



MONTHLY MARKET MONITOR

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INTRODUCTION

The deep freeze that has engulfed the majority of the United States is emblematic of the economic and credit conditions in the country. Consumption, trade, manufacturing and employment are contracting, with little evidence emerging for a near-term shift. Deflation is also infecting a wide swath of industries, with core inflation measures contracting at a three-month pace (-0.3 percent annualized) not experienced since the 1960s. The troubles in the credit markets moderated toward the end of the fourth quarter, but liquidity in non-Agency securities remains challenged, and mortgage lending and loan performance continue to be subpar.

The consumer shopping spree has not only come to a halt in the U.S., but is also waning in other countries. U.S. retailers reported dismal holiday sales, with December retail sales posting a numbing 10 percent drop, the largest monthly contraction in 40 years. The lack of global consumption also led to a sharp reversal in export growth moving from an expansion of roughly 40 percent in June 2008, to a contraction in November of approximately equal magnitude. The result was an overall contraction in U.S. GDP in the fourth quarter of 2008—a sharp reaction to the downward shift in global demand.

The impetus for this deteriorating economic trend — the U.S. housing market continues to ail. Unfortunately, the infection spread and labor conditions and credit availability are emerging as the critical elements to

an economic recovery. As this report will show, persistent and rising unemployment affect all sectors of the economy and prevent even the most aggressive monetary easing from curing the ills of the credit markets. As household and corporate balance sheets weaken, the willingness of entities to extend credit lessens. Those fortunate to earn income and post profits are more likely to save or hoard cash - a behavior hardly exhibited by American households. A sudden spurt in the savings rate can only prolong the economic freeze as less consumption (absent government spending) means fewer jobs and potentially further contraction in overall output.

The financial markets remain in turmoil as the participants seem to change from month-to-month. Fear of potential breakups or troubled conditions deter investors and function as barriers to new entries in the industry. Credit spreads have tightened, led by the Agency debt and the mortgage-backed securities market. The narrowing spreads were largely a result of the Federal Reserve's program to purchase up to \$500 billion in Agency securities. Since the Fed's announcement in December, mortgage rates have fallen more than 100 basis points (bps) and the current coupon mortgage-backed securities yield is down nearly 150 bps. But all is not well as illiquidity plagues non-Agency securities and the number of market participants is shrinking.

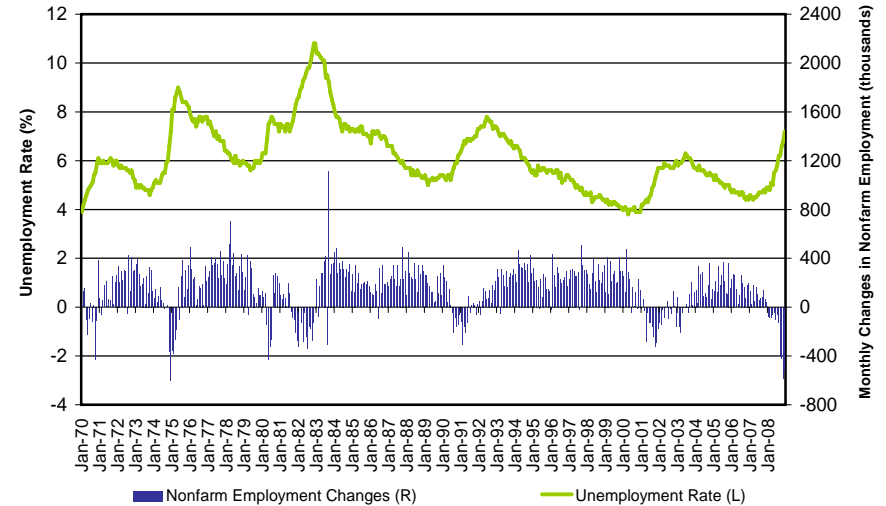
We have expanded our analysis of the housing market and mortgage loan performance. In this document, we provide analysis of peak- to-trough price changes and geographic dispersion, and review price behavior among property types. Finally, we present a review of loan performance by borrower type, loan product, and vintage. This analysis will be ongoing in future Monthly Market Monitors as the trends suggest the deterioration in delinquency and default rates will persist.

JOB MARKETS AND CONSUMER SPENDING

Nonfarm payroll employment fell and the unemployment rate rose dramatically in November and December. As shown in Chart 1, total nonfarm employment in the United States fell by 524,000 jobs in December 2008, after falling by 584,000 jobs in November. These monthly job losses are the highest on record since December 1974. Total nonfarm job cuts now stand at 2.6 million since the recession began in December 2007, with most of the job losses occurring in the last four months. Meanwhile, the national unemployment rate rose to 7.2 percent, the highest level in 16 years, and is 2.3 percentage points greater than one year ago. Based on announcements of planned layoffs by a significant number of large companies in the United States recently, substantially more jobs are expected to be eliminated in the first several months of 2009.

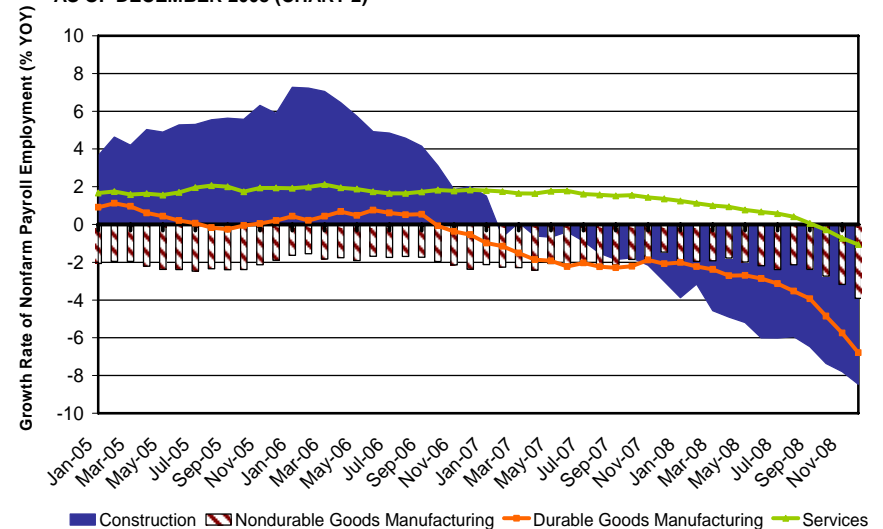
Payroll job losses were widespread across the vast majority of economic sectors and industries, underscoring the costly toll the deepening recession is taking on both workers and employers. Chart 2 shows that nonfarm payroll employment experienced significant declines across all major economic sectors in November and December, with the construction sector experiencing the most job losses in 2008. While the durable goods manufacturing sector has persistently shed jobs the past several years, the steep decline in payroll jobs for the nondurable goods manufacturing sector in the fourth quarter of 2008 is striking. Although the service-producing sector is usually a reliable source of stable job

NONFARM EMPLOYMENT AND UNEMPLOYMENT RATE AS OF DECEMBER 2008 (CHART 1)



SOURCE: BUREAU OF LABOR STATISTICS

NONFARM EMPLOYMENT GROWTH BY ECONOMIC SECTOR AS OF DECEMBER 2008 (CHART 2)



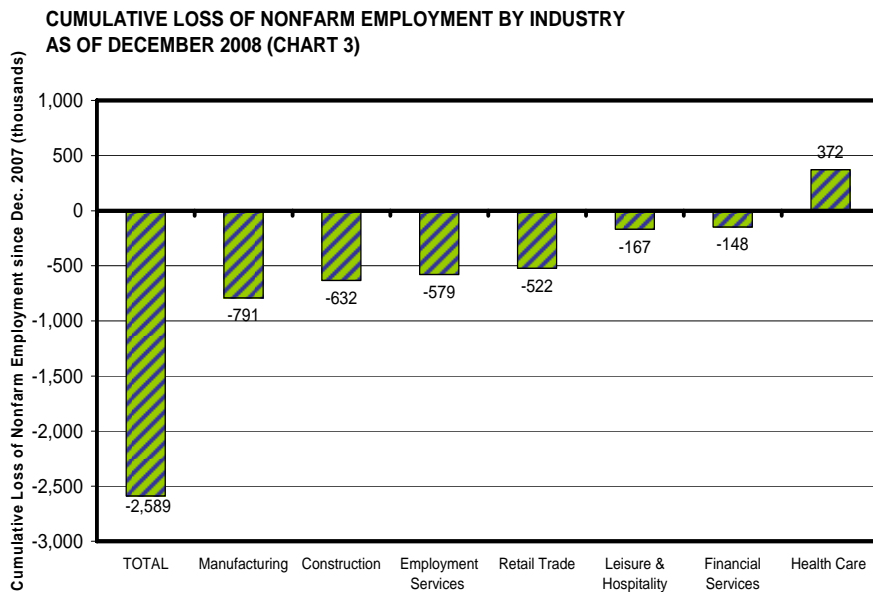
SOURCE: BUREAU OF LABOR STATISTICS

growth compared to other sectors, the industry experienced a sharp decline in nonfarm employment in the last three months of 2008.

Cumulative nonfarm payroll job losses since the recession began in December 2007 are shown in Chart 3. The hardest-hit industries are manufacturing, construction, employment services, retail trade, leisure and hospitality, and financial services. Between December 2007 and December 2008, manufacturers cut a net total of 791,000 jobs, construction companies eliminated 632,000 jobs, and the services industry cut 579,000 jobs. In addition, the leisure and hospitality industry cut 167,000 jobs, and banks and other financial institutions laid off 148,000 workers. Health care is one of the few industries that added a significant number of payroll jobs (+372,000) since the start of the recession.

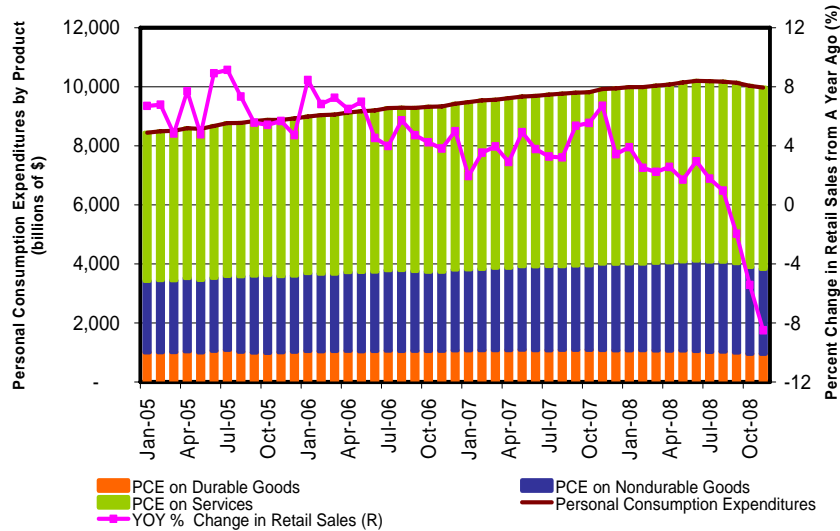
A dramatic pullback in consumer spending is the major catalyst responsible for the massive job losses and shrinking economy over the past several months. A combination of factors - including significant stock and home price declines, the global economic slump, and consumers' pessimistic sentiments and expectations - led to a substantial decrease in personal consumption expenditures (PCE) to an annual rate of \$9.97 trillion in November 2008, or \$56.1 billion less than one-month ago (Chart 4). The major source of the PCE decline was the substantial monthly reduction of \$63.4 billion in consumer spending on nondurable goods, which is in line with the steep decline in payroll employment that occurred in the nondurable goods sector. In comparison, consumer spending on services increased slightly (\$7 billion) in November. The purchases of durable goods were essentially flat, reflecting a mixed effect of moderate Thanksgiving holiday sales, in which consumer spending increased on items such as electronic products due to the deep price discounts offered by retailers but decreased on costly items such as motor vehicles and parts.

The PCE decline is also echoed in the performance of retail sales shown in Chart 4. As compared to one-year ago, retail sales in the United States dropped by 8.5 percent in November after a decline of 5.4 percent in October. No doubt, without large discounts offered by retailers to lure consumers to stores during the holiday season, both retail sales and PCE in November would have dropped even more. Therefore, in the absence of deep discounts continuously offered by retailers and large-scale policy interventions to stimulate consumption, we expect to see an even worse picture for the PCE and employment in the coming months of 2009.



SOURCE: BUREAU OF LABOR STATISTICS

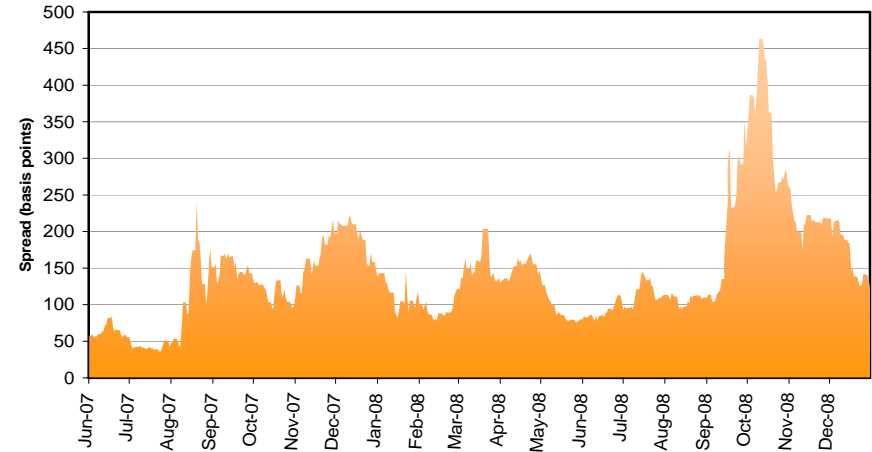
RETAIL SALES AND PERSONAL CONSUMPTION EXPENDITURES BY PRODUCT AS OF NOVEMBER 2008 (CHART 4)



SOURCE: BUREAU OF ECONOMIC ANALYSIS

Another indication that credit markets were continuing to thaw was the decline in overnight LIBOR. Between November 30 and December 31, this key lending rate fell from 116 bps to 13.5 bps.

SPREAD ON 3-MO. T-BILL VS. 3-MO. LIBOR, AS OF DECEMBER 31, 2008 (CHART 5)



SOURCE: BLOOMBERG, LP

MARKET COMMENTARY

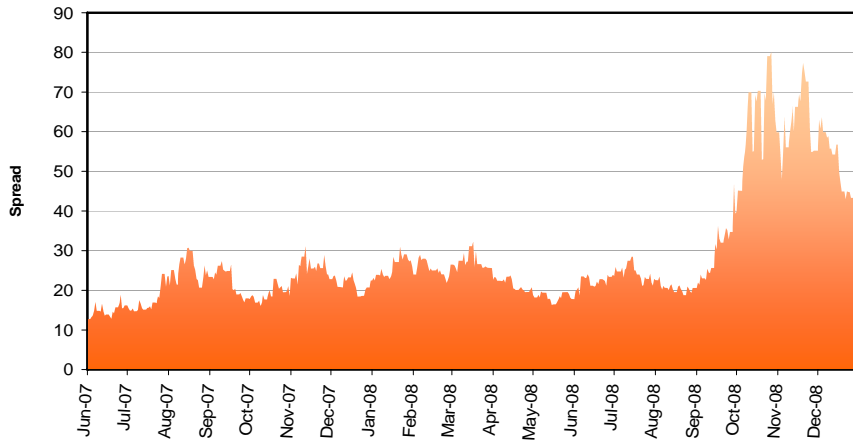
The credit markets continued to show signs of loosening in December.

The spread between three-month LIBOR and the yield on the three-month Treasury bill, or the TED spread, fell from 218 bps at the end of November to 123 bps at the end of December (Chart 5). The current level represents a dramatic reduction from the all-time high of 464 bps on October 10. There is an inverse relationship between the TED spread and the willingness of banks to extend credit, thus the narrowing in the spread is an encouraging sign. Another credit market indicator is the spread between one-month LIBOR and the one-month Overnight Index Swap rate, or the LIBOR-OIS spread. The LIBOR-OIS spread fell from 151 bps at the end of November to 26 bps at the end of December. There is an inverse relationship between the LIBOR-OIS spread and the amount of cash available for lending. The decrease in both spreads indicates that banks are less risk-averse and that more cash is available for lending.

The high degree of stock market uncertainty that was evident in October and November also showed signs of moderating in December.

A popular measure of the implied volatility of S&P 500 index options is the Chicago Board Options Exchange Volatility Index, or VIX. The VIX is quoted in terms of percentage points and indicates the expected movement in the S&P 500 index over the next 30-day period on an annualized basis. A high value corresponds to greater stock market volatility and hence more costly options, since investors require a greater premium in selling options. The VIX fell from 55.3 percent at the end of November to 40 percent at the end of December (Chart 6), a level dramatically below the all-time high of 80.1 percent on October 27. Although the VIX is frequently referred to as the “fear index” by investors, a high value for the VIX is not necessarily bearish for stocks since it is a measure of the fear of stock market volatility in either direction.

CHICAGO BOARD OPTIONS EXCHANGE VOLATILITY INDEX
AS OF DECEMBER 31, 2008 (CHART 6)



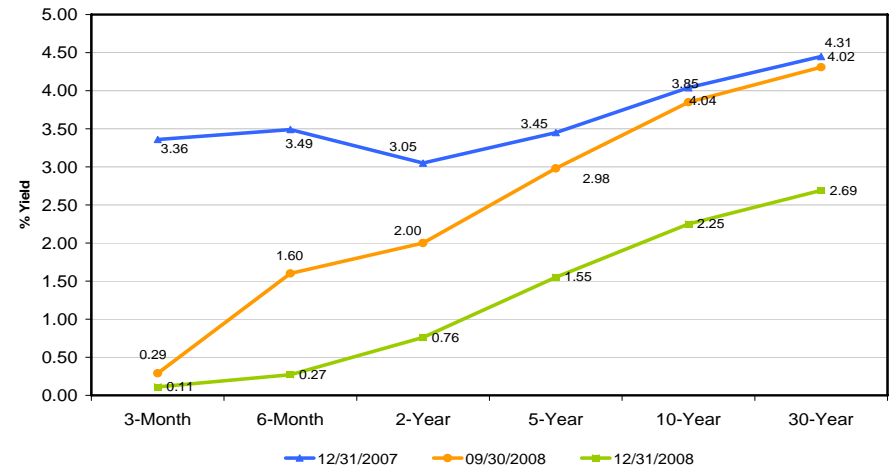
SOURCE: BLOOMBERG, LP

Between the end of September and the end of December, rates fell along the U.S. Treasury yield curve for all benchmark maturities, resulting in a much flatter yield curve (Chart 7). The three-month yield fell by 18 bps, while the five-year, ten-year, and 30-year yields fell by 143 bps, 179 bps, and 133 bps, respectively. The yields for all benchmark maturities in December were substantially below their values one year ago.

The Federal Reserve lowered the target rate for federal funds on December 16 to a range between zero and 25 bps. The target rate was last lowered from 150 bps to 100 bps on October 29. Consistent with the decrease in the target rate, the effective federal funds rate fell to 14 bps at the end of December, down from 52 bps at the end of November, and down dramatically from 203 bps at the end of September.

As a result primarily of the Federal Reserve's zero interest rate policy (or ZIRP), mortgage interest rates plunged in December. The 30-year mortgage rate, as measured by the contract rate on Freddie Mac commitments for fixed-rate, 30-year mortgages fell from 5.97 percent at

CONSTANT MATURITY TREASURY YIELD CURVES (CHART 7)



SOURCE: U.S. DEPARTMENT OF TREASURY

the end of November to 5.10 percent at the end of December. Mortgage interest rates were also favorably impacted by the Federal Reserve's announcement on November 25 of its program to purchase up to \$500 billion in agency mortgage-backed securities (MBS) starting in January 2009. Only fixed-rate MBS securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae are eligible for purchase, whereas other products, such as hybrid ARMs and structured bonds (e.g., CMOs, REMICs, Trust IO/POs) are excluded.

The Federal Reserve's agency MBS purchase program is separate from the Treasury's agency MBS purchase program, which has been totaling \$20 to \$25 billion during the past several months. Because of its potential size (\$500 billion), the Federal Reserve's purchase program could drive mortgage interest rates lower over the next several months. As a result, the pace of mortgage refinancing activity should accelerate, although it is unlikely that refinancing activity will be comparable to the 2003 wave unless mortgage underwriting standards are also relaxed. The MBA refinancing index started to climb in December, signaling a rise in prepayment speeds.

The agency MBS Index posted moderate increases in December, despite significant convexity (gamma) losses. Primary and secondary mortgage interest rates continued to fall and reached historical lows in December. Fixed-rate gross issuance of agency MBS was \$71 billion in December, approximately 20 percent higher than in November. Fannie Mae issuance rose sharply, while Freddie Mac and Ginnie Mae issuance remained steady. In 2008, fixed-rate net issuance of agency MBS was slightly above \$500 billion. The non-agency MBS market generated only \$51.5 billion of total new issuance in 2008, the lowest output since 1995. Most of the new non-agency issuance in 2008 stemmed from the re-packaging of existing deals and securitizing retained portfolios.

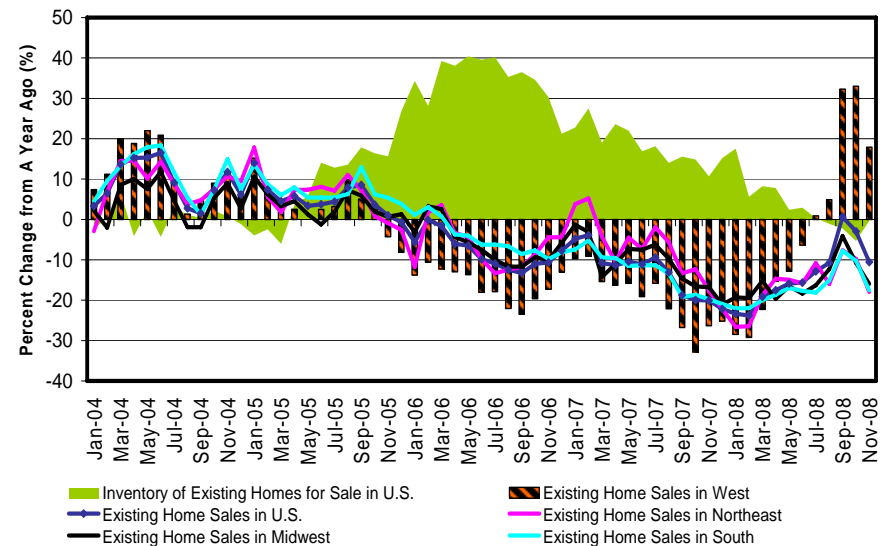
HOUSING MARKET CONDITIONS

As the root cause of the deepening recession, the deterioration of housing markets continued in terms of home sales and prices. As shown in Chart 8, existing home sales declined by 10.6 percent in November 2008, as compared to one-year ago. The downward trend is also observed in the Northeast, Midwest, and South census regions. However, the experience for the West census region was different. Between September and November, existing home sales in California and other western states grew by 32.3, 33 and 17.9 percent, respectively. This explosive growth of existing home sales in the West is apparently fueled by homebuyers and home investors who flooded the markets for deeply discounted foreclosure sales and the lowest mortgage rates in years. Nevertheless, it remains to be seen if this bottom-fishing in the West indicates a re-emergence of the speculation that substantially inflated the home price bubble or a start of increased housing demand tied to market fundamentals.

There was a positive development on unsold existing homes on the market. The inventory of existing homes for sale dropped continuously between August and November, an encouraging trend for a troubled housing market as a whole.

Some mixed developments occurred in the new home market. According to the U.S. Department of Commerce, new home sales in November 2008 dropped sharply across the country. The annual rate of decline in November was 35.3 percent in the United States: 27.3 percent in the Northeast census region, 34.9 percent in the Midwest, 38.1 percent in the South and 32.2 percent in the West. However, a significant positive development was also observed in the unsold new home market. The inventory of new homes available for sale also dropped substantially across all regions with the West experiencing the sharpest decline. As compared to one year ago, the November inventory of for-sale new homes declined by approximately 27 percent in the U.S.: 21 percent in the Northeast, 22 percent in the Midwest, 28 percent in the South and 31 percent in the West. This development clearly indicates that this shrinking supply in new homes did not stem from the increased sales to individual buyers but from substantially fewer homes built for sale.

HOME SALES AND INVENTORY OF HOMES FOR SALE, AS OF NOVEMBER 2008 (CHART 8)

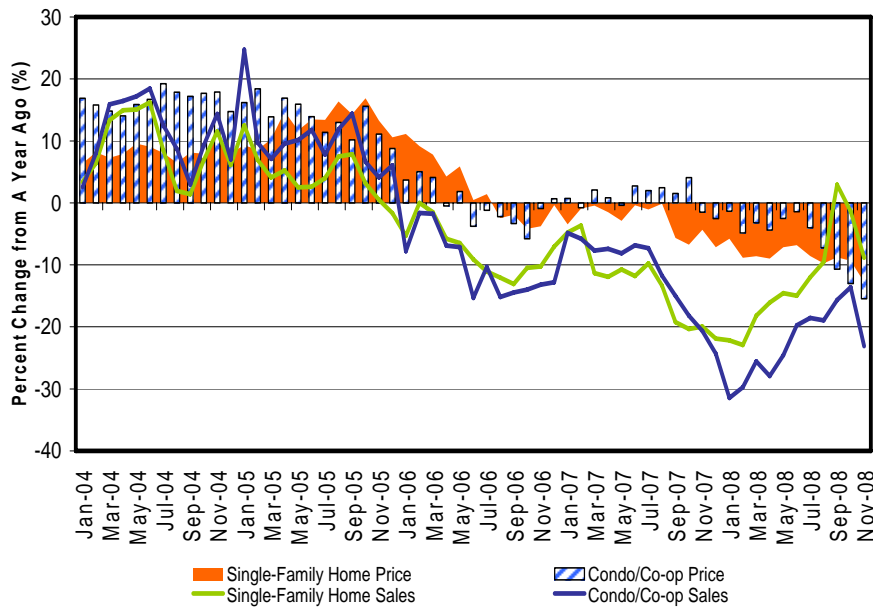


SOURCE: NATIONAL ASSOCIATION OF REALTORS

Despite some positive developments, prices and sales of single-family homes and condo/co-op plunged to the lowest level on record. Home sales and price changes are not, however, uniform across property types. As shown in Chart 9, in November 2008, the prices of condominiums and co-ops declined by 15.5 percent from one-year ago, as compared to a 12.8 percent decline for single-family home prices. Sales of condominiums and co-ops dropped sharply to an annual rate of -23.1 percent in November. In contrast, the annual rate of change in single-family home sales was -8.8 percent. Therefore, condominiums and co-ops had more significant declines in both sales and prices than single family homes did, indicating that the housing market in the United States is segmented by property type.

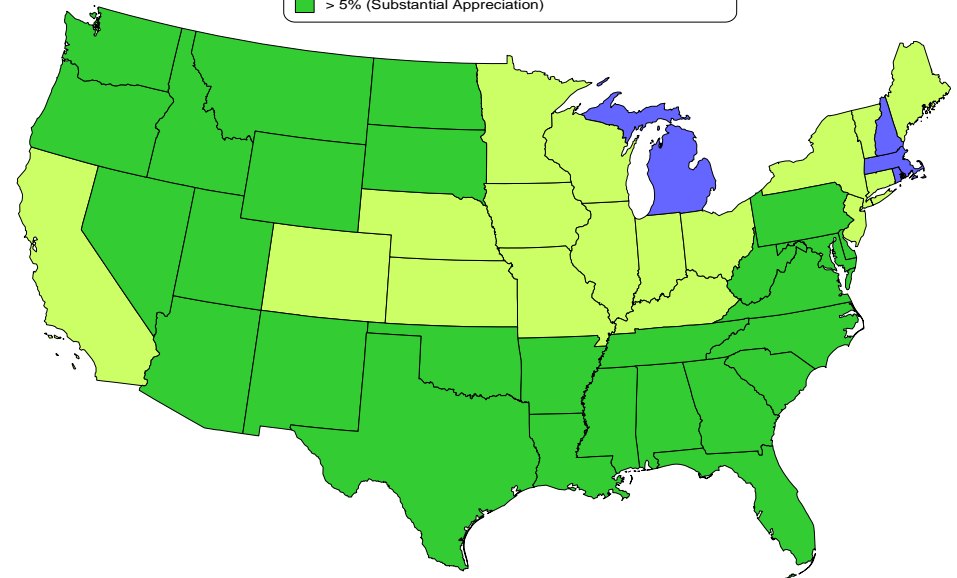
Home prices are further segmented by areas in which homes are located. Based on our calculations for the (year-over-year) annual growth rate using the purchase-only conforming loan home price index from the Federal Housing Finance Agency (FHFA), we created Maps 1 and 2 to illustrate the price changes for each state in the third quarter of 2006, compared with the third quarter of 2008 (the most recent data available for all states). The third quarter of 2006 was the time when home prices in the U.S. started to show substantial deceleration in the rate of growth as measured by the FHFA and Case-Shiller home price indices, and even began to exhibit a year-over-year depreciation as measured by the National Association of Realtor's median price series.

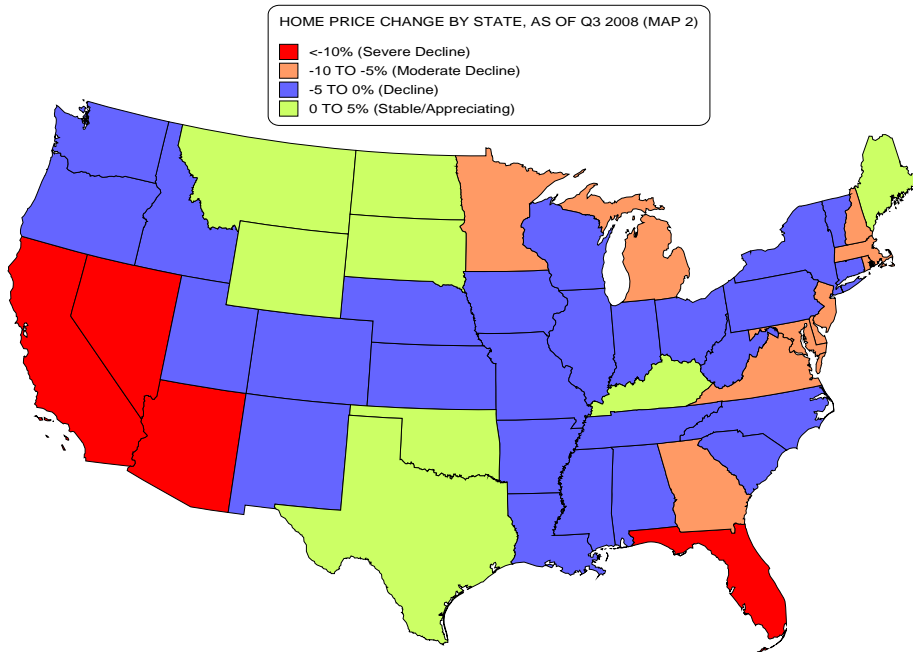
HOME PRICES AND SALES OF SINGLE-FAMILY HOMES VS. CONDO/CO-OP AS OF NOVEMBER 2008 (CHART 9)



SOURCE: NATIONAL ASSOCIATION OF REALTORS

HOME PRICE CHANGE BY STATE, AS OF Q3 2006 (MAP 1)





LOAN PERFORMANCE AND LOSS SEVERITY

As a result of widespread job losses, tightening credit and worsening housing market conditions, mortgage loan delinquencies and defaults continued to soar. This section is designed to provide detailed, timely and graphic data on U.S. residential loan performance and loss severity, stratified by mortgage borrower types, interest rate types, vintages and loan ages.

Residential loan performance is measured by the serious delinquency rate, i.e., percent of active loan dollar balances that are at least 60 days past due or in foreclosure/REO in a given month. The mortgage loss severity refers to the total losses as the result of liquidations in a given month, expressed as the percent of unpaid principal balances or cents on the dollar. Data for both measures are calculated from the information

for first liens as collected by the First American Loan Performance (LP) and standardized by the LP and CPR/ CDR Technologies Inc. The key findings as of November 2008 are summarized as follows:

- **The loan default rates continued to rise dramatically across all borrower and interest rate types, as illustrated in Charts 10 and 11.** The most dramatic increase occurred in subprime loans, as compared to prime and Alt-A loans, and in option ARMs, as compared to fixed rate and ARMs. As of November 2008, serious delinquency rates by borrower category are found to be 42.5 percent for subprime, 21.6 percent for Alt-A and 5.2 percent for prime. By interest rate type, serious delinquency rates were 29.5 percent for option ARMs, 14.4 percent for adjustable rate mortgages and 4.5 percent for fixed rate mortgages.
- **Loan performance varies substantially by vintages, with the 2007 vintage standing out as the worst, as depicted in Charts 12-15.** By examining serious delinquency rates by loan age for all loans types (jumbo, Alt-A, subprime and option ARMs), we found that the 2007 vintage has the worst performance, followed by the 2006, 2005 and 2004 vintages. The 2008 vintage appears to be the best book for jumbo and Alt-A mortgages. However, its performance is still too young to be conclusive. For subprime loans and option ARMs, the 2004 vintage performs the best regardless of loan ages (there was minimal production of these loan types in 2008.).
- **In addition to the default rate, loss severity is another key risk measure. Chart 16 shows loss severity over time for jumbo, Alt-A, subprime and option ARM loans.** As of November 2008, subprime loans sustained the severest loss (62.3 cents on the dollar) among all types of loans examined, followed by option ARMs (52.3 cents on the dollar), Alt-A (51.2 cents on the dollar) and jumbo (37.2 cents on the dollar). Note that, although option ARMs had a lower level of loss severity than Alt-A before May 2008, they have consistently

surpassed Alt-A since. In contrast, over the course of 2008, the loss severity rate for jumbo loans decelerated relative to other loan types.

- **Loss severity also varies by vintages, with the 2007 vintage clearly the cohort with the highest loss rate among loans originated since 2004.** Charts 17-20 show the loss severity for jumbo, Alt-A, subprime and option ARM loans by vintage and loan age. Regardless of loan type, the 2007 vintage has lost the most in nearly every month.¹ It is followed by the 2006 and 2005 vintages. The 2004 vintage has lost the least among all vintages examined.

CONCLUSION

The economic deterioration of 2008 is likely to persist and widen in early 2009. News of job losses and the shuttering of businesses that are household names creates an element of fear among consumers. This fear has paralyzed the credit markets, and corporations and households appear to have embarked on a savings plan that could prolong this economic freeze. As more jobs are lost, credit extension will be challenged further and sellers will continue to find few buyers for homes. These factors, coupled with deflation and low interest rates, will make for an arduous 2009 for thrifts.

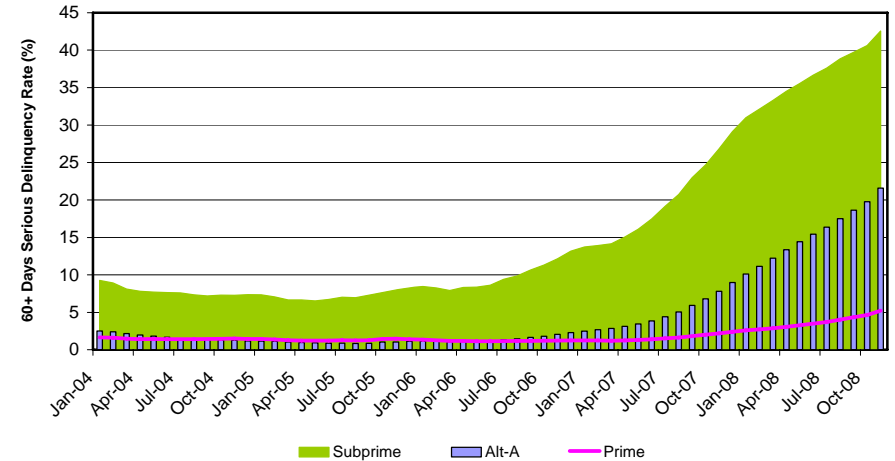
SOURCE FOR CHARTS 10-20: FIRST AMERICAN LOAN PERFORMANCE AND CPR/CDR TECHNOLOGIES INC.

NOTE: DATA USE ACTIVE LOAN DOLLAR BALANCES OF FIRST LIENS ON A MONTHLY BASIS; DATA FOLLOW THE MBA DEFINITION OF DELINQUENCY.

¹ These charts also show a few spikes of loss severity at the beginning or end of the loan age series. These spikes are caused by a very small number of losses occurred in these times and therefore should be treated as the outliers to be ignored.

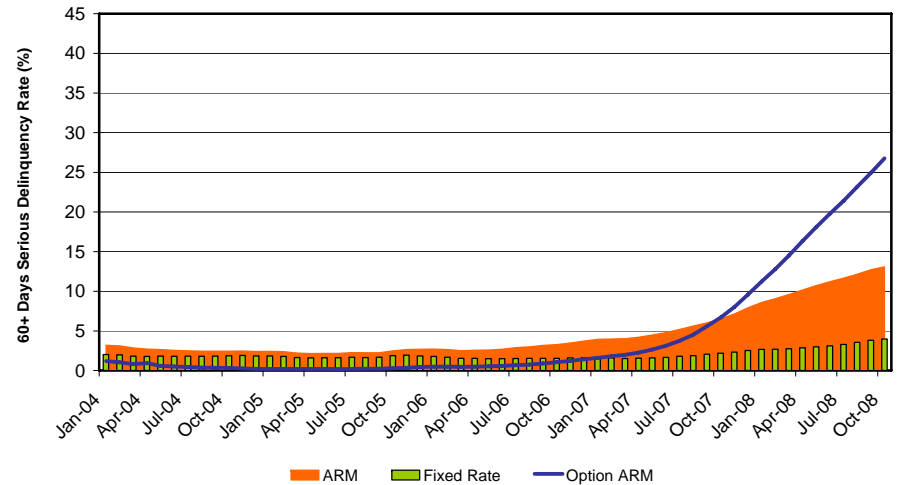
SERIOUS DELINQUENCY RATES BY INTEREST RATE & BORROWER TYPES

MORTGAGE LOAN PERFORMANCE BY BORROWER TYPE AS OF NOVEMBER 2008 (CHART 10)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

MORTGAGE LOAN PERFORMANCE BY INTEREST RATE TYPE AS OF NOVEMBER 2008 (CHART 11)

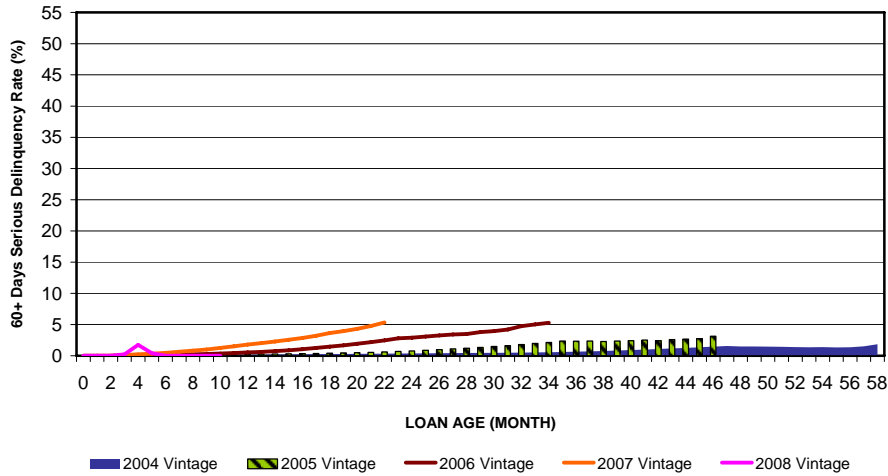


SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR



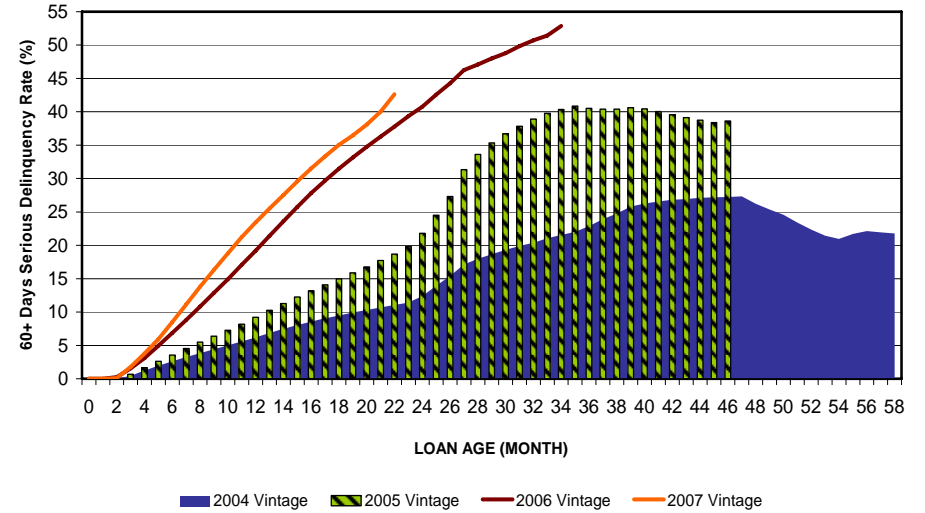
NATIONAL SERIOUS DELINQUENCY RATES BY VINTAGE

LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: JUMBO
AS OF NOVEMBER 2008 (CHART 12)



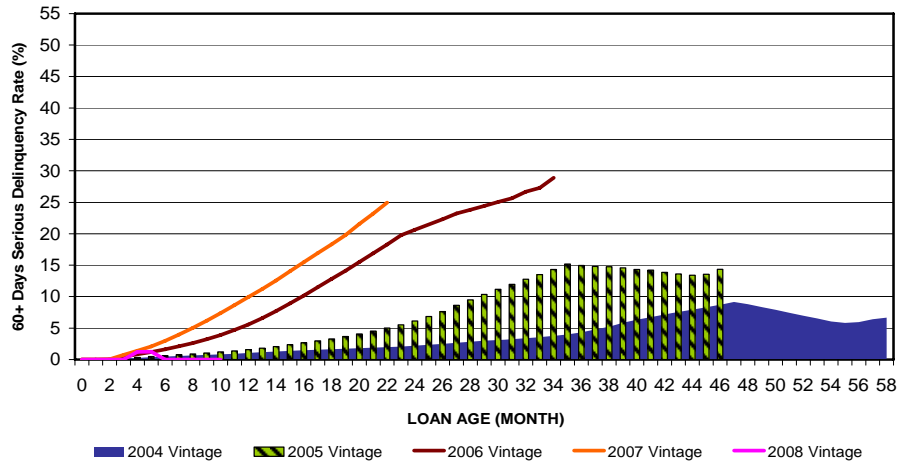
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: SUBPRIME
AS OF NOVEMBER 2008 (CHART 14)



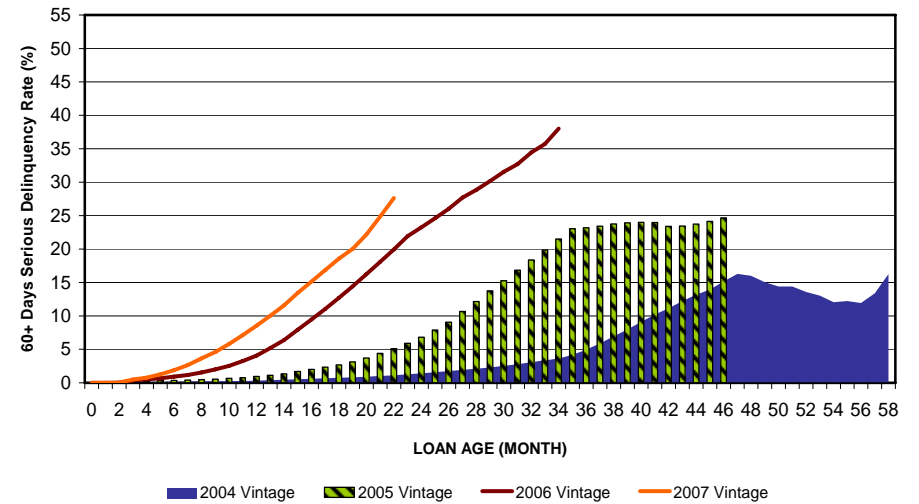
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: ALT-A
AS OF NOVEMBER 2008 (CHART 13)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: OPTION ARM
AS OF NOVEMBER 2008 (CHART 15)

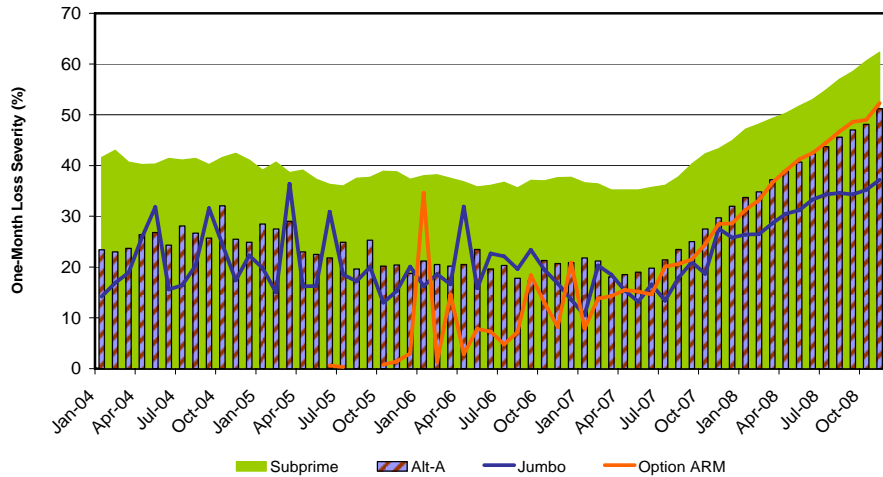


SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR



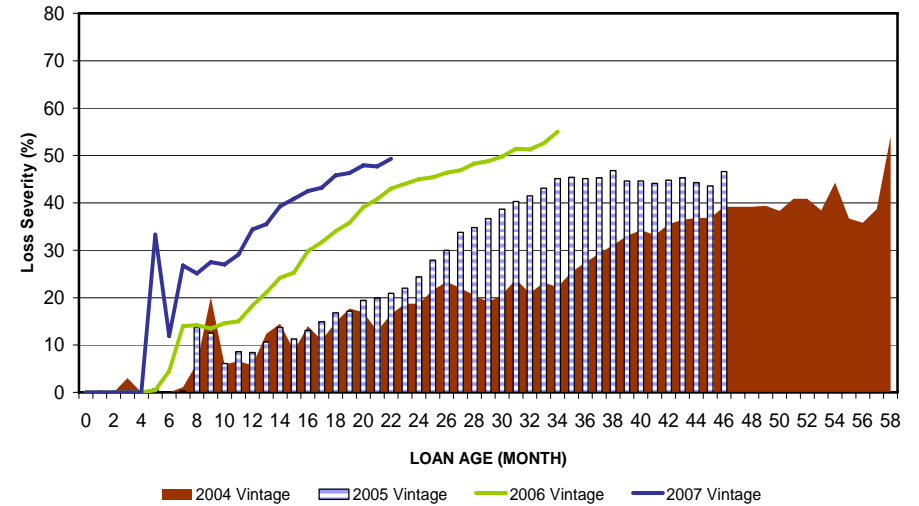
NATIONAL LOSS SEVERITY BY LOAN TYPE AND VINTAGE

LOSS SEVERITY BY LOAN TYPE, AS OF NOVEMBER 2008 (CHART 16)



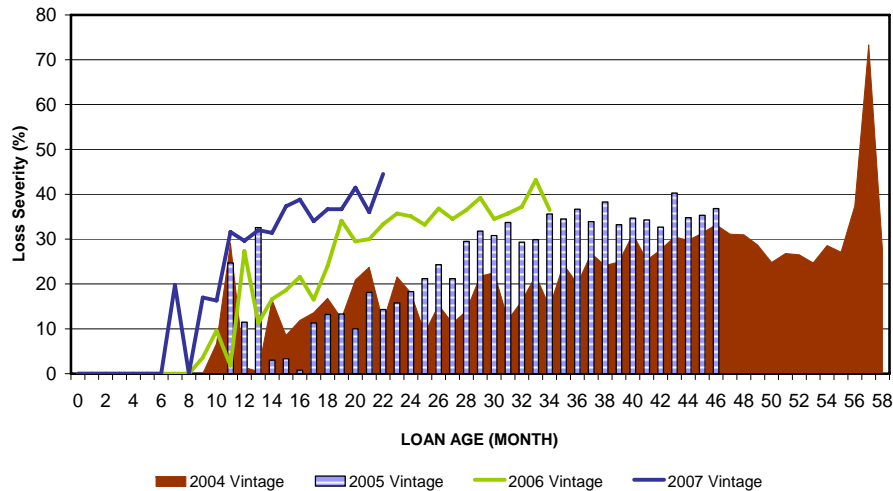
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOSS SEVERITY BY VINTAGE AND LOAN AGE: ALT-A AS OF NOVEMBER 2008 (CHART 18)



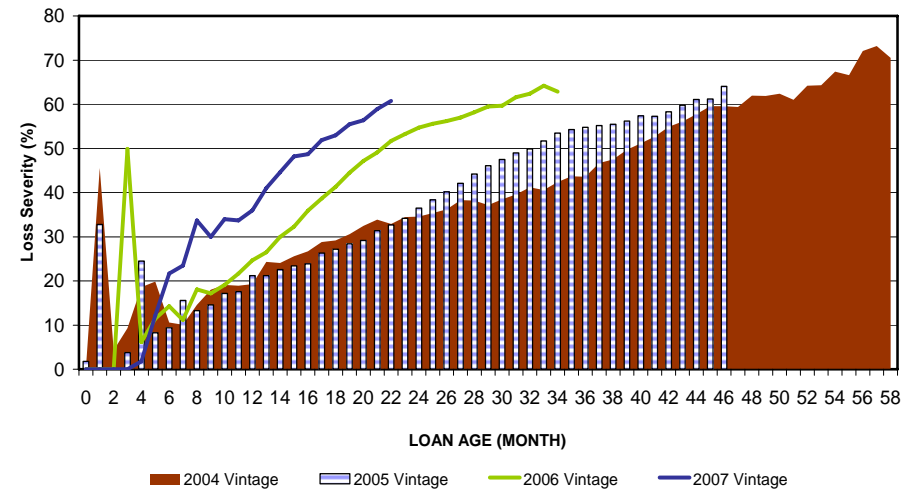
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOSS SEVERITY BY VINTAGE AND LOAN AGE: JUMBO AS OF NOVEMBER 2008 (CHART 17)



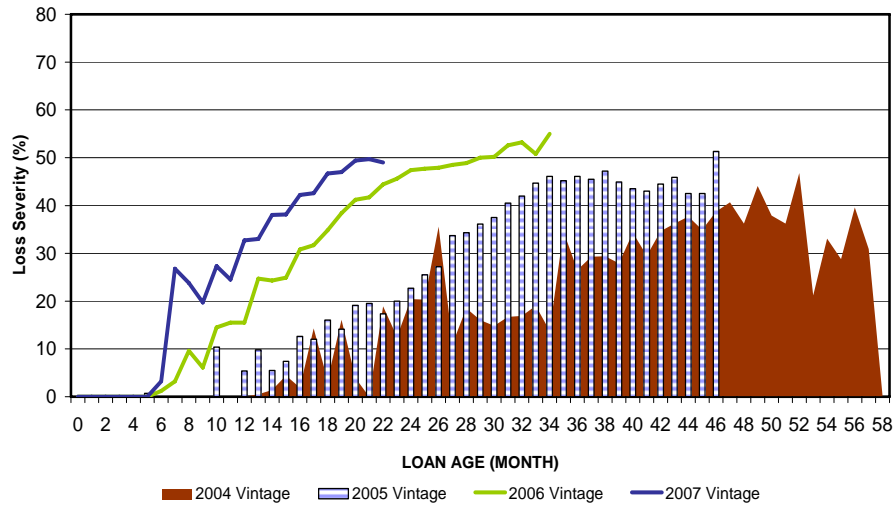
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOSS SEVERITY BY VINTAGE AND LOAN AGE: SUBPRIME AS OF NOVEMBER 2008 (CHART 19)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOSS SEVERITY BY VINTAGE AND LOAN AGE: OPTION ARM
 AS OF NOVEMBER 2008 (CHART 20)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

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