Market Comment *Economic Highlights for the week ended April 22, 2011*

Economic Week In Review: A Key Gauge Grows Even As Housing Struggles

Vanguard 4/21- Although **a credit-rating agency's warning about the outlook for the U.S. government's debt burden dominated headlines this week**, reports on the economy were more optimistic. The housing market, though weak, showed some improvement, and leading economic indicators showed an economic recovery that remains on track. For the week ended April 21, the S&P 500 Index rose 1.3% to 1,337 (for a year-to-date total return of about 6.9%). The yield of the 10-year U.S. Treasury note fell 3 basis points to 3.40% (for a year-to-date increase of 10 basis points).

NAHB Housing Market Index: April -Homebuilder Sentiment Edges Lower On Weaker Outlook

Barclays 4/18 - The NAHB index held steady at 16 for four consecutive months before edging higher to 17 in March, but a drop in future sentiment dragged the index lower to 16 this month. Looking at the underlying detail, the index of present single family sales fell from 17 to 16, the index of future single family sales tumbled from 26 to 23, and the prospective buyer's traffic index rose from 12 to 13. Home builder sentiment remains broadly steady at the low levels observed since the middle of 2009; we only expect sentiment to improve modestly this year, as housing demand improves gradually and inventories of new single family homes subside.

Econoday 4/18 - In another step backward for the housing and construction outlook, home builders report a sharp decline this month in sales six months out together with a small decline in current sales. April's weakness is centered in the largest region, the South, where sales are being hurt by an overhang of repossessed homes.

S&P Revises US Rating Outlook To Negative - First Impressions

Barclays 4/18 - What are the details of the S&P announcement on US sovereign ratings?

A couple of hours ago, **S&P put its long-term rating on US sovereign debt on negative outlook**. This means that it believes there is at least a 33% chance that it will lower the AAA long-term rating of the US within two years. Its base case remains that US policymakers will agree on a deficit reduction plan with savings of $4-5trn over the next 10-12 years. But importantly, S&P emphasizes that meaningful steps to implement this must start by 2013. *We believe this is an aggressive timetable,* since it means that policymakers will have to agree on a long-term deficit reduction plan *before* the 2012 elections. This will be tough, given the political landscape and the structural nature of the budgetary problems.

Why now?

S&P noted that the US fiscal profile has deteriorated steadily during the past decade and worsened further due to the financial crisis. According to S&P, the ratio of net general government debt/GDP would rise to 84% in the base case by 2013 (and 90% in a pessimistic scenario). Beyond the medium term, it views growth in entitlement programs to be the main source of fiscal pressure.

The catalyst for the negative outlook was the "increased risk" that there would be no resolution to "the medium and long-term fiscal challenges" facing the US until after the 2012 elections (for details, please see S&P's research update on the US credit rating from April 18, 2011). In other words, *once the two political parties put their deficit reduction plans on the table, it became obvious how far apart they were*, and how difficult the road to political convergence would be. S&P noted that despite more than two years having passed since the financial crisis, there has been no agreement on steps to reverse the fiscal deterioration. It highlighted the examples of other countries such as UK, France and Germany, which have begun implementing plans to address their fiscal problems.

Was this announcement a surprise?

The announcement was seemingly a surprise to the bond market: 30y yields reversed their early morning rally, and the yield curve steepened immediately after the announcement. It was a surprise to us, as well. While we have always emphasized the unsustainable nature of the US deficit and have outlined the likely factors that would drive a lowering of the US AAA rating, *we had believed that the rating agencies would wait till after the 2012 elections* before taking any action. The lack of agreement on fiscal issues in Washington, D.C., creates risks for the credit profile of the US. The rating agencies appear to be emphasizing the same point.

What are the implications of this statement?

This announcement was not about the debt ceiling; in fact, the debt ceiling is not even mentioned in the S&P release. In sharp contrast, the reason why US government ratings came under pressure in 1995-96 (Moody's put parts of US government debt on negative watch) was the debt ceiling impasse at that point. This means that even if the debt ceiling debate were to be resolved in the near term, it would not be enough to restore the outlook to stable.

On the other hand, the longer that debt ceiling negotiations drag on, the bigger the seeming rift between the two political parties and the greater the likelihood of a downgrade down the road. In turn, this would mean a steeper Treasury yield curve, higher yields on the long bond, narrower longer-term swap spreads, and a flatter swap spread curve.

The key to a stable outlook is that there be a concrete plan for deficit reduction that needs not only to be agreed upon, but also put in place by 2013. As noted earlier, this will be very challenging.

Housing Starts: March - US Housing Starts Improve In March; Rise 5.4% In Q1 11 Versus Q4 10

Barclays 4/19 –US housing starts rose 7.2% m/m in March to 549k units. Both single family and multi-family starts were up in March, with single family starts up 7.7% m/m to 422k from 392k and multi-family starts up 5.8% m/m to 127k from 120k. Overall, this report suggests that the housing market improved modestly in Q1 11, as the average level of starts in the quarter (563k) was 5.4% ahead of that seen in Q4 10 (534k), and provides further confirmation that the housing sector bottomed late last year. However, the level of starts remains at historically low levels and we foresee a gradual recovery in activity only as an improvement in labor market activity slowly restores demand for housing.

Econoday 4/19 - The March annualized pace of 549,000 units is down 13.4% on a year-ago basis. Housing permits gained 11.2% in March after decreasing 5.2% the prior month.

By region, the rebound in starts was led by a 32.3% jump in the Midwest. Also improving were the West, up 27.6%, and the Northeast, up 5.4%. The South slipped 3.3%.

Today's report is modest good news for a sector where expectations have been running low. Activity is still at a depressed level but now there is hope that housing is not back on a downtrend. Despite the favorable numbers, it is good that they were not much better. Supply is still high and too much of a boost in starts would simply mean pullback later until demand is more robust.

FOMC Members Fisher And Lockhart Highlight Risks From Higher Energy Prices

Barclays 4/18- Speaking at a conference on "Monetary Policy in a Globalized World" at the World Affairs Council of Atlanta, Dallas Fed President Fisher and Atlanta Fed President Lockhart highlighted risks to the economic outlook from higher energy prices, although they struck slightly different tones. Fisher described higher oil prices as a "double whammy" of slowing growth but also "adding to inflationary pressures". He went on to say that "many businesses are now trying to cope with price pressures." Meanwhile, Lockhart stressed the risks to growth, describing oil prices above $150 per barrel as "recessionary territory." On the near-term growth outlook, he added, "It appears the first quarter will come in soft," and attributed this in part to "the rising cost of gasoline and the effect that has on consumers."

Existing Home Sales: March - US Existing Home Sales Rebound In March

Vanguard 4/21 - Sales of existing homes increased 3.7% in March after declining 8.9% in February. Sales rose to an annualized rate of 5.1 million units, largely propped up by sales of single-family homes (+4.0%). All regions in the United States showed improvement, with existing-home sales in the South (+8.2%) and Northeast (+3.9%) seeing the most gains. Yet existing-home sales remain 6.3% below year-ago levels.

Econoday 4/20 - March was a "decent" month for existing home sales according to the National Association of Realtors. Prices firmed slightly, up 2.2% for the median reading to $159,600. Yet year-on-year,

price contraction of 5.9% is deeper than 5.2% in the prior month. Slightly more homes were on the market, 3.549 million, but the solid rise in sales brought down the supply reading slightly to a still very heavy 8.4 months.

The report warns that credit standards are still too tight, reflected in a record all-cash sales rate of 35% in the month. Distressed sales made up 40% of all sales for the highest rate in nearly two years.

Unemployment Insurance Weekly Claims Report – Week Ended April 16

Press Release 4/21 (excerpt) - In the week ending April 16, the advance figure for seasonally adjusted **initial claims** was 403,000, a decrease of 13,000 from the previous week's revised figure of 416,000. The 4-week moving average was 399,000, an increase of 2,250 from the previous week's revised average of 396,750.

The advance seasonally adjusted **insured unemployment rate** was 2.9% for the week ending April 9, unchanged from the prior week's unrevised rate of 2.9%.

The advance number for seasonally adjusted **insured unemployment** during the week ending April 9 was 3,695,000, a decrease of 7,000 from the preceding week's revised level of 3,702,000. The 4-week moving average was 3,716,750, a decrease of 17,500 from the preceding week's revised average of 3,734,250.

WEEK ENDING	April 16	April 9	Change	April 2	Prior Year
Initial Claims (Seasonally Adj)	403,000	416,000	-13,000	385,000	469,000
4-Wk Moving Average (SA)	399,000	396,750	2,250	390,250	467,500

Barclays 4/21 - The surge in initial claims for the week ending April 9 was likely related to volatility in filings received at the end of the calendar quarter, as claimants wait for a new quarter to file since benefits are calculated based on the previous four quarters of earnings. The drop in claims this week would be consistent with the passing of this quarter-end effect. We continue to see the longer-term trends in initial and continuing claims as signaling ongoing moderate improvement in labor market conditions.

Philadelphia Fed: April - US: Philadelphia Fed Manufacturing Index Drops In April

Econoday 4/21 - A slowing in month-to-month growth for new orders is a disappointment in this month's regional manufacturing report from the Philly Fed. Shipments and hiring also slowed but to a less degree. The general assessment of business conditions, which is the report's main headline, shows the most monthly slowing moving to 18.5 in April from March's 43.4. Prices remain elevated with output prices continuing to gain traction.

Both delivery times and inventory accumulation slowed in what could be early effects from Japanese-based shortages. A big negative in the report, and another hint of a Japanese effect, was a sudden and sharp weakening in the six-month outlook including a dramatic scaling back in order expectations.

Barclays 4/21 - The April headline print of 18.5 is consistent with a healthy pace of improvement in the Philadelphia-area manufacturing sector, and more in line with national trends.

Leading Indicators: March - US Leading Indicators Up 0.4% In March

Barclays 4/21 - The index of leading indicators rose 0.4% in March. The gain was driven by the wide interest rate spread, a jump in building permits, and an increase in supplier delivery times. Improvement in the average workweek and jobless claims also bolstered the index. A drop in consumer expectations provided some offset, along with declines in the stock market and the estimated real money supply. On a trend basis, the leading index continues to indicate expansion, with an annualized three-month gain of 6.6% in March.

Vanguard 4/21 – The index of leading economic indicators rose 0.4% in March, about 5% higher than a year earlier. Gains were broad-based, with six of the ten survey components increasing. The biggest drag came from consumer expectations, which were lower partly because of rising food and energy prices.

The leading indicators index has risen for nine consecutive months, signaling "sustained economic growth through year-end," said Ken Goldstein, economist at The Conference Board.

FHFA Housing Price Index: February - FHFA Home Price Index Moves Sharply Lower

Barclays 4/21 - The Federal Housing Finance Agency Purchase-Only House Price Index declined 1.6% in February, following a downwardly revised -1.0% change in January. The y/y decline in the index now stands at -

5.8%. We think house prices will continue to face headwinds as the large inventory of foreclosed properties makes its way through the market, but some of this should be offset as demand for homes increases due to the improving economic backdrop.

The Economic Week Ahead: April 25 – April 29, 2011

Vanguard 4/21 – Next week's lineup is a busy one, with the highlight on Thursday when the first-quarter gross domestic product figures are released. The remaining reports are scheduled as follows: new-home sales (Monday); consumer confidence (Tuesday); durable goods and the Federal Open Market Committee's report on monetary policy (Wednesday); and employment costs and personal income and spending (Friday).

This Week's U.S. Economic Calendar ***Source: Briefing.com***

Date	ET	Release	For	Briefing.com	Consensus	Prior
Apr 25	10:00	New Home Sales	March	265K	280K	250K
Apr 26	09:00	Case-Shiller 20-city Index	February	-3.2%	-3.2%	-3.06%
Apr 26	10:00	**Consumer Confidence**	April	65.0	64.4	63.4
Apr 27	07:00	MBA Mortgage Index	04/22	NA	NA	NA
Apr 27	08:30	Durable Orders	March	3.0%	1.9%	-0.6%
Apr 27	08:30	Durable Orders -ex Transportation	March	3.5%	1.6%	-0.3%
Apr 27	10:30	Crude Inventories	04/23	NA	NA	NA
Apr 27	14:15	FOMC Rate Decision	April	0.25%	0.25%	0.25%
Apr 28	08:30	**Gross Domestic Produce-Adv. Estimate**	**Q1**	0.1%	1.7%	3.1%
Apr 28	08:30	GDP Deflator	Q1	2.0%	2.3%	0.4%
Apr 28	08:30	Initial Claims	04/23	390K	390K	NA
Apr 28	08:30	Continuing Claims	04/16	3700K	3700K	NA
Apr 28	10:00	Pending Home Sales	March	0.0%	1.5%	2.1%
Apr 29	08:30	Personal Income	March	0.4%	0.4%	0.3%
Apr 29	08:30	Personal Spending	March	0.6%	0.5%	0.7%
Apr 29	08:30	PCE Prices - Core	March	0.1%	0.1%	0.2%
Apr 29	08:30	Employment Cost Index	Q1	0.5%	0.5%	0.4%
Apr 29	09:45	Chicago PMI	April	62.0	67.1	70.6
Apr 29	09:55	Michigan Sentiment - Final	April	70.0	69.6	69.6

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes $million	New Bonds $millions	Issue Count	Called Bonds Par $millions	Issue Count
25-Mar	$ 4,165	$ 1,311	19	$ 823	7
1-Apr	3,950	441	11	247	5
8-Apr	7,235	1,745	13	10	1
15-Apr	6,970	2,288	11	200	2
22-Apr	3,440	1,353	17	812	5