Research
U.S. Market Outlook

SIFMA
Securities Industry and Financial Markets Association

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The Securities Industry and Financial Markets Association is pleased to present the results of its annual 2007 credit market forecast for the municipal, corporate, money market and securitization and structured finance markets. This report provides information on anticipated issuance volumes and interest rate and spread outlooks for 2007. The forecast is based on a survey of the Association's member firms conducted during December of 2006. Specialists at member firms in each of the market sectors provided the forecasts, indicating key assumptions behind their projections.

This year we continue our practice of expanding the depth of forecast information about the specific market sectors. The innovations in this year's survey and report reflect important trends and developments in the marketplace. The specific enhancements include (a) updated CDO product classifications to reflect product structure trends; (b) forecasts of the Credit Default Swap North America High Yield (CDX.NA.HY) Index, and the Credit Default Swap North America Investment Grade (CDX.NA.IG) Index, closely followed in the institutional investor marketplace; and (c) distinctions between jumbo (above the agency conforming loan size limit) private label, or non-agency, mortgage-related securities issuance and conforming loan size private label mortgage-related securities issuance.

Bond Issuance in Credit Markets to Remain Strong in 2007 at $4.4 Trillion, but Moderate from 2006 Level; CDO, Money Market Volumes Expected to Increase

The median forecast projects total long-term bond issuance in the credit market sectors—including municipal, corporate, asset-backed securities (ABS), asset-backed, mortgage-related securities and collateralized debt obligations (CDO)—to remain healthy in 2007 but decline modestly by 4.3 percent to $4.4 trillion compared to $4.6 trillion estimated for 2006. If the net change in projected commercial paper outstanding is included, there would be a forecasted net gain of approximately $78 billion in 2007. The lower forecasted issuance volume results from corporate bond volume moderation from the unsustainably high record level in 2006 as well as the effect of the housing correction in the securitized product sectors. Despite a forecasted lower volume, corporate bond issuance is still expected to be strong in 2007 from a historical perspective. As context, the forecasted corporate supply would be 17 percent higher than the 2005 level. The continued surge in transactions, such as share buybacks, M&As and LBOs, combined with business investment spending growth, will fuel the substantial corporate volume. Panelists commented that corporate issuance in 2007 potentially could be higher if the growth in debt financed M&A and LBO transaction volume exceeds expectations. The

Highlights Median responses to the survey:

- Total 2007 long-term issuance for the covered sectors is expected to decrease 4.3 percent to $4.4 trillion, compared to $4.6 trillion issued in 2006. There is a forecasted volume gain in 2007 over 2006 of approximately $78 billion if the net increase in projected commercial paper outstanding is included.
- Long-term municipal issuance in 2007 will be $350 billion, 9.1 percent lower than the 2006 volume of $385 billion.
- Corporate issuance will be $889 billion in 2007, 14.1 percent less than the $1.04 trillion issued in 2006.
- ABS issuance in 2007 will be $715 billion, down 4.7 percent from the $750 billion issued in 2006.
- CDO issuance will be $369 billion in 2007, 12.1 percent higher than the previous record of $330 billion issued in 2006.
- Mortgage-related issuance will be $2.07 trillion in 2007, down 2.5 percent from the 2006 issuance volume of $2.12 trillion. Agency mortgage-related volume will be $1,146 billion in 2007 compared to $1,190 billion in 2006, and private label issuance will be $975 billion compared to $972 billion in 2006.
- Commercial paper outstanding will be $2.17 trillion at the end of 2007, an increase of 12.5 percent over $1.92 trillion outstanding on November 30, 2006.

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Bond Issuance in Credit Markets to Remain Strong in 2007 but Moderate from 2006 Level; CDO, Money Market Volumes Expected to Increase

housing correction has slowed mortgage related securities volume, though the anticipated issuance level is expected to be only modestly lower than last year. ABS volume is projected to be essentially flat (a decline of less than one percent) resulting from lower home equity volumes. With rising employment and personal income, survey respondents expect growth in other consumer ABS product sectors. Municipal bond issuance is projected to slip modestly due to a lower refunding volume, though new money issuance should be higher in the coming year. CDO issuance continues to grow as new and more efficient structures are developed and spreads relative to more commoditized structured and securitized asset classes attract investors. The level of outstanding commercial paper is also expected to increase based on volume associated with business investment spending and corporate acquisition.

The issuance forecast trends should be viewed within the context of the economic and interest rate environment. Despite the housing correction and auto sector slowdown, the economic expansion has remained in place, though at a more moderate, below-trend pace. Consequently, the economy appears poised for a "soft landing". The Fed has left the target Fed funds rate at 5.25 percent since August and is expected to keep rates at that level until economic data give a clear sign of a change in balance between growth and inflationary risks to the economy. Longer term benchmark yields have come down in concert with the stable Fed funds rate environment since mid-year. As of January 10, the 10-year yield was 4.70 percent, about 50 basis points lower than six month ago. The inverted yield curve is seen as reflecting market confidence in Fed policy and more transparent communication by the Fed, controlled inflation and inflationary expectations, and investor demand for longer dated fixed-income instruments. As distinct from the past, the yield curve inversion appears to be affected more by these factors than expectations of an economic downturn.

Credit market conditions continue to be favorable. Default rates remain at near record lows and credit spreads historically tight, supported by liquid balance sheets, ample cash positions, and an extended period of double digit profit growth. Substantial liquidity, strong investor appetite for credit products and low volatility further characterize the current protracted benign phase of the credit cycle.

As we enter 2007, the consensus view is for a continuation of current market conditions. Economic growth is expected to be maintained at the moderate below trend pace but will pick up later in the year with the completion of the housing correction. The expectation is for the Fed to keep the Fed funds target rate at the current level with the possibility of a rate cut in the first half of the year. Benchmark yields may edge up during the course of the year with the lower value of the dollar a potential risk to the rate outlook. While inflation has been a dominant market concern as inflation metrics have been at or near the level the Fed considers acceptable, the consensus view is that inflation is likely to slow based on economic growth moderation and lower energy prices since midyear. Credit market conditions should remain largely unchanged early in the year. However, spreads may potentially widen later in the year, as the pace of corporate profit growth slows and default rates move closer to, but still below, historical averages. The surge in M&A and LBO deal volumes and shareholder friendly strategies in general add to the event risk exposure, particularly in the high-yield and lower investment-grade sectors. Generally strong corporate balance sheets, good market liquidity and investor demand for credit products are likely to limit any credit market weakening.

THE FOLLOWING FIRMS PARTICIPATED IN THE SURVEY:

ABN AMRO Inc.
ACA Capital
Bank of America Securities LLC
Barclays Capital Inc.
BB&T Capital Markets
Bear, Stearns & Co. Inc.
Citigroup
Countrywide Securities Corporation
Deutsche Bank Securities Inc.
Euclid Financial Group
First Southwest Company
Fitch Ratings
Goldman, Sacks & Co.
JP Morgan Securities Inc.
Lehman Brothers Inc.
Merrill Lynch & Co. Inc.
Morgan Stanley
RBC Capital Markets
Stone & Youngberg LLC
UBS Investment Bank
Wachovia Corporation

MUNICIPAL MARKET

Municipal Issuance Expected to Be Lower on Reduced Refunding; New Money Volume to Increase

The median forecast projects total municipal issuance of $395 billion in 2007, a 7.7 percent decline from $428 billion issued in 2006. Long-term municipal issuance is projected to be $350 billion in 2007, 9.1 percent less than the $385 billion issued in 2006. The survey respondents' forecasts for 2007 long-term issuance ranged from $330 billion to $425 billion. Short-term issuance is expected to be $45 billion, an increase from the $42 billion issued in 2006. Short term issuance forecasts ranged from $33 billion to $50 billion.

Refunding activity is expected to fall from 32 percent of total long-term issuance in 2006 to 25 percent in 2007, which translates into a decline from $124 billion to $88 billion. This lower projected refunding level reflects the expectation of a somewhat higher long-term rate environment and the reduced volume of debt available for refunding. Respondents expect new money issuance to increase in 2007 from 68 percent to 75 percent of total long-term volume, or an increase from $257 billion to $275 billion.

Respondents expect general purpose to be the largest issuing use-of-proceeds sector in the coming year, followed by education and transportation. Education was the top issuing sector in 2006.

Interest Rate Outlook

The consensus view of survey respondents is for the yield curve to steepen, with short-term rates either unchanged or declining and long-term rates moderately rising during the year. The median projection for the ratio of the yield on AAA G.O. municipal securities to the 10-year Treasury benchmark is 83.5 percent at the end of June and 82 percent at the end of 2007. At year-end 2006, the ratio stood at about 81 percent. The implication is that tax-exempt yields will rise during the first half of the year relative to taxable yields, before easing back to close to current relative levels by year-end.

Risks in the Forecast

Survey respondents identified several risks to their 2006 issuance forecast. An extended housing market correction, higher than expected inflation, and a geo-political event were cited as the dominant risks to the issuance forecast. The value of the dollar, energy prices and the performance of taxable securities were also mentioned as risks to the forecast. Panelists also noted that changes in federal tax policy could affect the market and volume outlook.

MUNICIPAL ISSUANCE

$ Billions

	2006	2007	% Change
Short-Term	43	45	4.7
Long-Term	385	350	-9.1
Total	428	395	-7.7
Refunding as % of Total	33%	25%	-24.2%
Largest Issuing Sector	Education	General Purpose	

Source: Thomson Financial for 2006 numbers

10-YR MUNICIPAL G.O. AAA TO 10-YR TREASURY RATION

	2006	Projected June 30, 2007	Projected December 31, 2007
Ratio	81	84	82

Source: Bloomberg

CORPORATE BOND MARKET

Corporate Bond Issuance to Remain Near Historically High Level, but Moderate Following Record 2006; Some Spread Widening Possible Later in the Year as Strong Credit Metrics, Investor Risk Tolerance Seen as Slowly Receding

The Corporate Credit Market Environment

Corporate credit remained well entrenched in its sweet spot at the close of 2006. The benign market conditions continued throughout the year with both investment-grade and high-yield credit spreads at historically tight levels and returns well in excess of Treasuries. The credit metrics were supported by double digit profit growth leading to strong corporate cash positions, relatively low debt burden and near record low default rates. Meanwhile, widespread liquidity, low volatility and heightened risk tolerance fueled investor demand for credit products. Within this environment, higher levels of issuance supply were easily digested by investors. The substantial growth in corporate supply this past year was driven by the M&A and leveraged buy out surge, along with business capital investment spending and restructuring of existing debt.

As we enter into 2007, these trends are generally still in place but with expectations that the supportive market conditions are likely to wane later in the year. Panelists see the current macroeconomic environment to continue into 2007 with the Fed keeping rates at about the same level and the 10-year edging up modestly, perhaps approaching 5 percent. Default rates are expected to move up, but stay below historical averages, with survey respondents projecting default rates in the 2 to 3 percent range. The panelists expect increased balance sheet leverage as a result of continued LBO growth and share buybacks which may be increasingly debt financed. The financing gap (internal cash flow relative to capital expenditures) as traditionally measured is to remain within historical norms. The gap, or demand for external financing, rises if we include share buybacks in the calculation.

Increased leverage, and more specifically LBO risk, is a source of heightened credit exposure over time, but panelists see the current phase of the credit cycle still intact. Other market risks noted were higher than expected inflation affecting Fed policy, a spillover of the housing correction to the broader economy and a pick up in volatility.

Issuance Projections

The median projection has corporate bond issuance, including investment grade and high yield, at $889 billion compared to $1.04 trillion in 2006. As context, 2006 issuance surged by nearly 50 percent over the 2005 volume of $703 billion. The projected 2007 volume would be the second highest level, topped only by 2006. The expectation of lower refinancing activity is a factor in the moderating projected supply volume. Issuance could exceed forecasts depending on LBO and M&A deal volumes, which respondents noted are difficult to forecast. LBO transaction volume in particular exceeded expectations in 2006 and pushed up 2006 corporate bond volumes.

The median forecast for investment grade volume is $750 billion compared to $886 billion in 2006, with forecasts ranging from $680 billion to $970 billion. The financial sector is expected to once again account for the majority of issuance. The median high yield issuance forecast is $139 billion compared to $149 billion in 2006, with forecast ranging from $125 to $150 billion. The continued growth is driven by a combination of shareholder-friendly strategies and issuers coming to market to take advantage of current favorable borrowing conditions.

Credit Spread Projection

The median forecast has credit spreads remaining close to current levels or even tightening further in the first half of the year and widening to some degree later in the year. The credit

CORPORATE ISSUANCE

$ Billions

	2006	2007	% Change
Investment-Grade	886	750	-15.3
High-Yield	149	139	-6.7
Total	1,035	889	-14.1

Source: Thomson Financial for 2006 numbers

CORPORATE SPREADS

	Dec. 06	Jun. 07	Dec. 07
AA Financial	78	73	75
BBB Industrial	127	125	131
CDX.NA.IG	34	30	41
CDX.NA.HY	268	275	310

spread projections are driven by a combination of risk appetite, low volatility and solid credit fundamentals, as well as an assumption that swap spreads remain low. The projections suggest widening spreads across credit quality sectors due to heightened event risk and the effect of lower positive profit and economic growth levels. Panelists expect some of the risks noted earlier to begin to become more evident later in the year, including the effect of moderating growth, some pick up in default rates, and LBO and event risk, perhaps spawning increase in volatility. The projected widening in expected to be contained by investor demand and continued solid credit fundamentals.

The AA financial spread was at 78 basis points at the end of December, 2006. The median projection has the spread at 73 basis points on June 30 and 75 basis points at year-end. The BBB industrial spread was at 127 basis points, and respondents see spreads tightening to 125 basis points at mid-year, widening to 131 basis points at year-end.

The CDX.NA.IG credit default swap investment grade index is at 34 basis points and expected to be 35 basis points at June 30 and 41 basis points at the end of 2007. The CDX.NA.HY credit default swap index is at 103 basis points, expected to rise modestely to 275 basis points by June 30 and widening to 310 basis points at the end of 2007. The panelists generally expect the negative basis (CDS spreads tighter than cash spreads) to continue at least through the first half of the year but with the cash-to-derivative differential seen as narrowing. The credit derivative trends are sensitive to synthetic CDO issuance growth and the relative attractiveness of other credit derivative product sectors (such as loan CDS and ABS CDS) as well as credit fundamentals.

MONEY MARKET

Commercial Paper Outstanding Expected to Rise in 2007

Building on rising outstanding volumes over the last few years including 2006 , survey respondents project commercial paper (CP) outstanding levels to once again grow in 2007 based on expectations of continued though moderating GDP growth, rising business investment spending, and M&A activity remaining at a high level. Although not unanimous, the consensus view is that the Federal Reserve will cut the target Fed funds rate in 2007, which should keep short-term rates at historically low levels and provide for a favorable funding cost environment for issuers in the short term money market sectors.

According to the median survey response, total CP outstanding is projected to be $2.17 trillion at the end of 2007, 12.5 percent higher than the $1.92 trillion as of the end of November 2006. Asset-backed CP (ABCP) is forecast to increase by 12.9 per cent to $1.17 trillion by the end of 2007 over the $1.03 trillion as of November 2006. According to an S&P study, product development and innovative structures are leading to reduced required liquidity support and increased program limits, contributing to the expansion. Unsecured, that is, non-asset backed, financial CP outstanding is expected to reach $815 billion in the upcoming year, a rise of 10.6 percent compared to $737 billion as of November 2006. The median forecast expects non-financial CP to total $185 billion, 20.1 percent over the $154 billion outstanding at the end of November 2006. Outstanding CP for A2/P2, or lower investment grade, CP is forecast to total $80 billion, according to the median estimate, up from $70 billion level at November of 2006. Total Euro CP outstanding is expected to reach $750 billion and extendible notes to $168 billion by the end of 2007. Certificates of deposits outstanding are projected to rise to $780 billion at the end of 2007.

MONEY MARKET 2007

$ Billions

	2006*	2007	% Change
ABCP	1,032	1,165	12.9
Non-ABCP	737	815	10.6
Nonfinancial CP	154	185	20.1
Total	1,924	2,165	12.5

**According to the Federal Reserve as of November 30, 2006*

Forecast Assumptions

The panelists' money market forecasts for 2007 are based on a number of key assumptions including GDP growth, the Fed funds rate, the shape of the yield curve, tax and accounting policy and M&A volume. The consensus view is that we should continue to have a favorable operating environment in 2007.

The median survey response has GDP growth at 2.5 percent in the first half, slowing to 2.0 percent over the next three quarters of 2007. While there were diverse views, the consensus is for the FOMC to maintain the target Fed funds rate at 5.25 percent in the first quarter, reducing the Fed funds rate by 25 basis points later in 2007. The yield curve is expected to maintain the current inverted to flat shape during 2007. These assumptions suggest a relatively low cost funding environment for the money markets during the coming year.

Panelists generally had a positive view with respect to the other key operating assumptions in 2007. Most believe that tax and accounting policy in the coming year would be more favorable for issuance in the short-term money markets. In addition, the consensus view is that M&A volumes will equal or surpass 2006 levels.

ASSET-BACKED SECURITIES MARKET

ABS Volume to Dip Slightly in 2007 on Lower Home Equity Volume; Credit Card, Auto Receivable and Student Loan Issuance to Increase

The median survey response projects asset-backed issuance (ABS), which excludes collateralized debt obligations and private label residential mortgages, to be $715 billion in 2007, a modest decline from $750 billion in 2006. Home equity loan (HEL) issuance, the largest ABS sector, is expected to decline for the first time in six years, the result of the decelerating housing price trends and reduced home sale volumes. The consensus view, however, is for other consumer-related sectors, including credit card receivables and auto loans, to pick up, in part the result of consumers accessing other loan products as mortgage equity withdrawals are expected to slow in the coming year. In addition, consumer ABS has been increasingly used as a source for funding corporate acquisitions.

The HEL sector, despite the projected decrease, is expected to account for nearly 63 percent of projected 2007 ABS issuance volume. The median forecast has HEL issuance at $448 billion in 2007, 6.7 percent less than the $480 billion in 2006. Survey participants noted downside risks to their HEL forecast, including housing price weakness extending for a longer period or a substantial HEL rate rise.

The median forecast has auto loan ABS at $85 billion, up 4.9 percent from the $81 billion in 2006. Despite an anticipated soft auto sales market for 2007, issuance will benefit from banks and finance companies, including credit facilities affiliated with auto makers, securitizing loans in the capital markets. The third largest ABS volume sector is projected to be credit card receivables at $73 billion, compared to $67 billion, a beneficiary of lower mortgage equity withdrawal trends. The panelists also based their higher issuance projections on historically low unemployment rates and anticipated reduced volume of bankruptcy fillings. Student loan ABS volume is expected to grow by 6.1 percent in 2007 to $70 billion. The extension of the Higher Education Act passed in 2006, and the rising cost of education are important drivers of the anticipated volume growth.

ABS ISSUANCE[1]

$ Billions

	2006	2007	% Change
Home Equity	480	448	-6.7
Credit Cards	67	73	9.0
Auto Loans	81	85	4.9
Student Loans	66	70	6.1
Other	56	39	-30.4
Total	750	714	-4.7

[1] Excludes CDOs and Mortgages
Source: Thomson Financial for 2006 numbers

High Investment Grade Credit Spread Outlook

The panelists suggested a favorable view of ABS credit quality outlook based on their forecasts of high investment grade ABS spread trends. (Especially in the home equity sector, the possibility exists for greater spread differentiation by credit rating category.) The view takes into account the economic and rate environment for the coming year. The SIFMA economic outlook has GDP growth picking up in the second half from a below trend level in the early part of the year, and a Federal Reserve rate cut during the second quarter. Home equity loan (HEL) AAA spreads moved up to 72 basis points late in 2006, reflecting concerns over the housing correction and the effect of rate adjustments on floating HEL products. With the consensus view that the housing correction should be completed this year, the median spread projection has AAA HEL spreads tightening to 50 basis points by mid-year and staying there through the second half of 2007. AAA credit card spreads to Treasuries are projected to stay at 34 basis points through mid-year and tighten to 29 basis point by year-end. AAA auto loan spreads to Treasuries are seen tightening to 35 basis points in June of 2007 and ending the year at about 29 basis points.

CDO MARKET

CDO Issuance Expected to Have Record Year in 2007 Led by CLOs, High Grade Structured Finance

Over the past several years, the collateralized debt obligation (CDO) market has arguably been the most dynamic credit market sector in terms of volume growth, product development and collateral diversification. There has been significant growth especially in synthetic issuance but also funded leveraged loan and structured finance (SF) products, including residential and commercial real estate.

The U.S. CDO market is expected to continue its growth trajectory into 2007. The forecasted growth in 2007 will remain broad based with growth supported by institutional investor demand, including new investors and hedge funds. While CDO spreads have tightened over the last few years, sector returns are perceived to be attractive compared to the more commoditized structured and securitized finance sectors, generating high levels of institutional investor demand. Tighter CDO debt spreads have had the effect of reducing funding costs and thus raising the demand for CDO equity. The spread and return outlook will be affected by the performance of collateral asset classes supporting CDO products as the credit cycle matures and economic growth moderates.

The median forecast for funded CDO issuance in 2007 is $369 billion, 12.1 percent above the previous record volume of $330 billion in 2006. High yield loan, including middle market loan-backed CDOs, or collateralized loan obligations (CLOs) are expected to be the leading product sector, at $109 billion or 14.7 percent higher than the $95 billion issued in 2006. CLO volumes have benefited from loan market trends of historically strong corporate cash flow. Anticipated business investment growth and loan-financed merger and acquisition and leveraged buy out (LBO) volumes continue to drive loan market supply. Building on residential mortgage and home equity loan growth in recent years, the high grade structured finance (SF) CDO sector is projected to be the second largest product area with $108 billion in 2007, slightly higher than the $106 billion issued in 2006. Combined, CLOs and high grade SF CDOs are expected to account for 59 percent of U.S. funded CDO issuance in 2007, similar to their combined 2006 share. The median issuance forecast for mezzanine SF CDOs is $80 billion, or 12.0 percent higher than the $72 billion issued in 2006, indicative of continued strong demand as investors search for higher returns. Survey participants indicated that the risk to the mezzanine CDO growth projection is that the housing market downturn exceeds expectations. Continued

FUNDED CDO ISSUANCE

$ Billions	2006	2007
High Yield Loans	95	109
High Grade Structured Finance	106	108
Mezzanine Structured Finance	72	80
Commercial Real Estate (CRE)	28	32
Trust Prefferred (TRUPS)	12	14
Other	19	25
Total	330	369

by Motivation	2006	2007
Arbitrage CDO Issuance by Motivation	305	341
Balance Sheet CDO Issuance	25	28
Total	330	369

growth in commercial real estate securitization will boost commercial real estate CDO issuance which is projected to grow by 6.0 percent in 2007 to $32 billion. In percentage terms, the median forecast calls for trust preferred CDOs to outpace all other products in 2007 by increasing 16.7 percent to $14 billion, up from the $12 billion issued in 2006.

With respect to CDO structure type, funded arbitrage CDO volume is projected to account for 92.4 percent of funded issuance in 2007, increasing by 11.6 percent to $341 billion. The median forecast has balance sheet CDO issuance at $28 billion in 2007, up 15.3 percent from the $25 billion issued in 2006.

Compared to the funded CDO product sector, common issuance metrics and definitions are still evolving for purely synthetic transactions, as the synthetic market has grown dramatically in a short period of time. Nevertheless, it is clear that synthetic transactions are the high growth part of the market. "Bespoke" (customized structures to meet specific customer requirements) synthetic issuance, including both corporate credit and ABS transactions, is projected to grow by about 30 percent in 2007, well above the cash CDO projection.

MORTGAGE-RELATED MARKET

Mortgage-Related 2007 Issuance Only Slightly Below 2006 Level, Despite Projected Modest Rate Rise, Housing Correction

Despite the current housing sector slowdown, the median survey forecast has mortgage-related securities, including agency and non-agency pass-through and collateralized mortgage obligations (CMO), decreasing by only 2.5 percent in 2007 to $2.07 trillion from the $2.12 trillion in 2006. Agency mortgage-backed securities issuance is expected to be $805 billion, down 7.9 percent from the $874 billion in 2006. Survey panelists project issuance of agency CMOs to increase 4.6 percent to $285 billion from the $273 billion in 2006. Non-agency jumbo MBS is seen as being only slightly below last year's level at $405 billion, compared to the $408 billion in 2006, while non-agency, non-jumbo MBS is projected to rise slightly, to $570 billion. Should the 2006 trend hold, which is quite likely, non-agency issuance will be stronger in the prime than subprime products.

The panelists' rate outlook has a great influence on the issuance projections. According to the respondents, the 30-year fixed-rate mortgage interest rate will gradually increase from around 6.2 percent at the end of the first quarter to 6.5 percent at the end of the year. As of December 15, the 30-year rate was 6.12 percent. Most participants expect that during 2007, the yield curve will transition from its current inverted shape and flatten out. Consistent with the moderately rising rate scenario, the consensus view is that the AAA MBS option-adjusted spreads to Treasuries will remain unchanged in the first half of the year, but widen slightly by the end of 2007, which reflects some extension risk.

MORTGAGE-RELATED ISSUANCE

$ Billions

	2006	2007	% Change
Agency Pass-throughs	874	805	-7.9
Agency CMO	273	285	4.4
Non-Agency Jumbo MBS	408	405	-0.7
Non-Agency Non-Jumbo MBS	565	570	0.9
Total	2,120	2,065	-2.6