REGIONAL BOND DEALERS ASSOCIATION

FEBRUARY 2010

Economic Advisory Committee Survey

NATIONAL OUTLOOK

- Private sector growth will pick up as the monetary and fiscal stimulus winds down.
- Unemployment will remain elevated for some time.
- Inflation and interest rates will remain low.

REGIONAL OUTLOOK

- Housing and employment will gain from a low starting point, while commercial real estate conditions will continue to weaken across regions.

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Introduction

This report introduces a semiannual economic forecast survey series of the Regional Bond Dealers Association's Economic Advisory Committee. The RBDA developed the forecast survey questionnaire with the assistance, advice and guidance of Moody's Economy.com. This economic forecast survey stands apart from other forecast surveys in at least two respects. First, the economic advisory committee includes both chief economists of middle market bond dealers and other market participants and market strategists at the firms. Second, the survey addresses both national economic and regional economic issues.

About RBDA

» The Regional Bond Dealers Association is the Washington DC-based trade organization for securities dealers and banks primarily focused on the U.S. fixed income markets. The RBDA provides advocacy on federal legislative and regulatory matters in addition to a wide range of conferences and events and publishes research on trends, policy and market practice issues affecting the demographic of the fixed income securities dealer.

About Moody's Economy.com

» Moody's Economy.com, a division of Moody's Analytics, is a leading independent provider of economic, financial, country and industry research designed to meet the needs of businesses, governments and professional investors. Its research has diverse dimensions: country analysis, financial markets, industrial markets, and regional markets.

Executive Summary

Macroeconomic Forecast

The Regional Economic Advisory Committee consensus view, according to the survey,[1] is for the economy to gain momentum later in 2010 and into 2011, benefiting from aggressive monetary and financial market policies and the fiscal stimulus over the last 12 to 18 months.

» The median forecast calls for GDP growth of 2.7 percent in 2010, with a higher rate of growth later in the year and into 2011.

» Inflation, as measured by the consumer price index, is expected to remain controlled at less than 2 percent based on the median forecast.

» Private sector consumer and business spending will pick up later in the year and replace the federal stimulus as the engine of growth. Inventory rebuilding also is contributing to the improved economic outlook.

» Unemployment will remain persistently high by historic standards, averaging 9.8 percent in 2010 and 9.1 percent in 2011, based on the survey's median forecast. Employment growth will resume in 2010, albeit at a very modest pace, accelerating to some degree by 2011.

[1] The RBDA economic forecast survey was conducted the week ending February 14 with 13 participating firms.

Forecast Risk

Despite the more generally upbeat outlook, substantial economic headwinds remain. The survey respondents believe there is more downside risk to the forecast than upside. The dominant downside risks are labor market conditions and credit availability, along with significant financial stress at state and local governments. Stronger than expected growth outside the U.S. or a faster return of private credit growth could result in higher than projected growth.

Monetary Policy and Treasury Yields

The survey consensus is that the FOMC statement will be largely unchanged at the upcoming March 16 meeting, based on the view that the "warrant exceptionally low federal funds rates for an extended period of time" language will be maintained. There is a minimal probability that the federal funds target rate will be increased at the next FOMC meeting, with slightly more than a 50 percent probability that the Fed will not begin to increase the fed funds rate until next year. The historically steep two-year to 10-year yield curve spread is expected to begin to flatten in a somewhat higher interest rate environment over the next year.

Fiscal Policy and Deficit

The deficit for the current fiscal year is expected to reach $1.4 trillion, reducing to a still-concerning $1.1 trillion in fiscal 2011, based on the expectation of a slower rate of government spending and the revenue effect of anticipated economic growth. Respondents expect that the federal government will need to provide more assistance to state governments than is proposed in the fiscal 2011 budget.

Regional Forecast Trends

Business conditions will improve modestly over the next six months in all regions except the West, where conditions are expected to weaken further. Manufacturing, the service sector, and retail sales are expected to improve in varying degrees across regions.

Commercial real estate is expected to deteriorate further across all regions, with significant deterioration in the West.

House prices are expected to weaken further this year in the Northeast and Midwest and improve in the West and South. House prices are generally expected to rise in all regions in 2011, except for the Midwest, and 2012.

Monetary Policy

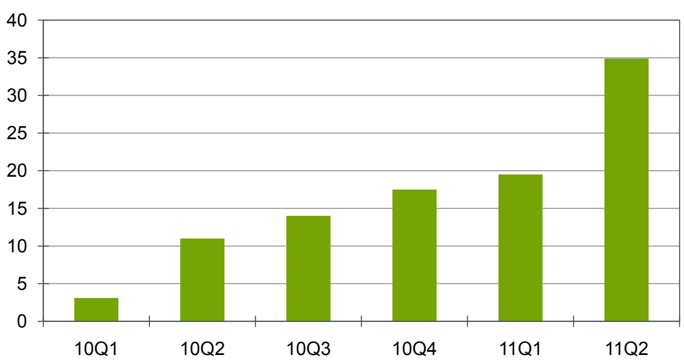
Rates Policy Unlikely to Change

The strong consensus view of the Regional Economic Advisory Committee is that the Federal Open Market Committee will retain its monetary policy stance at the upcoming meeting on March 16 and through much of the year. By a 90 percent to 10 percent margin, the respondents agree that the core statement of "warrant low fed funds rates for an extended period of time" will remain largely unchanged. The phrase has been in every FOMC statement for the past year as a summary of its position on the target rate and economic conditions.

Furthermore, the committee believes there is little chance the fed funds rate will increase during the first half of the year. The respondents place a slightly greater than 50 percent probability that the Fed will postpone raising the target fed funds rate until 2011 and a more than one in three chance that the target rate will not be raised until after the first quarter of 2011. As one respondent commented, "Fed policy is being driven by core inflation and unemployment. As long as the current trends are in place, it is unlikely that the policy will change."

Fed Likely to Stand Pat Until Next Year

Probability that the Fed will begin raising the fed funds rate, by quarter



Interest Rates and Financial Markets

The Federal Reserve has confirmed its intention to curtail MBS (residential mortgage-backed securities) purchases, let the CMBS (commercial mortgage-backed securities) lending program expire on June 30, and let other non-ABS support programs expire at the end of the month, based on the expectation that the private market will become more active in these markets. The committee members are generally in support of the Fed's announced plans. There was near-unanimous support to cease MBS purchases but less agreement on letting the CMBS program expire, where 58 percent were in favor and 42 percent were opposed. About 75 percent supported the expiration of the other asset-backed security support program. Some respondents commented that the Fed should reserve the right to re-enter the markets if necessary.

Treasury and Yield Curve

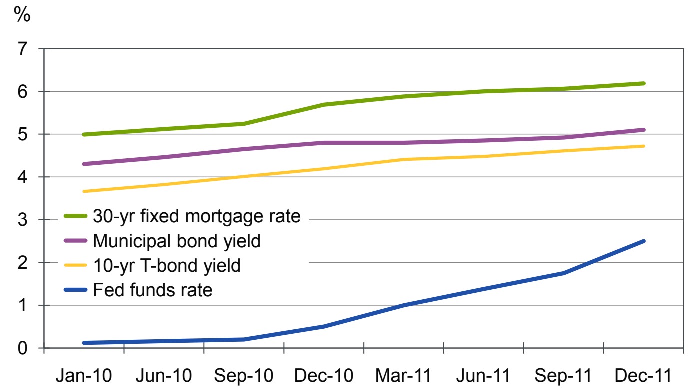
The consensus view calls for the yield curve to begin to flatten in a rising rate environment over the course of the year. The movements reflect the higher likelihood of a rate hike as the year progresses, increased government bond issuance to finance the deficit, and the GDP growth and inflation forecasts. As of the end of last year, the two-year to 10-year spread was 272 basis points. The median projection has the yield curve spread at 246 basis points at the end of this year and 200 basis points at the end of 2011. The median 10-year yield forecast was 3.82 percent at the end of June and 4.19 percent at the end of the year.[2] (The 10-year yield on February 24 was 3.69 percent).

Credit Markets

Both the taxable (corporate) and tax-exempt markets have rallied strongly following the height of the credit crisis and introduction of various policy measures to support the credit market. In the corporate sector, spreads have come in as a result of improved profits through cost-cutting, reduced default rates,

[2] The 10-year yield forecast was 3.5 percent to 4.2 percent for June and 3.5 percent to 4.7 percent for the end of 2010.

Higher Rates Expected in 2011



Note: After January 2010, data are forecast.

and a slightly stronger appetite for risk. In the taxable bond sector, 25 percent of the respondents expect investment grade spreads to widen, 17 percent expected spreads to tighten, and the remaining 58 percent expect spreads to be stable over the next six months relative to where they were at the end of January (a 181 basis point spread at that time). There was more support for spreads tightening than widening in the high-yield sector relative to spreads at the end of January (684 basis points).

Despite the current volatile economic environment, the consensus view is for tax-exempt bond spreads to remain about where they are, indicative of the continued appetite for municipal bonds despite uncertainties surrounding state fiscal conditions. There was a unanimous view that municipal bond issuance will hold steady or increase compared with last year, with 91 percent holding the view that issuance will hold steady or rise modestly and the balance expecting significant issuance growth.

Fiscal Policy

The median forecast has the federal budget deficit this year (fiscal 2010) rising to $1.4 trillion, about the same as the last fiscal year but declining to a still-elevated $1.1 trillion in fiscal 2011.[3] Contributing to the deficit is the substantial growth rate of federal spending; the median forecast projects a 4.3 percent growth rate this fiscal year, slowing to 2 percent in fiscal 2011.

State and Local Government Budget Impact

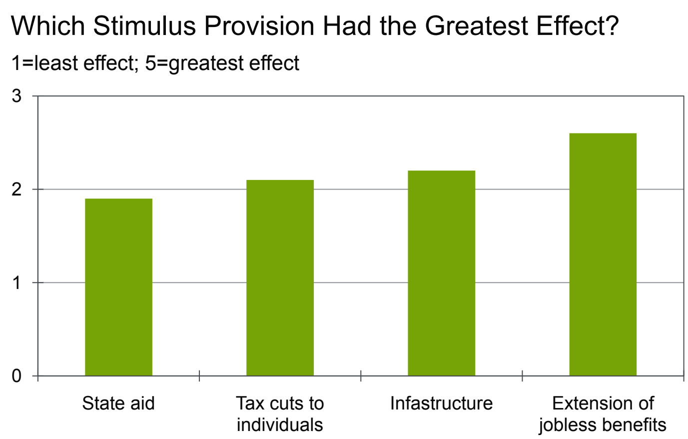
Federal spending has offset the drag from slower local government spending as state budgets feel the pinch from higher unemployment and faltering revenues. Improving from the net contraction last year, state and local government spending is projected to grow beginning in the second quarter by 0.3 percent this year and 0.4 percent next year, which will be dependent on continued federal financial support for state and local governments. According to the survey, 82 percent of the respondents assert that the federal government will need to provide more assistance to state governments than is planned in the current fiscal 2011 budget, especially for states whose budgets are hit hardest. As one respondent commented, "strains on state and local budgets will be a problem for the foreseeable future."

The survey found that, generally, the states in the strongest condition were those close to Washington DC and presumably most positively affected by federal spending: Virginia, Maryland and Delaware. Texas and North Dakota were also cited as relatively strong states in terms of their financial conditions. Conversely, the state budgets in the most difficult conditions were generally those where the housing crisis has aggravated the state budget situation. As expected, California was identified as the state in the most difficult budget situation, with New York, Arizona, Florida and Illinois prominently mentioned.

[3] The federal deficit forecast for fiscal 2010 ranged from $1.2 trillion to $1.6 trillion.

Which Stimulus Provisions Had the Greatest Effect?

There has been a great deal of debate as to which provisions in the federal stimulus program have had the greatest effect. While the results are closely bunched, infrastructure spending and the extension of jobless benefits were considered to have the greatest effects. One respondent commented that relatively little of the stimulus package went to business tax incentives, and another cited the necessity of the stimulus programs to "fills gaps." [4]



Extension of Dividend, Capital Gains Tax Rate Reductions Supported

In addition, most of the respondents supported an extension of the dividend and capital gains tax rate reductions by a 75 percent to 25 percent margin. Furthermore, 75 percent believed that not extending these investment tax incentives would have some effect on the markets, and an additional 8 percent believe it would have a strong effect.

[4] The graph below represents the average response to the question of which provisions in the federal stimulus program had the greatest effect on 2009-2010 economic growth.

Economy

GDP

The median projection calls for GDP growth of 2.7 percent in 2010 (2.9 percent fourth quarter to fourth quarter) and 3 percent (3.1 percent fourth quarter to fourth quarter) in 2011, with quarterly growth rates between 2.8 percent and 3 percent this year, accelerating to 3.5 percent at the end of 2011.

Downside Forecast Risks Dominate—Credit Availability and Employment Growth Important Variables

The consensus view of the committee is that the forecast risks are predominantly on the downside (42 percent of the respondents held that view) rather than on the upside (18 percent of the respondents held the upside view), with the remaining 40 percent judging the forecast risks to be balanced between the upside and downside. The most prevalent downside risks are that the labor market and employment would be weaker than expected, that there would be less access to credit than anticipated, and state and local government budget contraction. Conversely, the upside risks are that global growth, especially from emerging markets, would be stronger than expected; employment growth would exceed consensus expectations; a lower-valued dollar would stimulate net export growth; and that credit would flow to a greater extent than anticipated. Thus, important variables on both the downside and upside are the labor market and credit access. A prominent upside and downside risk factor was energy—the price of energy is always an uncertainty that moves the economy.

Committee members were asked to identify the dominant risk to economic growth on a regional basis. Credit availability is the major upside risk in the Northeast, and state and local government spending is on the downside. Energy was the most important upside risk in the South, and energy, housing and credit were the downside risks. The labor market is the most prominent risk on both the upside and the downside for the Midwest. In the West, energy was the dominant upside risk, and housing and credit availability were the most important downside risks.

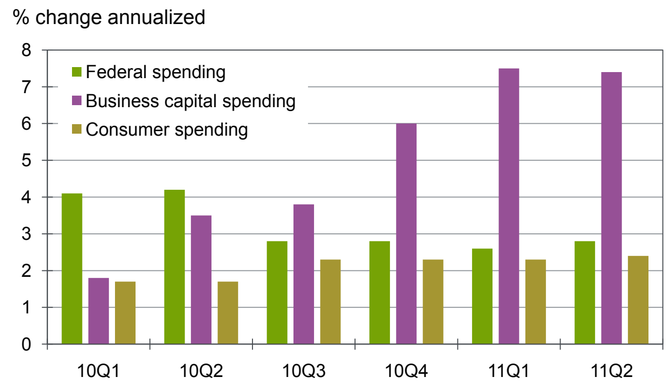
Inflation Under Wraps: Stable Oil Price Trend

The median responses suggest an expectation that inflation will remain modest. Price measures are expected to remain within a range that traditionally has been considered acceptable by policymakers of 1.5 percent to 2 percent for both headline CPI and core CPI.[5] The panelists identified the value of the dollar and energy prices as the most prominent risks to the inflation forecast on both the upside and the downside. A declining dollar would place more inflationary pressure on the economy, while a strengthening dollar would reduce inflationary risk. Similarly, rising energy prices would add to the risk of higher prices, while a muted energy price trend will help keep inflation under wraps. The median forecast calls for the price of a barrel of oil to average \$73 in 2010 and \$76 in 2011.

Economic Performance by Sector

Through the first half of the year, growth will be led by government spending, which is expected to moderate in the second half of this year and into next year. Government spending has generated demand, compensating for subdued private investment due to unused available capacity in the business sector and reduced spending by the deleveraging consumer. As noted previously, federal spending has also offset some of the drag from slower state and local government spending.

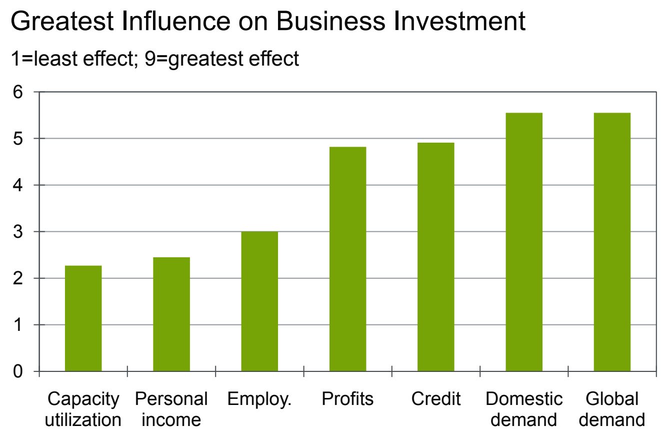
Private Sector Spending Overtakes Government Support

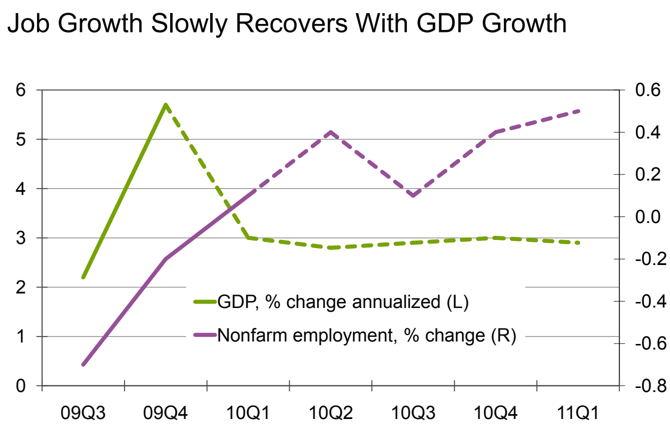


Consumer and business spending is expected to begin to pick up as government spending slows. Consumer spending, representing the largest sector of the economy, is expected to grow by less than 2 percent annualized in the first half of the year on a quarter-over-quarter basis to 2.3 percent to 2.9 percent on a quarter-over-quarter basis for the rest of the forecast period through the end of 2011.[6] Committee members expect retail sales to improve modestly in every region over the next six months.

[5] Consumer price index forecasts for 2010 ranged from 0.6 percent to 2.6 percent.

[6] Consumer spending for 2010 forecasts range from 1.7 percent to 4.4 percent.





A slower drawdown in inventories is supporting growth. The median projection has business capital spending increasing from a slow 1.8 percent rate of growth this quarter, escalating to 7 percent to 8 percent quarter-over-quarter growth in 2011. The business spending outlook over the balance of the year will be driven by domestic and non-U.S. demand, credit availability, and business confidence, translating into corporate capital spending decisions.[7]

Employment: Improving, but Unemployment Problem Still Significant

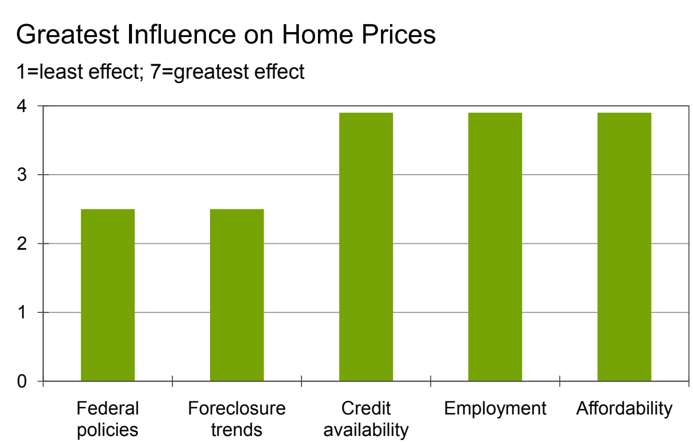
Despite the forecast for sustained economic growth, the unemployment rate will remain at historically high levels. The median forecast projects the unemployment rate will decline from 10 percent in the fourth quarter of 2009 to 9.9 percent in the current quarter and remain above 9 percent through the third quarter of 2011. The committee expects payroll employment declines to end and employment to increase at a very modest pace in 2010, with somewhat more job growth momentum in 2011.[8]

Starting from the current weak employment environment, the committee expects the pace of employment to pick up gradually and unemployment to decline over the next two years across the regions. The committee expects net employment gains over the next six months across the regions, although job growth in the Midwest is expected to be slower than in the other regions. Generally, the South and West are expected to have the strongest employment growth in 2010-2012.

Housing

The committee expects housing to begin its long-delayed recovery this year with rising housing starts, sales and prices in 2010. The consensus is for house prices to be slightly higher in 2010 and again in 2011, based on forecast S&P/Case-Shiller index trends. Even so, house prices will remain well below their peak following the double-digit losses over the last few years. Based on the survey responses, four interrelated factors will affect housing prices: affordability, employment, mortgage rates and credit availability.[9]

Regionally, the consensus view is that prices generally will be rising over much of the forecast period, and prices are expected to be rising by 2012 in all regions. House price declines are expected to continue in the Northeast over the next six months, and Midwest prices are not expected to turn around until 2012, while prices will rise over the entire forecast period in the South and West. The respondents also are predicting upticks in housing construction permits across all regions over the forecast period of 2010-2012.



[7] The graph above represents the average response to the question of what factors most influence business capital investment spending.

[8] The average 2010 unemployment rate forecast ranged from 7.5 percent to 10.2 percent, and the employment growth forecast for 2010 ranged from -1 percent to 4 percent.

[9] The graph below represents the average response to the question of what factors most influence the respondents' outlook on house price trends over the next year.

Regional Outlook

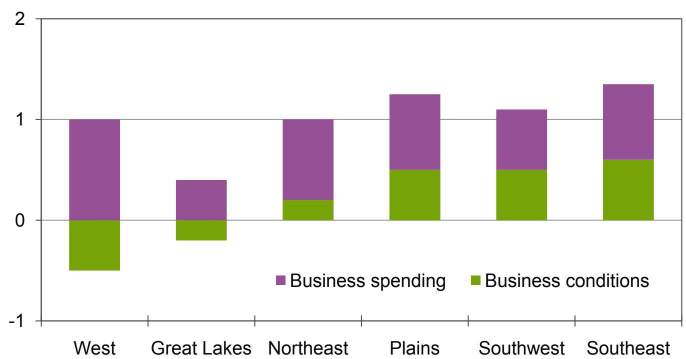
Short Term

General business condition improvements are expected in four of the six regions—the exceptions being the West and Great Lakes—over the next six months. Respondents forecast business spending to increase modestly in every region of the country, with the strongest growth anticipated in the West and the slowest in the Great Lakes. Similarly, there is an expectation across regions for gains over the next year in services and manufacturing.

The exception of the modest regional improvement trend across sectors over the next six months is commercial real estate. The consensus view is for commercial real estate to weaken across all regions, with the most significant deterioration in the West.

Business Spending vs. Business Conditions

Significantly weaker (-2) to significantly strong (+2), by region



Among the six sectors of regional economic conditions addressed in Table 4 of the Appendix, the outlook for retail sales shows the greatest regional disparity. The respondents expect the outlook for the coming six months to be strongest in the Southeast and the Great Lakes regions. The West trails far behind, with the consensus barely positive for an improvement in retail sales during this time. Similarly, the expected downturn in commercial real estate is the most severe in the West.

Across the six indicators, the West ranks as the weakest in five of the six indicators—business conditions, services, business spending, retail sales, and commercial real estate. The survey respondents, however, expect the West, along with the Northeast and the Plains regions, to have the greatest improvement in manufacturing.

Long Term

The long-term structural advantages and barriers for each region of the country are summarized below. They present some insights as to how the various regions can think about economic development strategies.

Region	Advantage	Barrier
East	Capital markets	Cost of living
Midwest	Industrial mix	Infrastructure
South	Cost of living	Labor/demographics
West	Demographics	Cost of doing business/living

Conclusion

The first Regional Bond Dealers Association Economic Advisory Committee forecasts trends that offer a dose of optimism punctuated by sustained economic growth and moderate inflation and with improvements in business and consumer spending as well as expectations of reversing job losses and housing price declines. Although the committee forecasters are optimistic, the dominant forecast risks are on the downside, in the form of reduced credit availability and a still-weak labor market. Stronger than expected global growth is the largest upside risk to the forecasts.

The committee continues to see substantial federal budget deficits, although the deficit is expected to recede somewhat in fiscal 2011.

With the exception of commercial real estate, the committee generally sees modest economic improvements across the regions. The South and West are expected to have the strongest employment gains over the next two years. House prices are expected to improve in the forecast period through 2012 but with the Northeast and Midwest still encountering price declines over the next six months.

Appendix

Regional Bond Dealers Association Economic Advisory Committee Survey Results (Median Response)

Table 1

National Economic Data Forecast

National	Actual 09Q3	09Q4	2009	10Q1	10Q2	10Q3	10Q4	2010	11Q1	11Q1	11Q3	11Q4	2011
Real GDP (%)	2.2	5.7	**-2.4**	3.0	2.8	2.9	3.0	**2.7**	2.9	3.2	3.4	3.5	**3.0**
GDP 4Q-4Q			***0.1***					***2.9***					***3.1***
CPI* (%)	3.6	3.4	**-0.3**	2.2	2.0	1.9	2.0	**1.8**	2.2	2.3	2.2	2.2	**1.8**
GDP 4Q-4Q			***1.7***					***1.9***					***2.2***
Core CPI* (%)	1.5	1.5	**1.7**	1.6	1.5	1.4	1.4	**1.5**	1.7	1.8	1.8	1.8	**1.7**
GDP 4Q-4Q			***1.5***					***1.4***					***1.9***
Real [personal consumption Growth (%)	2.8	2.0	**-0.6**	1.7	1.7	2.3	2.3	**1.7**	2.3	2.4	2.7	2.9	**2.3**
Real nonresidential fixed investment (% change)	-5.9	2.9	**-17.9**	1.8	3.5	3.8	6.0	**3.6**	7.5	7.4	7.5	8.4	**6.1**
Real federal government spending (% change)	8.0	0.1	**5.2**	4.1	4.2	2.8	2.8	**4.3**	2.6	2.8	3.0	3.0	**2.0**
Real state & local government spending* (% change)	-0.6	-0.3	**-0.1**	-0.3	0.0	0.9	1.0	**0.3**	-0.1	0.0	0.7	0.8	**0.4**
Single-family existing home sales (mil, SAAR)	4.7	5.3	**4.6**	5.7	5.6	5.9	6.3	**5.3**	6.7	6.9	6.9	8.6	**6.5**
Housing price change: Case-Shiller® Home price index: single-family Aggregate index, (Index), SA	1.8	1.9	**0.6**	0.0	2.2	-2.1	3.4	**0.7**	3.6	4.9	4.4	5.9	**0.7**
Housing starts (mil, SAAR)	0.6	0.6	**-12.0**	0.6	0.6	0.7	0.7	**0.5**	0.8	0.9	1.0	1.1	**1.0**
Nonfarm payroll employment (% change)	-0.7	-0.2	**-3.7**	0.1	0.4	0.1	0.4	**0.1**	0.5	0.4	0.4	0.3	**1.9**
Unemployment rate (%)	9.6	10.0	**9.3**	9.9	9.9	9.8	9.8	**9.8**	9.7	9.6	9.3	8.5	**9.1**
Federal budget deficit fiscal year ($ bil)			**-$1,472**					**-$1,410**					**-$1,122**
Oil price ($ per barrel, annual average)			**$74**					**$74**					**$79**

Table 2

Interest Rate Forecast

	Actual 9/30/09	12/30/09	Week of 1/20/10	6/30/10	9/30/10	12/31/10	3/31/11	6/30/11	9/30/11	12/31/11
2-yr T-Bond yield	0.95	1.08	0.89	1.12	1.46	1.73	2.13	2.50	2.57	2.70
5-yr T-bond yield	2.69	2.31	2.42	2.60	2.76	2.88	3.03	3.25	3.54	3.75
10-yr T-bond yield	3.31	3.80	3.66	3.82	4.01	4.19	4.41	4.48	4.61	4.72
30-yr fixed mortgage (%)	4.94	5.14	4.99	5.12	5.24	5.69	5.88	6.00	6.06	6.19
Municipal bond yield	4.23	4.25	4.30	4.46	4.65	4.80	4.80	4.85	4.92	5.10
Federal Funds rate	0.11	0.11	0.12	0.16	0.20	0.50	1.00	1.38	1.75	2.50

Table 3

Regional Forecast Trends: Employment and Housing, Average Score

SCALE: +2=Substantial improvement +1=Modest improvement 0=No change -1=Modest weakening -2=Substantial weakening

	Actual 09Q3	Actual 09Q4	Next 6 months	2011	2012
Northeast					
Non-farm employment change	-1%	-2%	0.80	1.00	1.40
Unemployment rate, %	9%	9%	0.20	0.80	1.40
Housing prices: Case-Shiller® Home Price Index: Single-family aggregate index, SA	0%	-1%	-0.33	0.33	0.67
New residential construction permits: total, (000s, SAAR)	69.3	70.4	0.80	0.80	1.00
Midwest					
Non-farm employment change	-2%	-1%	0.33	1.50	1.00
Unemployment rate, %	10%	10%	0.20	1.60	1.00
Housing prices: Case-Shiller® Home Price Index: Single-family aggregate index, SA	1%	0%	-0.50	-0.20	0.60
New residential construction permits: total, (000s, SAAR)	107.6	102.6	0.33	1.17	1.17
South					
Non-farm employment change	-2%	-1%	1.25	1.18	1.50
Unemployment rate, %	9%	9%	0.38	0.60	1.25
Housing prices: Case-Shiller® Home Price Index: Single-family aggregate index, SA	1%	-1%	0.25	0.43	1.29
New residential construction permits: total, (000s, SAAR)	316.10	290.50	1.18	1.00	1.50
West					
Non-farm employment change	-3%	-2%	1.00	1.60	1.40
Unemployment rate, %	11%	11%	0.83	1.20	1.00
Housing prices: Case-Shiller® Home Price Index: Single-family aggregate index, SA	2%	-3%	0.33	0.67	1.50
New residential construction permits: total, (000s, SAAR)	129.80	122.40	1.00	1.67	1.60

Notes

*Annualized % change; historical data provided by Moody's Economy.com; SAAR=seasonally adjusted annual rates; SA=seasonally adjusted; House price change is quarter over quarter based on the S&P Case/Shiller index.

Regional Definitions

East: New England and Mid-Atlantic
South: Southeast and Southwest
Midwest: Great Lakes and Plains
West: Mountain and Pacific

Table 4

Change in Regional Conditions Over Next Six Months, Average Score

SCALE: +2=Substantial improvement +1=Modest improvement 0=No change -1=Modest weakening -2=Substantial weakening

Region	Business conditions	Manufacturing	Services	Business spending	Retail sales	Com. RE
Northeast	0.43	1.00	0.71	0.71	0.57	-1.00
Southeast	0.71	0.83	0.71	0.71	1.00	-0.86
Southwest	0.83	0.71	0.67	0.67	0.86	-0.71
Great Lakes	0.14	0.86	0.57	0.83	1.00	-0.86
Plains	0.83	1.00	0.67	0.71	0.71	-0.71
West	-0.13	1.00	0.38	0.50	0.25	-1.38

Regional Definitions

Southeast: VA to FL plus East South Central Census Division
Southwest: West South Central
Great Lakes: East North Central (industrial Midwest)
Plains: West North Central
West: Mountain and Pacific

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Committee Staff Advisor

- Mike Nicholas
  RBDA