0 and 1.8 percent.

The survey projects a slight flattening of the yield curve (approximately 2 basis points, or bps) in 2Q'10, as measured by the 2-year to 10-year Treasury yield spreads. The 282 bps spread as of March 31 was one of the highest spreads recorded to date; the average spread for 2009 was 233 bps, compared to an average of 281 bps for the first three months of 2010. Although the survey projects a flattening of the yield curve through the majority of 2010, consensus expectations are for the curve to gradually steepen as the economic recovery accelerates and begins to drive inflation.

The survey projects the 2-year to 10-year Treasury yield spread will be the same for both the second and third quarters of 2010, at 280 bps, with both the 2-year and 10-year separate yields rising in corresponding increments of 0.2% yield through the second quarter and another 0.1% yield through the third quarter (see Table 1 below).

Table 1. Projected 2- to 10-Year Treasury Yield Movement



Source: Second Quarter 2010 SIFMA Government Forecast Survey

Stronger than Expected Economic Recovery Still the Main Rate Upside Risk; Recessionary Concerns, Sovereign Risk and Deflation the Main 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 (summarized below in Table 2). The dominant risks identified on the upside (higher-than-expected yields) are: a

[6] Net bill issuance projections for the second quarter of 2010 ranged from a net redemption of $170 billion to a net issuance of $64 billion. A net redemption, or negative net issuance, number may be interpreted as a net paydown of outstanding Treasury debt.

[7] As of April 23, the 2-year note yield was 1.1 percent, the 5-year note yield was 2.6 percent, the 10-year note yield was 3.8 percent, and the 30-year bond yield was 4.7 percent.

greater-than-expected economic recovery, continued record-low rates, and subsequent inflationary pressures. The dominant risks identified on the downside (lower-than-expected yields) are: the chance for a double-dip recession, deflation, and additional sovereign risk problems stemming from the Greek crisis.

Table 2. Summary of Risks to Rate Forecasts

	Risks to Upside	Risks to Downside
#1	Accelerating recovery, relative supply and fiscal policy	Disinflation, EU sovereign distress
#2	We have long been in the more muted growth camp. If data continue to come in strong, this could represent some upside to our call.	Greece issue becomes more widespread.
#3	If rates remain range-bound and the Fed remains on hold for longer than expected, the front-end has further potential to rally (more steepening).	If the Fed decides to hike sooner than expected, the curve could bear flattening.
#4	More aggressive Fed tightening, larger Chinese revaluation	Deflation, double-dip recession, equity decline
#5	Stronger-than-expected economic growth or higher-than-expected inflation.	Lower inflation, a prolonged period of risk aversion/flight to quality, and weaker-than-expected economic growth.
#6	If Fed changes wording of statement to indicate closer to tightening than market thinks	If economy heads toward double dip
#7	Higher trajectory in real growth than expected. This may lead the Fed to be more hawkish in their hiking cycle, which in turn could lead to a faster than expected rise in rates. Continued higher supply in the absence of Fed purchases also argues for higher rates.	Sovereign risk concerns in Europe may lead to a flight to U.S. Treasuries. Also, a sustained downward trajectory (deflation) in core inflation could bring down nominal rates as inflation expectations become more subdued.
#8	Include faster than expected improvement in the labor markets and a quicker absorption of excess capacity than forecast; occurrences which might cause the Federal Reserve to abandon its commitment to low rates for an extended period sooner than is currently anticipated. Any event which could lead to the diminution of foreign interest in U.S. Treasury securities.	Problems emanating from smaller sovereign securities markets. Should events evolve in a worse case manner, problems could then manifest themselves in the private sector of the markets (banking system), or in the middle to upper tier of the sovereign space. Persistent shortfalls in measurements of inflation could underscore the notion that the environment is moving into deflation.

Source: Second Quarter 2010 SIFMA Government Forecast Survey

Federal Agency Issuance Expected to Slightly Drop; FHLBs Crucial Provider of Liquidity to Communities

The survey forecasts total gross coupon issuance by the four largest Federal agencies of $294.3 billion in the second quarter, compared to $307.4 billion in the first quarter of this year.[8] Approximately 42 percent of the issuance volume is expected to come from the Federal Home Loan Banks (FHLBs), reflecting their increasing importance as a key provider of low-cost funding to communities, especially those in areas of lower economic development. Fannie Mae and Freddie Mac are projected to account for 26 percent and 24 percent of total agency issuance in the second quarter, respectively.

Agency Spreads Largely Expected to Rise; Swap Spreads and LIBOR Also See Moderate Increases

Respondents expect agency yields and agency-to-Treasury yield spreads to increase in the second quarter of 2010 from first quarter levels. Respondents predict a 2 bps drop between 1Q'10 and 2Q'10 for 2-year agencies spreads, a 6 bps increase for 5-year agencies spreads, and a 5 bps increase for 10-year agencies spreads. Interestingly, respondents forecast a steady decrease in 2-year agencies spreads going forward through 3Q'10, but expect a steady increase in the 10-year agencies spreads through the third quarter. Respondents also expect interest rate swap-to-Treasury yield spreads to rise through the second and third quarters of this year, and specifically see a quicker rise in the 10-year swap spreads than the 2- or 5-year swap spreads.

As for the three-month London Interbank Offered Rate (LIBOR), the survey projects it will increase slightly through the next two quarters, to 0.4 percent in 2Q'10 and 0.5 percent in 3Q'10 from its 0.29 percent level as of March 31.

Most Recommend Neutral–to-Under Weight; Some Advise Overweight

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 results generally favor a neutral to underweight recommendation (as depicted in Table 3). Notably, 25% of responses are also overweight for the very short-term and very long-term maturities, and 38% advise to strongly underweight the longest-term maturities. The divide over specifically the 10-30 years maturity timeframe further reflects the uncertainty over the direction of rates in the long-term.

Table 3. Distribution of Duration Weightings

	Strong Over	Over	Neutral	Under	Strong Under
0-3 yrs	**0%**	**25%**	**38%**	**38%**	**0%**
3-7 yrs	**0%**	**13%**	**50%**	**25%**	**13%**
7-10 yrs	**0%**	**13%**	**38%**	**38%**	**13%**
10-30 yrs	**0%**	**25%**	**25%**	**13%**	**38%**

Source: Second Quarter 2010 SIFMA Government Forecast Survey; percent of total respondees

[8] Includes Fannie Mae, Freddie Mac, the Federal Home Loan Banks (FHLBs), and the Federal Farm Credit Banks Funding Corporation.

U.S. GOVERNMENT FORECAST

SIFMA's Government Securities Research Committee Forecast

Forecast numbers appear in bold

Issuance Projections

$ Billions

U.S. Treasury Borrowing[1]	1Q'10	2Q'10
Net Coupon Issuance	433.2	**423.5**
Net Bill Issuance	50.0	**(72.5)**
Quarter end cash balance	212.0	**250.0**
U.S. Treasury Quarterly Gross New Issuance		
4 week Bill	329.3	**297.0**
13 week Bill	300.0	**336.0**
26 week Bill	324.0	**343.0**
52 week Bill	78.0	**78.0**
2 year Treasury Note	135.3	**129.0**
3 year Treasury Note	126.5	**117.0**
5 year Treasury Note	129.1	**124.0**
7 year Treasury Note	98.4	**96.0**
10 year Treasury Note	70.9	**67.0**
30 year Treasury Bond	44.5	**42.0**
Treasury Inflation-Indexed Securities	18.4	**19.0**
Federal Agency: Projected Total Gross Coupon Debt Issuance[2]		
Fannie Mae	90.5	**75.5**
Freddie Mac	85.2	**70.0**
Federal Home Loan Bank System - Office of Finance	88.4	**123.8**
Federal Farm Credit Banks Funding Corporation	43.3	**25.0**

	FY estimates
Federal Budget Deficit Estimate - FY2010	**1,400.0**
Federal Budget Deficit Estimate - FY2011	**1,200.0**
Federal Budget Deficit Estimate - FY2012	**900.0**

Rates & Spreads Outlook

	3/31/10	6/30/10	9/30/10
Interest Rates (End of Quarter in %Yield)			
2 year Treasury Note	1.0	**1.2**	**1.3**
5 year Treasury Note	2.5	**2.7**	**2.8**
10 year Treasury Note	3.8	**4.0**	**4.1**
30 year Treasury Bond	4.7	**4.9**	**4.9**
3 Month LIBOR	0.3	**0.4**	**0.5**
Spreads to Treasury (End of Quarter in Basis Points)			
2 year Agency Benchmark/Reference Notes[3]	23*	**21.0**	**19.0**
5 year Agency Benchmark/Reference Notes[3]	16*	**22.0**	**21.0**
10 year Agency Benchmark/Reference Notes[3]	21*	**26.0**	**28.0**
2 Year SWAP Spreads	19.0	**22.5**	**23.0**
5 Year SWAP Spreads	19.5	**20.0**	**21.0**
10 Year SWAP Spreads	(1.0)	**5.0**	**9.0**

**Spreads as of April 23, 2010.*

[1] *Excluding Federal Reserve's purchases*

[2] *Including all callable coupon issuance and excluding all discount notes*

[3] *Agency spreads to Treasury yield are in basis points.*

SIFMA Committees Participating in the Survey

<u>Primary Dealers Committee</u>:

Richard C. Volpe (Co-Chair)
RBS Securities Inc.

Paul Murphy (Co-Chair)
Bank of America

<u>Government Securities Research and Strategist Committee</u>

<u>SIFMA Staff Advisor</u>
Robert Toomey
Managing Director and Associate General Counsel
rtoomey@sifma.org

<u>Other SIFMA Contributors</u>
X. Lily Hao
Analyst, Capital Markets
lhao@sifma.org

Charles Bartlett
Vice President and Director of Statistics
cbartlett@sifma.org

The Securities Industry and Financial Markets Association's Quarterly Government Securities Issuance and Rates Forecast reflects the responses to a survey of members of the Association's Primary Dealers Committee and Government Securities Research and Strategist Committee. 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.