Research

U.S. Market Outlook

THE BOND MARKET ASSOCIATION

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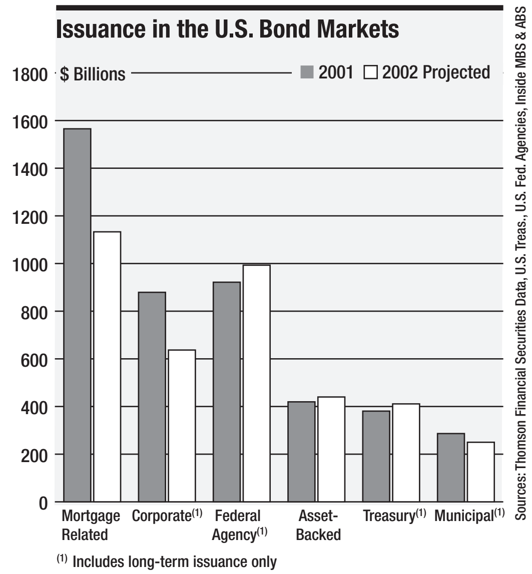
U.S. Bond Issuance Expected to Remain Strong in 2002 Totaling $3.9 Trillion



Long-term bond issuance in the U.S. market is projected to reach $3.9 trillion in 2002, down 13 percent from record issuance of $4.5 trillion in 2001.[1] The record issuance level attained in 2001 will be difficult to surpass given the historically low interest rate environment that persisted last year which spurred a surge in new issue activity, both for new projects as well as refinancing of higher-coupon debt. However, the outlook for issuance in the United States in 2002 is very positive. New issue volume is expected to increase in the Treasury, federal agency, asset-backed, and high-yield markets. Market participants expect the U.S. economic recovery to begin in 2002 and look for increases in business activity, which should buoy continued borrowing in the bond markets. Interest rates are expected to increase later in the year, but respondents anticipate that interest rates are likely to remain relatively stable and that inflation will remain benign. In the government markets, financing of the federal budget deficit is likely to lead to an increase in issuance of Treasury securities. On the state and local level, weaker fiscal conditions will keep new issue volume in the municipal market at a strong, albeit lower level than in 2001. Issuance of mortgage-related securities and investment-grade corporate debt is likely to slow, but remain strong following record issuance in those markets in 2001. Risks to the issuance outlook cited by respondents include: an unexpected delay in the timing of U.S. economic recovery, rapid increases in interest rates, escalation of tensions in the Middle East, a rapid correction in the stock market, or an oil price shock. Any unforeseen jolt to the U.S. economy, such as another terrorist attack, could also alter the outlook for issuance activity.

Treasury Market

Issuance in the Treasury market is expected to increase in 2002, with marketable coupon new issues likely to total $411 billion, up from $380.7 billion in 2001. Member firms anticipate the level of outstanding Treasury bills will be $820 billion at the end of December 2002, a slight increase over the record level of $811.2 billion outstanding at yearend 2001. The size of the federal budget deficit is the main factor driving the projections for Treasury issuance. Most firms expect the budget deficit to widen in 2002 as government spending accelerates and Treasury receipts from taxes are likely to fall. Market participants expect $364 billion of Treasury coupons to mature in 2002 and anticipate a sharp slowdown in buybacks from the $33.5 billion of buybacks in 2001. The net effect will likely be a small increase in the amount of marketable Treasury securities outstanding in 2002.

[1] *Estimates were derived by surveying Association member firms. Twenty-three firms participated in the survey, however all firms did not provide projections for every market. The projections represent the median of the individual member's submissions. Data for 2001 is preliminary and may be subject to revision.*

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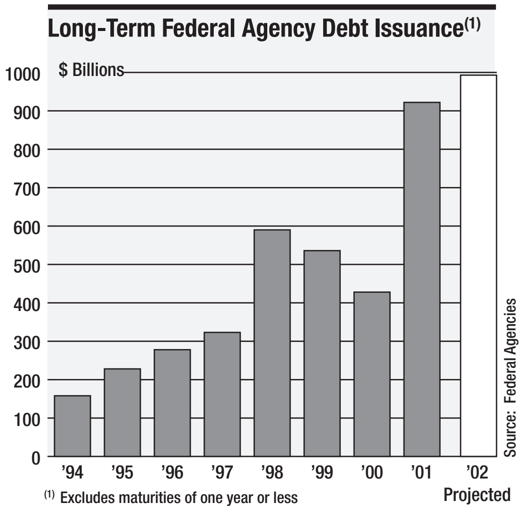
Federal Agency Market



New issues of long-term debt by federal agencies are expected to increase 8 percent to $993 billion in 2002, following record issuance of $921.6 billion in 2001. Most survey participants said they expect the housing agencies to continue growing their retained mortgage portfolios, which is a major driver of debt issuance. Despite one dissenting opinion that housing agency issuance would slow from last year's record level, there was consensus that issuance would remain very strong in 2002. Issuance by non-housing related agencies is expected to remain virtually unchanged from 2001 levels.

Municipal Market

MUNICIPAL ISSUANCE

$ Billions

	2001*	Projected 2002	% Change
Short-Term	56.1	50.0	-11%
Long-Term	286.5	250.0	-13%
Total	**342.6**	**300.0**	**-12%**

* Source: Thomson Financial Securities Data

Long-term municipal new issues are projected to remain strong, totaling $250 billion in 2002, but are likely to slow from the $286.5 billion issued in 2001. Short-term note issuance is also likely to fall in 2002, with expected issuance of $50 billion, down from $56.1 billion last year. Survey respondents cited expectations that interest rates would begin to rise, contributing to a decrease in the volume of refunding issuance. In contrast, new money issuance is likely to increase as a result of continuing infrastructure needs throughout the country, as well as rebuilding needs in New York City. Education was also cited as a sector where new issue volume is likely to grow in 2002. Several long-term issuance programs were delayed in 2001 and are likely to come to market in 2002, which will help buoy issuance volume. In addition, weaker state and local fiscal conditions will make it difficult to finance new investment from cash surpluses, which should also spur new issue activity.

Corporate Bond Market

CORPORATE ISSUANCE

$ Billions

	2001*	Projected 2002	% Change
Investment-Grade	707.7	450.0	-36%
High-Yield	87.6	95.0	8%
Convertible	83.9	92.0	10%
Total	**879.2**	**637.0**	**-28%**

* Source: Thomson Financial Securities Data

Issuance in the investment-grade corporate bond market is expected to drop 36 percent to $450 billion in 2002, following record issuance of $707.7 billion in 2001. Low interest rates attracted issuers to the long-term market in 2001. In addition, credit deterioration led several large issuers to exit the short-term market and switch to long-dated maturities. Market participants do not anticipate that this trend will continue once the economic recovery gets underway. Capital expenditures by corporations are expected to be well below 2001 levels, so financing needs will be lower, thus contributing to the likely decline in new issuance. New issuance in the high-yield market is expected to increase 8 percent to $95 billion in 2002, up from $87.6 billion in 2001. Market participants anticipate the downward trend in credit quality will begin to reverse in 2002, which will increase the attractiveness of the high yield market. Convertible bond issuance is projected to increase to $92 billion in 2002, up from a record $83.9 billion in 2001. New issue activity is likely to remain strong as companies continue to seek the savings that arise from the lower cost of financing provided by convertibles.

Asset-Backed Market

ABS ISSUANCE

$ Billions

	2001*	Projected 2002	% Change
Public	321.8	340.0	6%
Private	97.8	100.0	2%
Total	**419.6**	**440.0**	**5%**

* Source: Thomson Financial Securities Data, Inside MBS & ABS

New ABS volume, including public and private issues, is expected to increase 5 percent to $440 billion in 2002, up from the record $419.6 billion issued in 2001. Issuers have been attracted to the ABS market because the overall cost of funding tends to be lower in the ABS market, especially for lower-rated companies. Growth in the home equity sector is expected to continue, but is likely to slow from the strong pace seen in 2001. Auto-backed issues are expected to increase as a result of ratings downgrades of several large manufacturers, which makes the cost of borrowing in the corporate market comparatively higher than in the ABS market. Credit card issuance is also likely to remain strong, but increasing chargeoffs, delinquencies, and bankruptcies may be a cause of concern for investors in this sector. Collateralized debt obligation (CDO) issuance is also likely to grow in 2002 as collateral credit problems are expected to be alleviated as the economy recovers. Market participants don't anticipate much growth in the student loan sector, where issuance is expected to remain relatively flat. In contrast to the increases expected in most sectors of the ABS market, issuance in the stranded cost and manufactured housing sectors is likely to fall in 2002.

Mortgage-Related Securities

MORTGAGE-RELATED ISSUANCE

$ Billions

	2001*	Projected 2002	% Change
Agency MBS	1,070.0	768.0	-28%
Agency CMO	278.0	225.0	-19%
Private-Label MBS/CMO	217.3	140.0	-36%
Total	**1,565.3**	**1,133.0**	**-28%**

* Source: Thomson Financial Securities Data, Inside MBS & ABS, Federal Agencies

Issuance of mortgage-related securities—agency and private-label mortgage-backed securities (MBS) and collateralized mortgage obligations (CMO)—are projected to decrease 28 percent to $1.1 trillion in 2002, down from a record $1.6 trillion issued in 2001. Most market participants expect interest rates to remain fairly stable early in the year, but anticipate rates will rise in the second half. Market participants anticipate a slowdown in mortgage originations and refinancings, along with decreases in housing starts and new and existing home sales. CMO issuance is expected to slow, but remain strong as collateral production is likely to remain robust. CMBS new issue volume is also expected to decline in 2002 as a result of rising interest rates, less acquisition activity, a slowdown in construction activity, and insurance concerns, particularly for single asset and trophy properties.

Commercial Paper Market

COMMERCIAL PAPER OUTSTANDING

$ Billions

	12/31/01*	Projected 12/31/02	% Change
Financial Co.	1,236.5	1,264.0	2%
Nonfinancial Co.	204.4	284.0	39%
Total	**1,440.9**	**1,548.0**	**7%**

* Source: Federal Reserve System

Commercial paper (CP) outstanding is expected to grow 7 percent to $1.5 trillion in 2002, following a contraction in 2001. The largest increase is expected to occur in the nonfinancial sector where outstanding CP is expected to grow 39 percent. CP outstanding of financial companies is expected to increase slightly to $1.3 trillion in 2002. Asset-backed CP outstanding , which is included in the financial company category, is expected to reach $816 billion in 2002, up from $745.3 billion in 2001. The asset-backed CP market sector is expected to continue growing as a result of both the creation of new programs and the expansion of existing programs. Market participants indicated that an anticipated increase in business activity and a turnaround in the U.S. economy will contribute to growth in the CP market. Some respondents said that they expect further contraction to occur early in 2002 as credit deterioration continues to affect some issuers. Later in the year, as the economic recovery picks up and interest rates begin to move higher, issuers are more likely to move to the short-term markets for financing.