



2006 Municipal Outlook

Economics and Demographics and Municipal Yields



May 11, 2006

This report has been prepared by UBS Financial Services Inc.

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Section 1

Economics: Transition to Slower Growth



Economics: Transition to Slower Growth

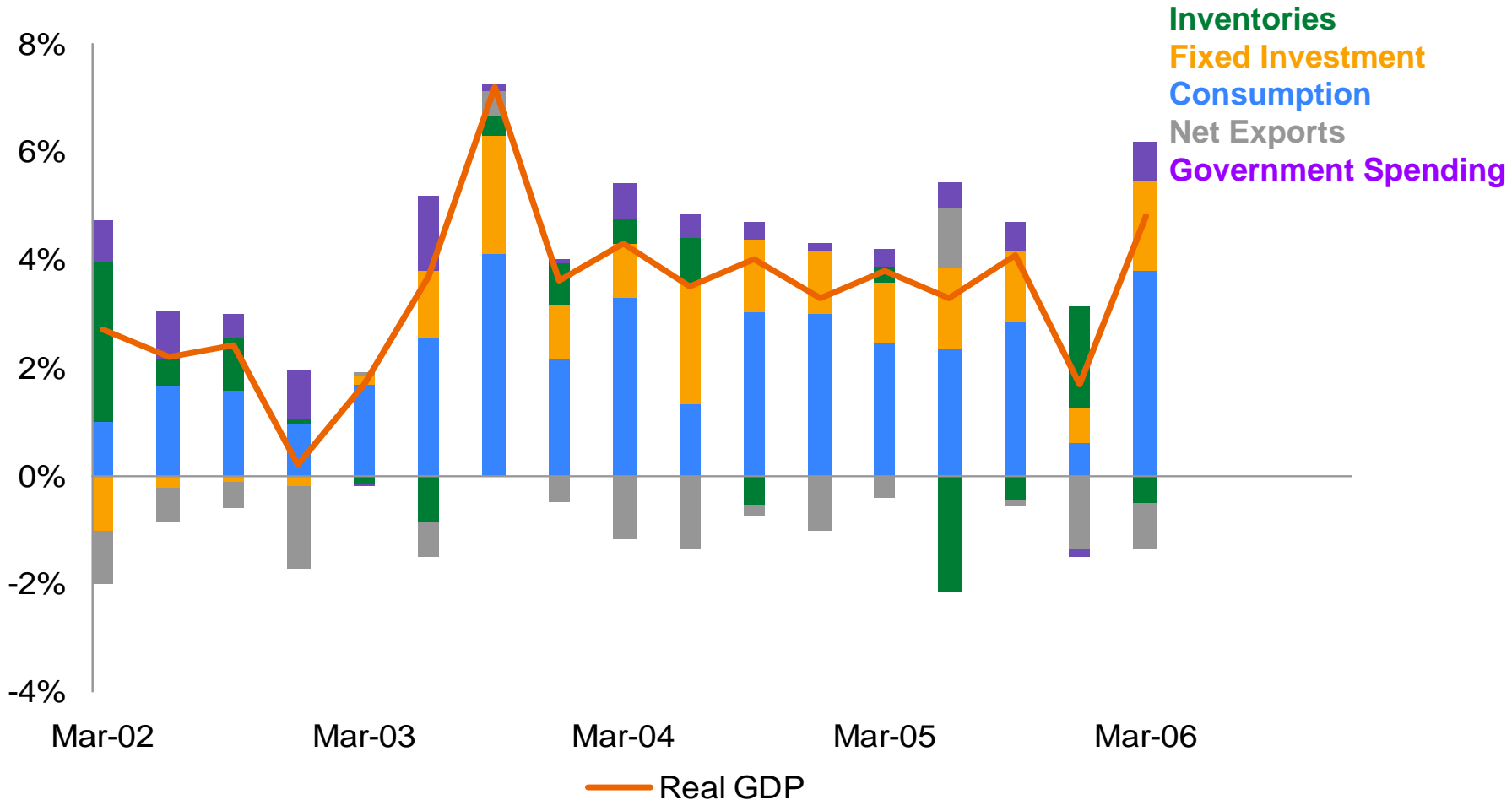
Overview

- ◆ Strong real GDP in Q106 is primarily payback for weak Q405
- ◆ Rising house prices have undermined affordability
- ◆ A weak housing market will weigh on real PCE growth
- ◆ The strong US labor market may drive wage inflation
- ◆ Consumption growth slowdown will drag overall growth lower
- ◆ UBS WMR forecast signals economic slowdown



Economics: Transition to Slower Growth

Strong real GDP in Q106 is primarily payback for weak Q405

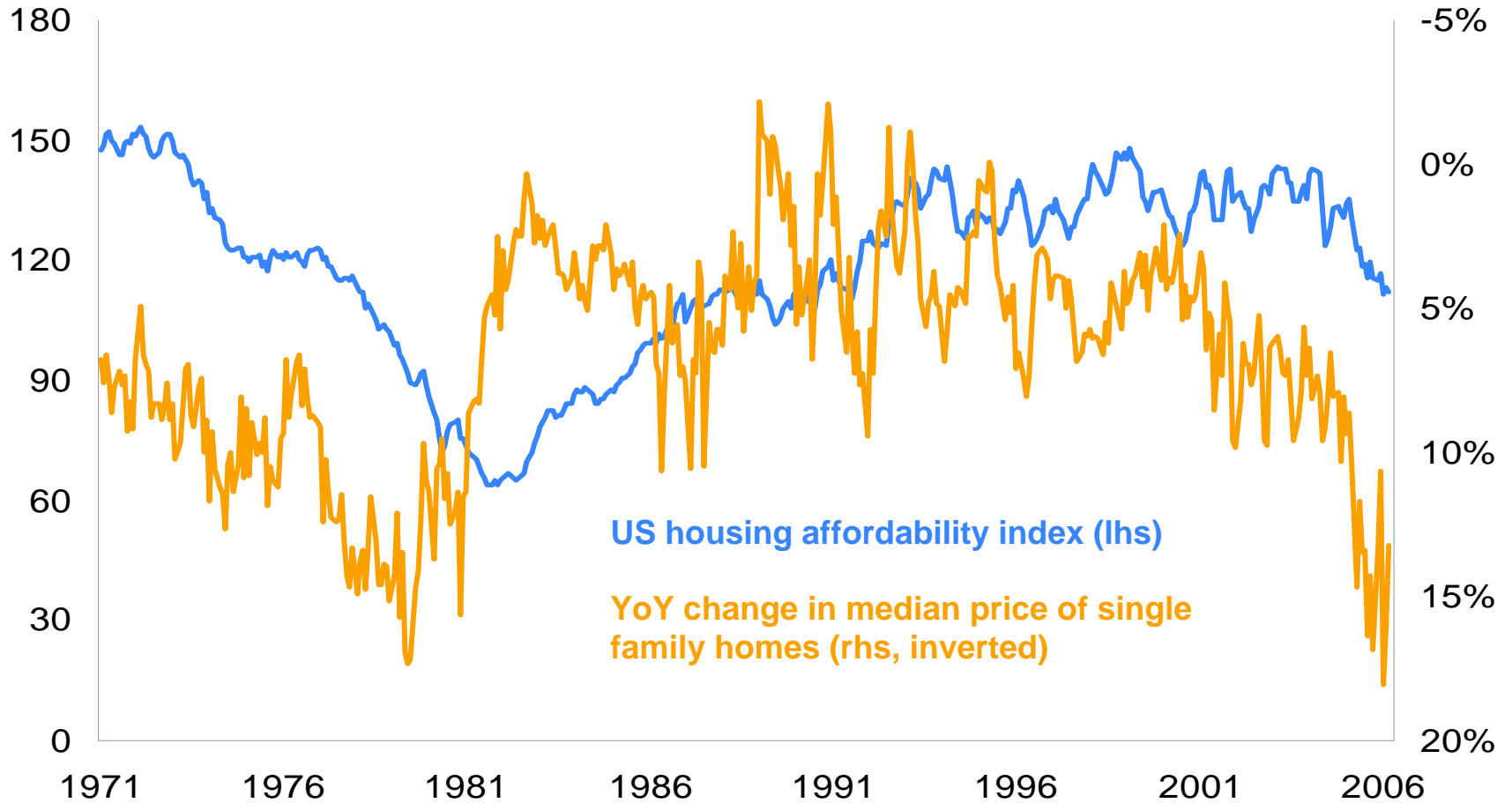


Source: Bloomberg, UBS WMR



Economics: Transition to Slower Growth

Rising house prices have undermined affordability

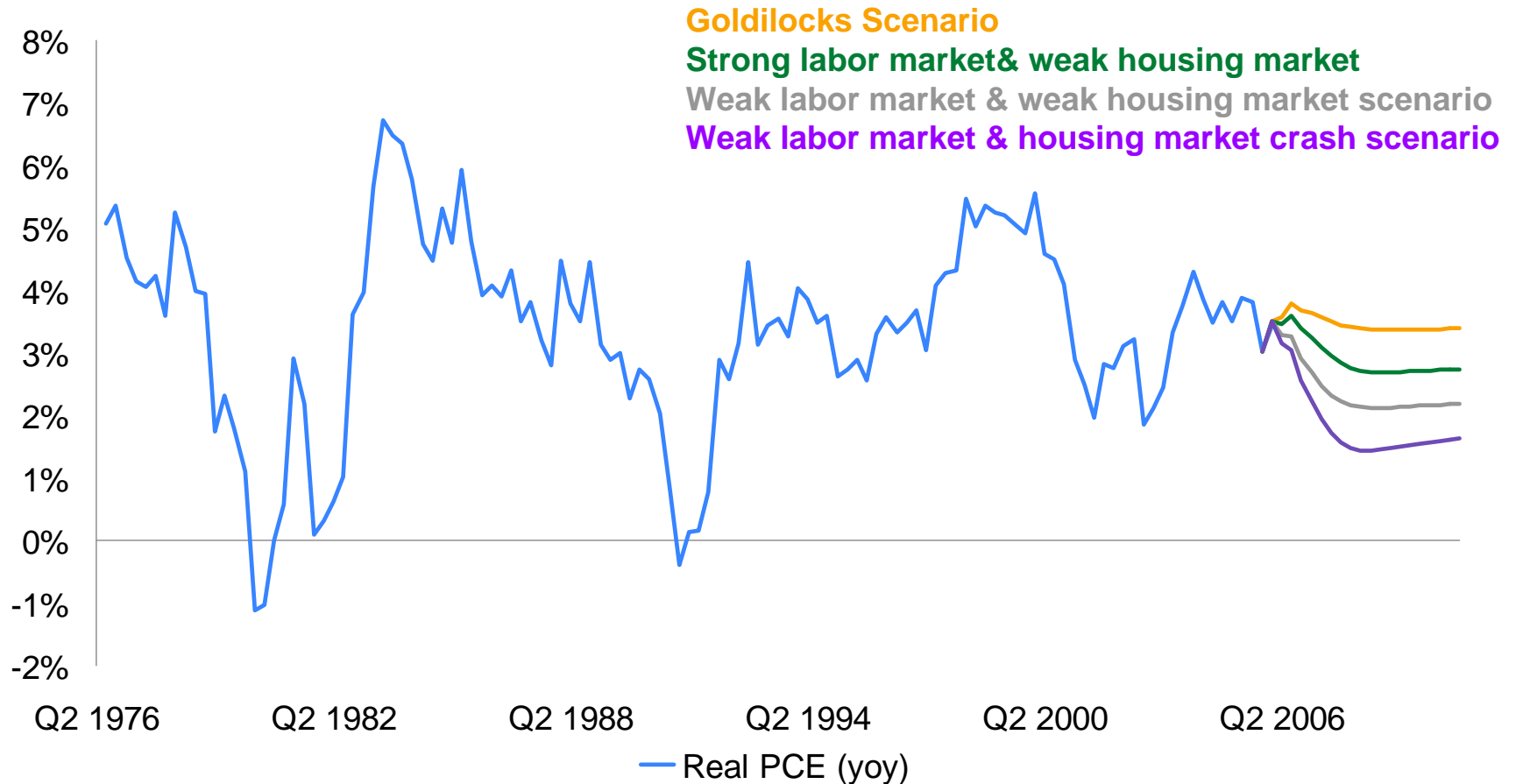


Source: Datastream, UBS WMR



Economics: Transition to Slower Growth

A weak housing market will weigh on real PCE growth

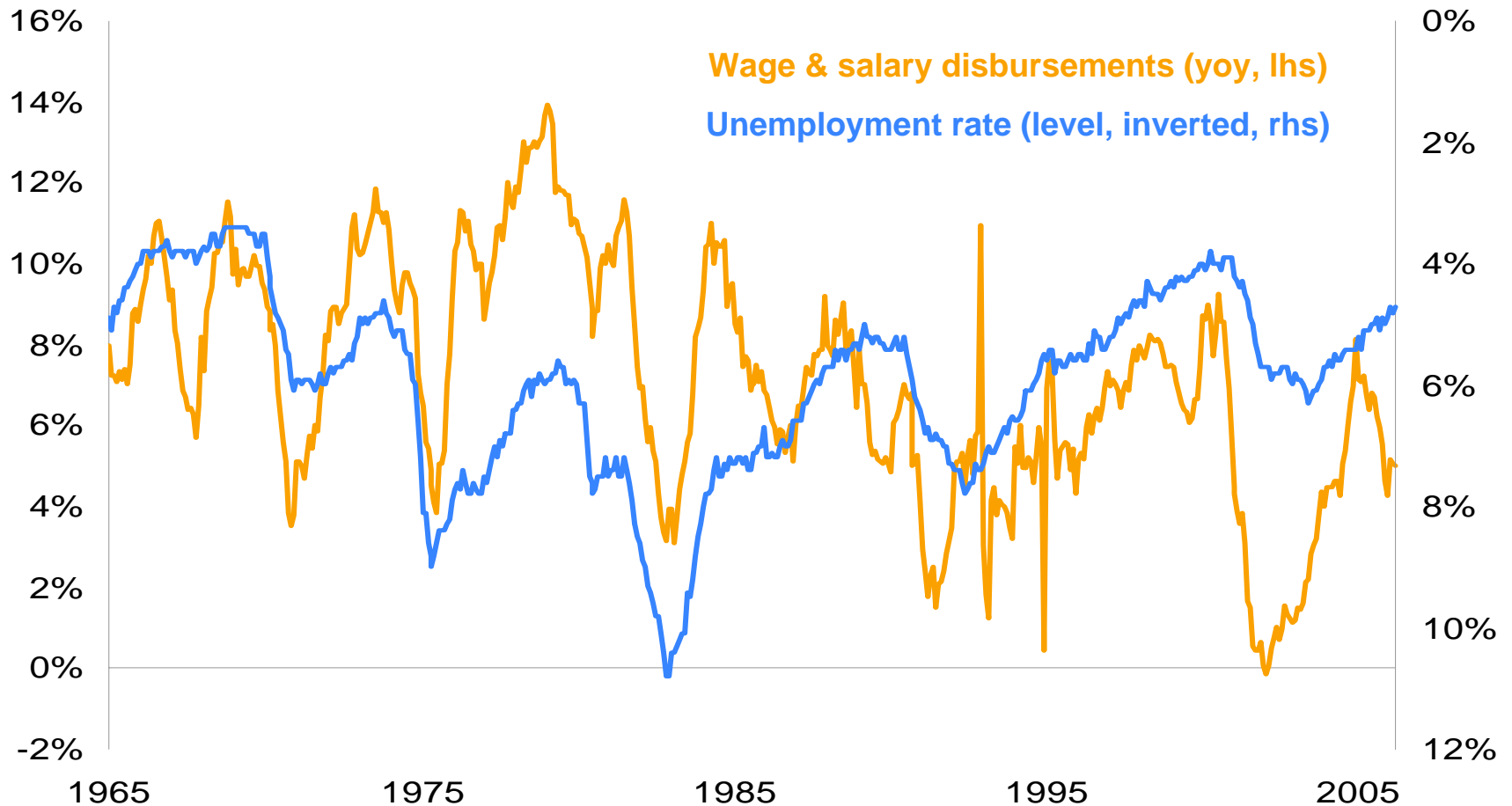


Source: UBS WMR



Economics: Transition to Slower Growth

The strong US labor market may drive wage inflation

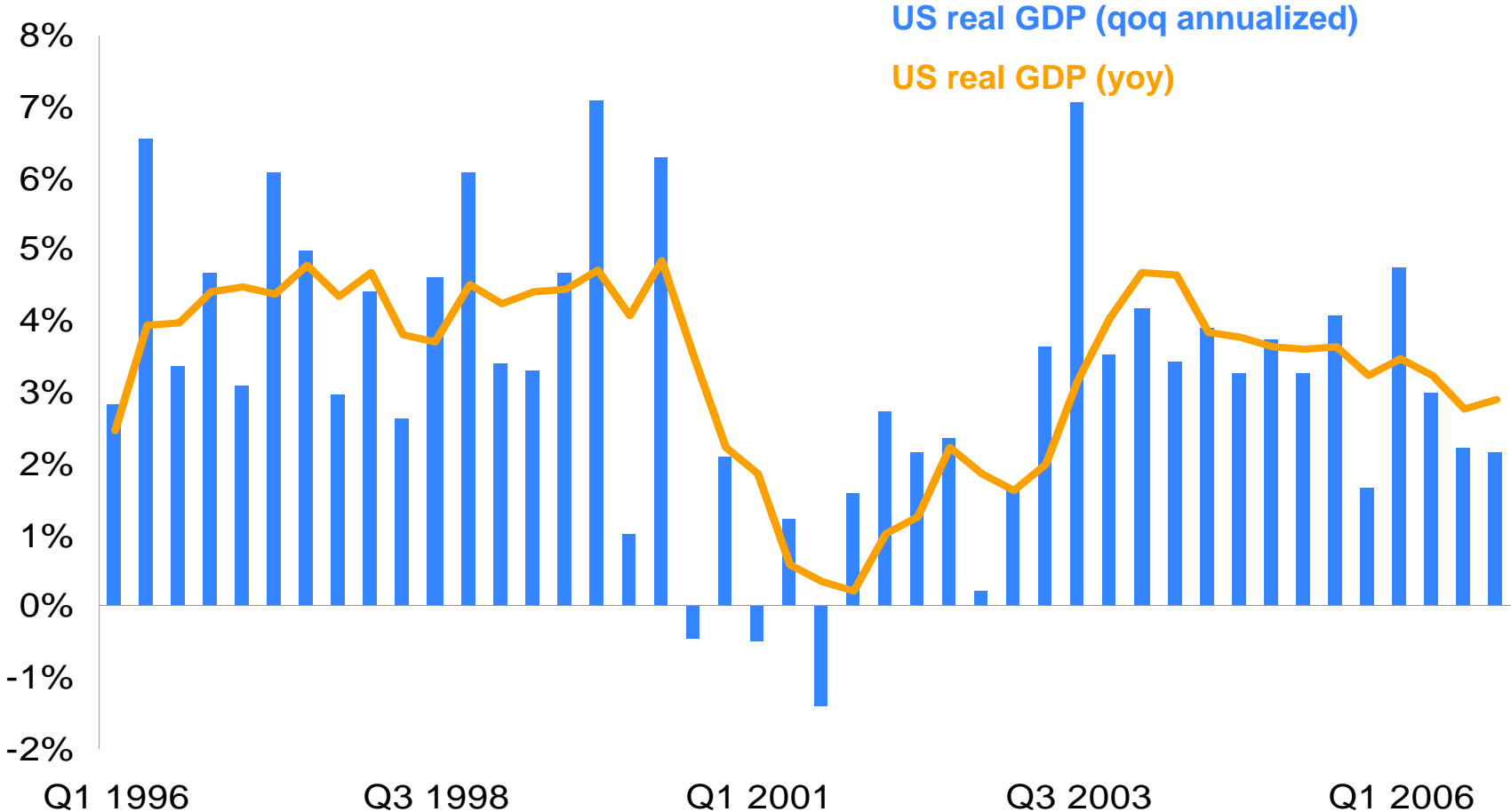


Source: Datastream, UBS WMR



Economics: Transition to Slower Growth

Consumption growth slowdown will drag overall growth lower



Source: Datastream, UBS WMR



Economics: Transition to Slower Growth

UBS WMR forecast signals economic slowdown

UBS WMR Forecasts

in %	2002	2003	2004	2005	2006F	2007F
Real GDP (yoy)	1.60	2.70	4.20	3.50	3.00	2.00
CPI (yoy)	1.60	2.30	2.70	3.40	3.40	2.70
Core CPI (yoy)	2.30	1.50	1.80	2.20	2.40	2.60
Unemployment rate (level)	5.80	6.00	5.50	5.10	4.90	5.30
Fed funds rate (level)	1.25	1.00	2.25	4.25	4.75	4.00

Source: Datastream, UBS WMR



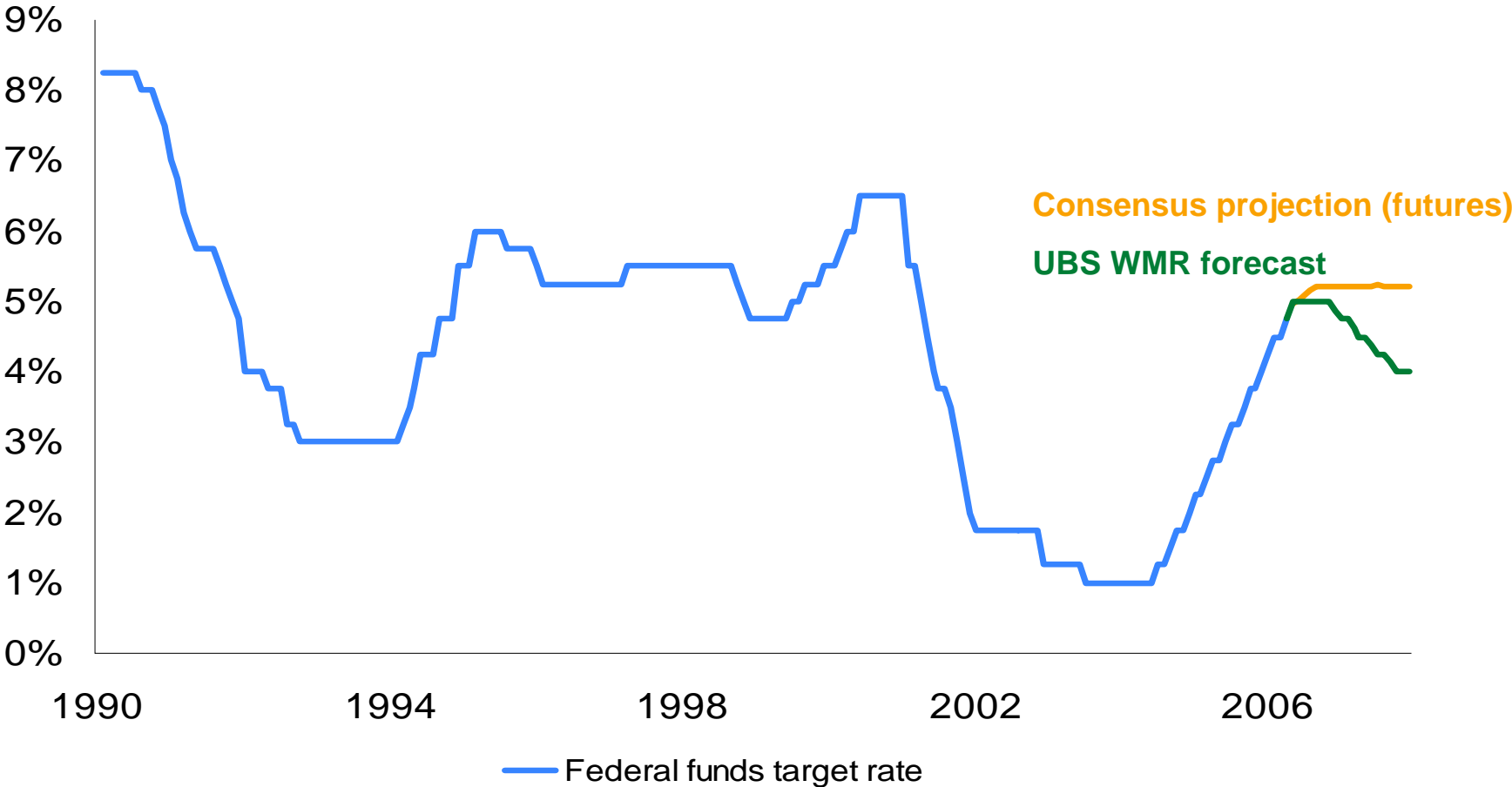
Section 2

Monetary Policy: Fed on Hold



Monetary Policy: Fed on Hold

Our growth deceleration call implies earlier rate cuts than consensus



Source: Bloomberg, UBS WMR



Section 3

Municipal Yields in 2006



Municipal Yields in 2006

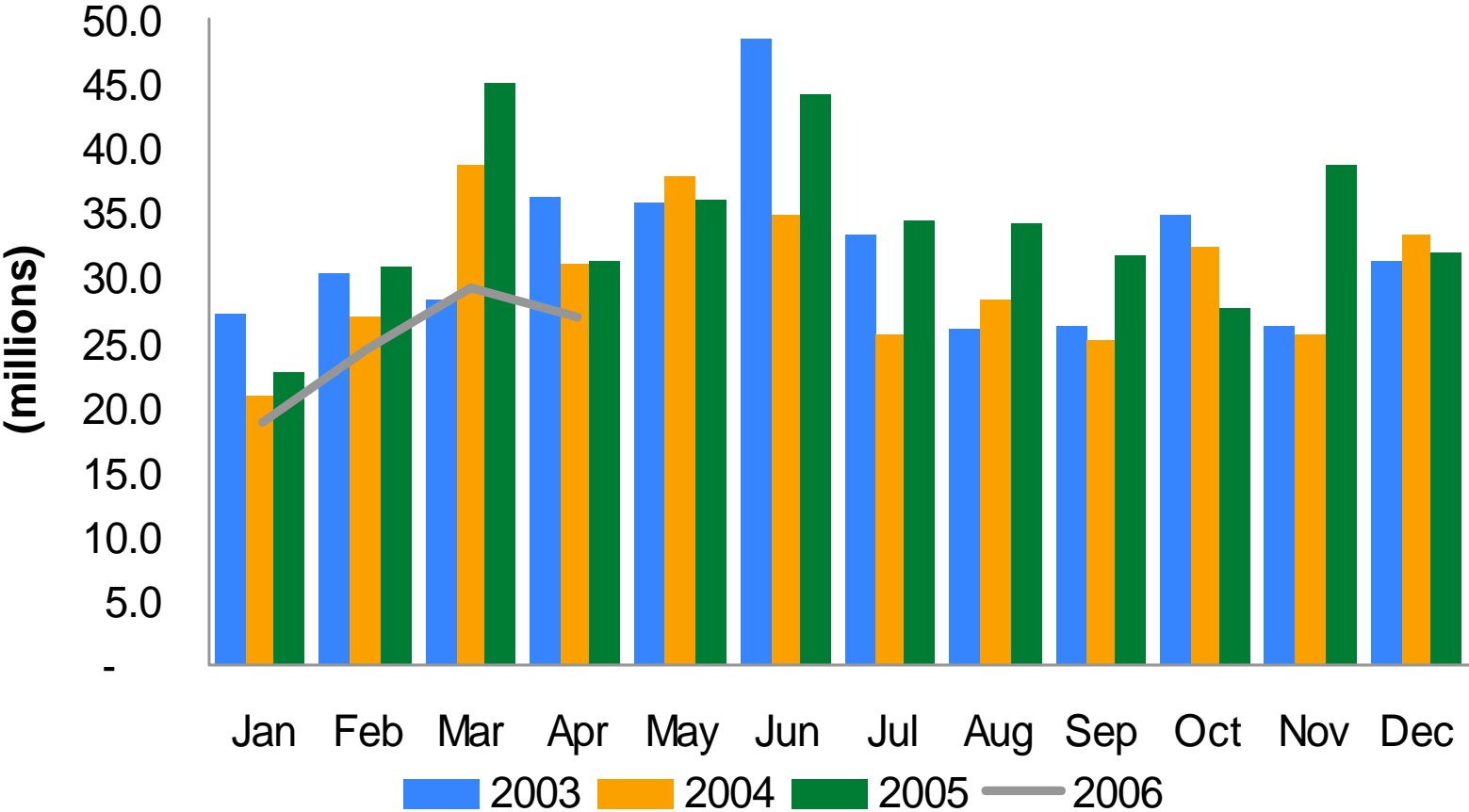
Overview

- ◆ Strong real GDP in Q106 is primarily payback for weak Q405
- ◆ So far, monthly supply has been lower than in the past three years
- ◆ Municipal floating rate yields follow monetary policy
- ◆ Longer municipal yields have fallen versus treasuries
- ◆ UBS projected figures for year-end 2006



Municipal Yields in 2006

So far, monthly supply has been lower than in the past three years

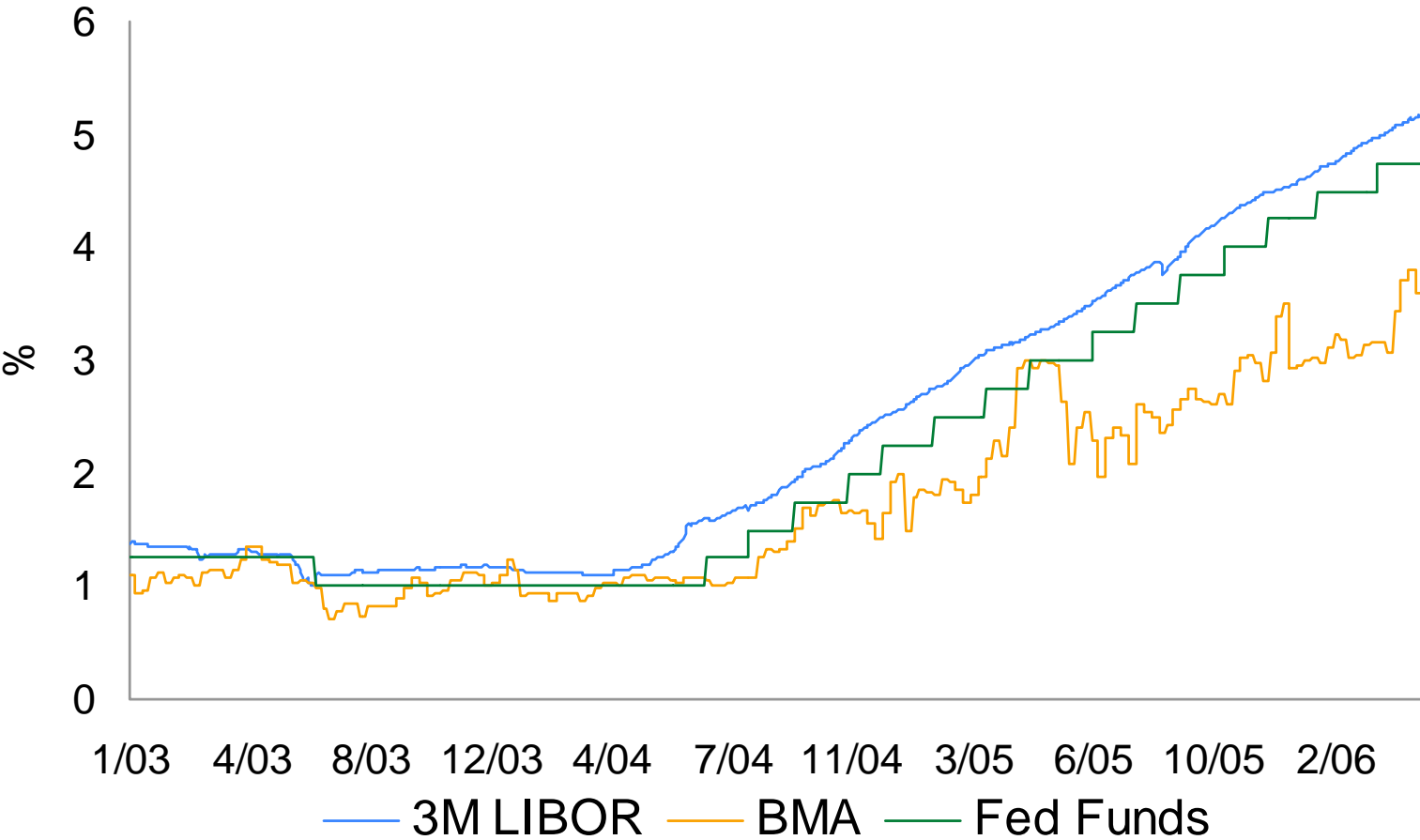


Source: Bond Buyer, UBS WMR



Municipal Yields in 2006

Municipal floating rate yields follow monetary policy

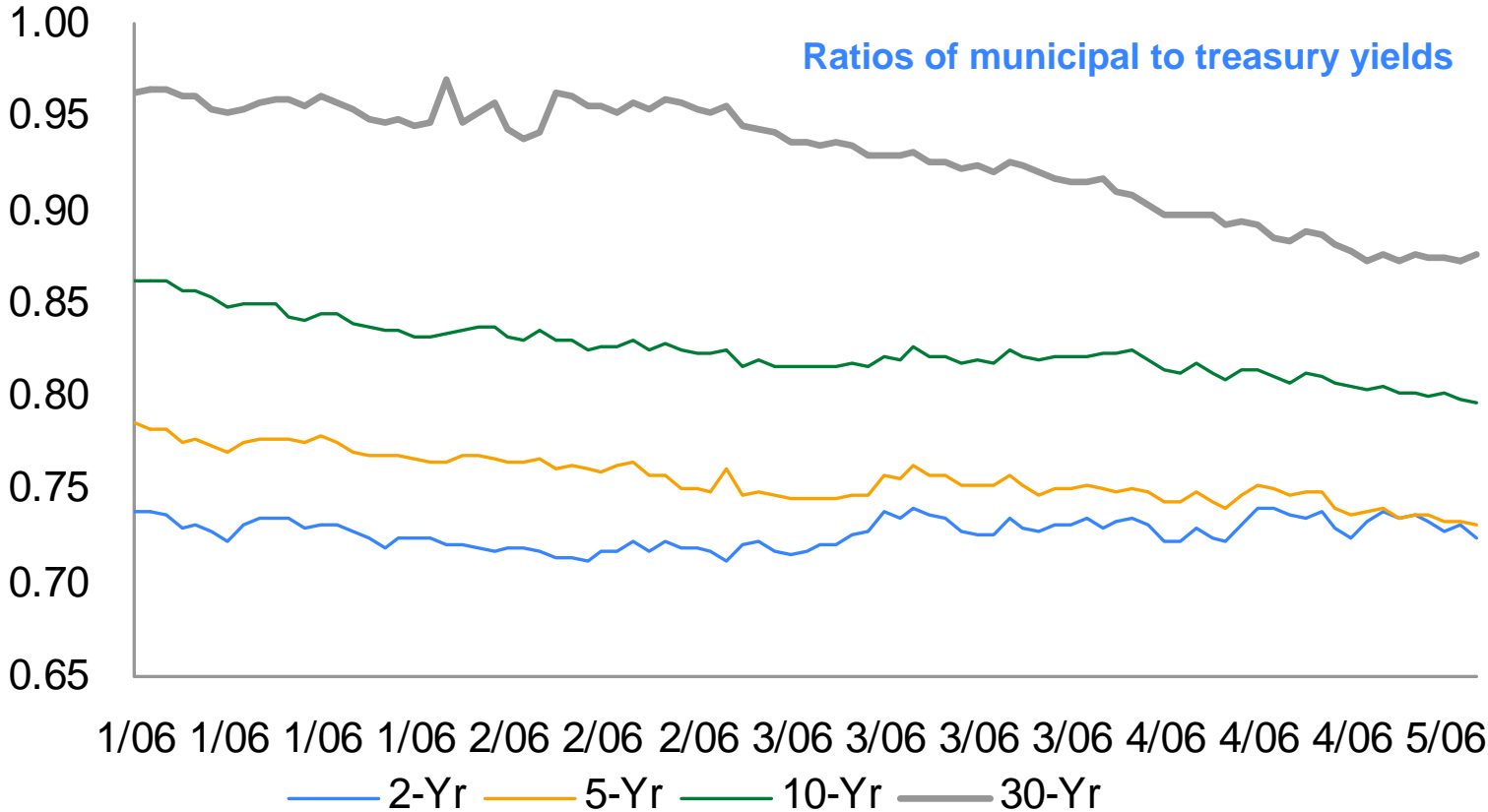


Source: Bloomberg, UBS WMR



Municipal Yields in 2006

Longer municipal yields have fallen versus treasuries



Source: Bloomberg, UBS WMR



Municipal Yields in 2006

UBS projected figures for year-end 2006

Issuance:	\$365 billion
Yields:	Likely lower
M/T ratio:	Range bound
BMA/LIBOR ratio	Higher
Curve:	Steeper
Credit Spreads:	Slightly wider
Ratings:	Overall positive
Notables:	Retiring boomers

Source: UBS WMR



Section 4

The Future: Municipals and the Baby Boomers



The Future: Municipals and the Baby Boomers

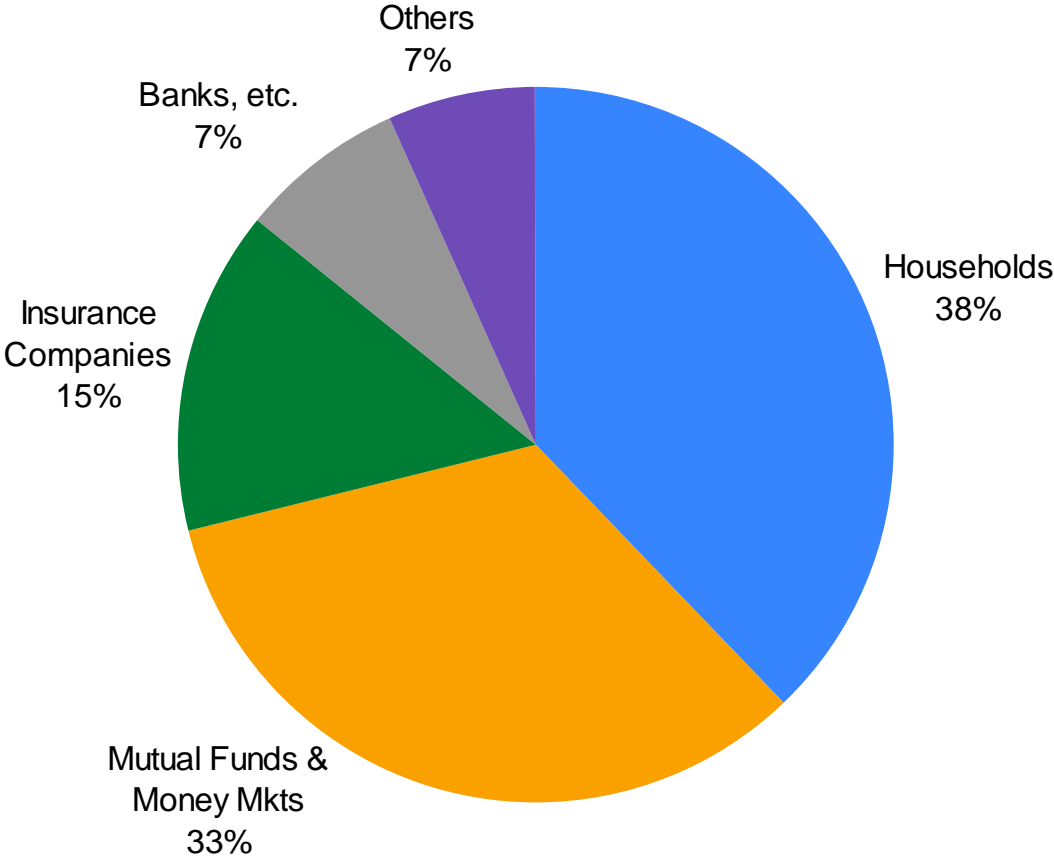
Overview

- ◆ Households are the primary holders of municipal bonds
- ◆ Older investors allocate more of their portfolio to fixed income
- ◆ As investors age, more invested assets become taxable
- ◆ Federal spending priorities will pressure future tax rates
- ◆ Municipal credit quality should remain strong, supporting yields
- ◆ Potential risks to the muni market exist
- ◆ Conclusion



The Future: Municipals and the Baby Boomers

Households are the primary holders of municipal bonds

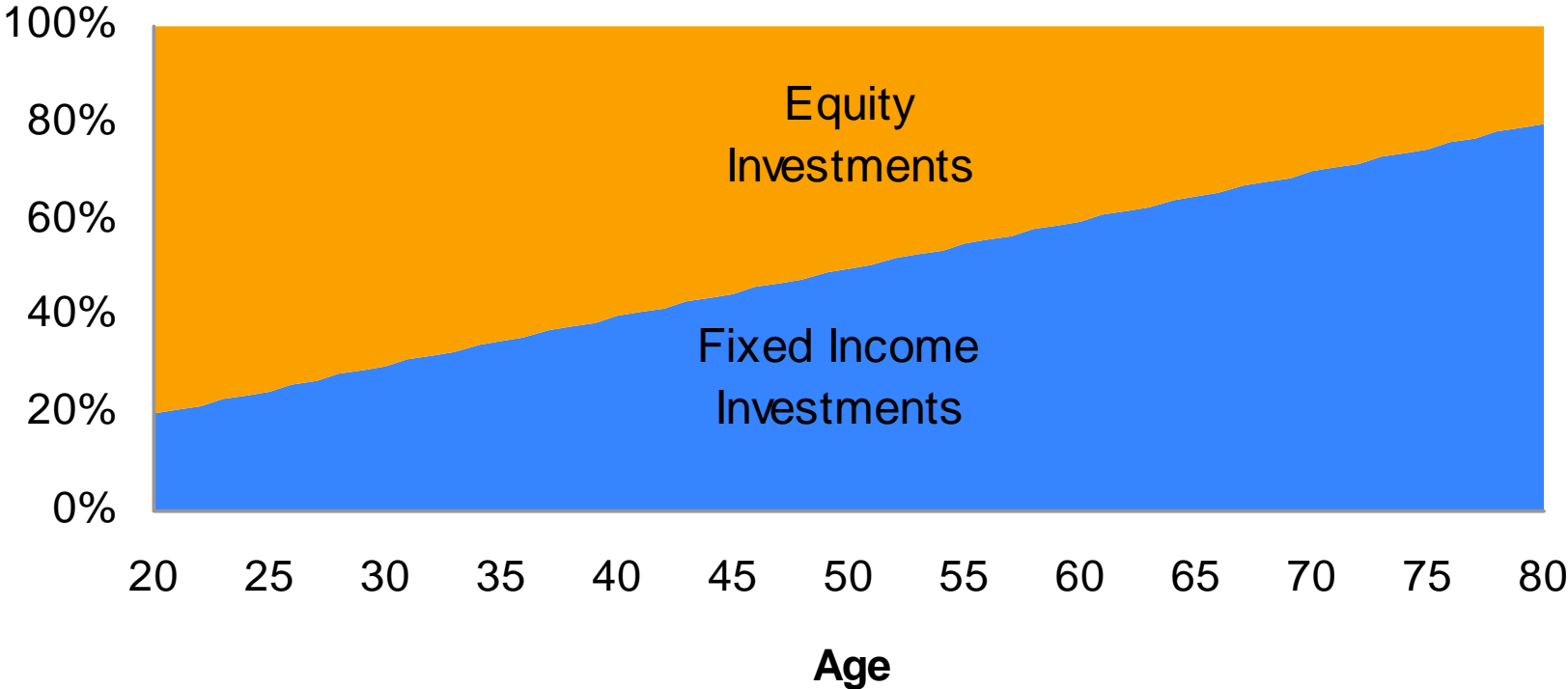


Source: Federal Reserve, UBS WMR



The Future: Municipals and the Baby Boomers

Older investors allocate more of their portfolio to fixed income

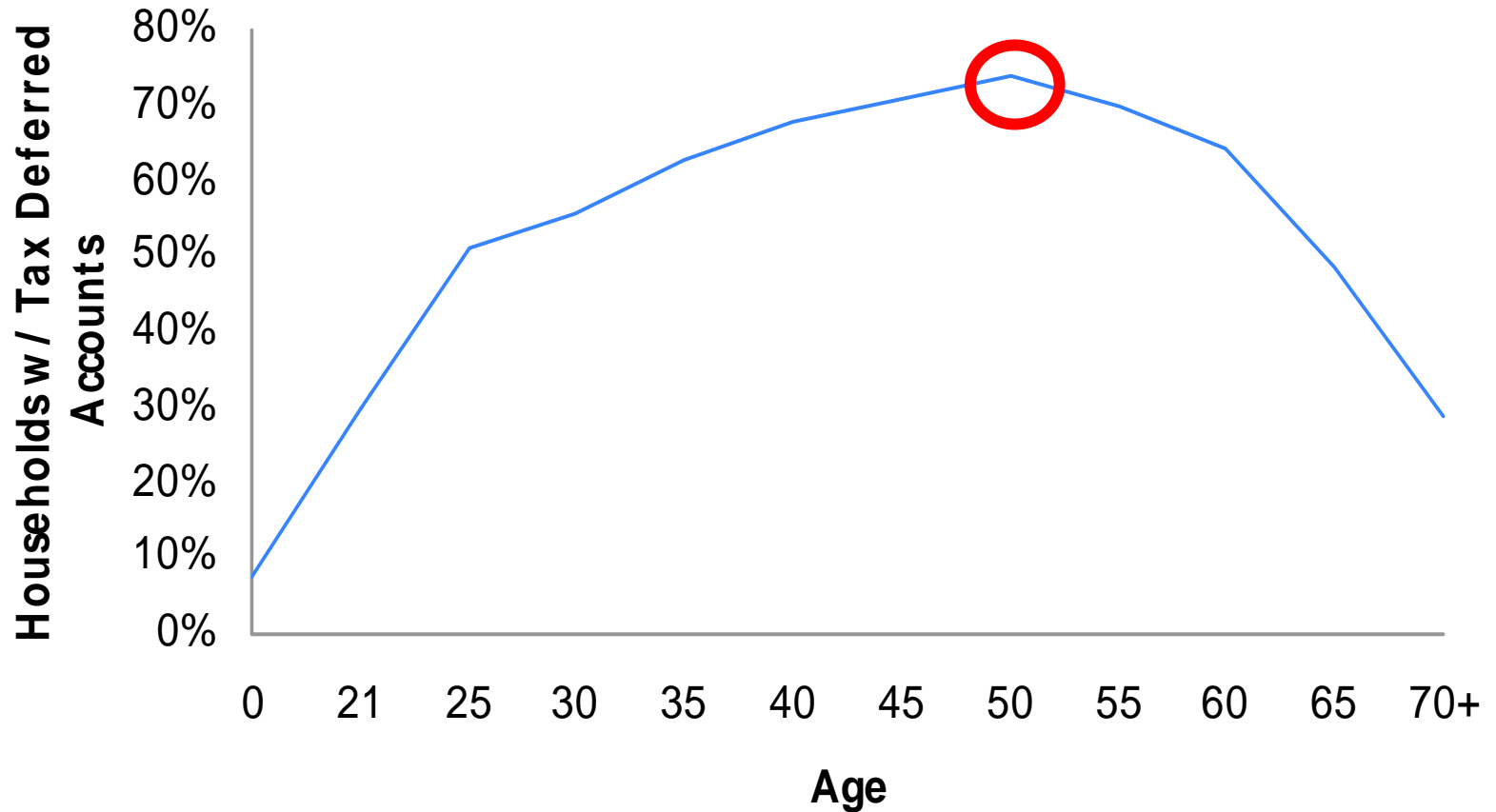


Source: UBS WMR



The Future: Municipals and the Baby Boomers

As investors age, more invested assets become taxable

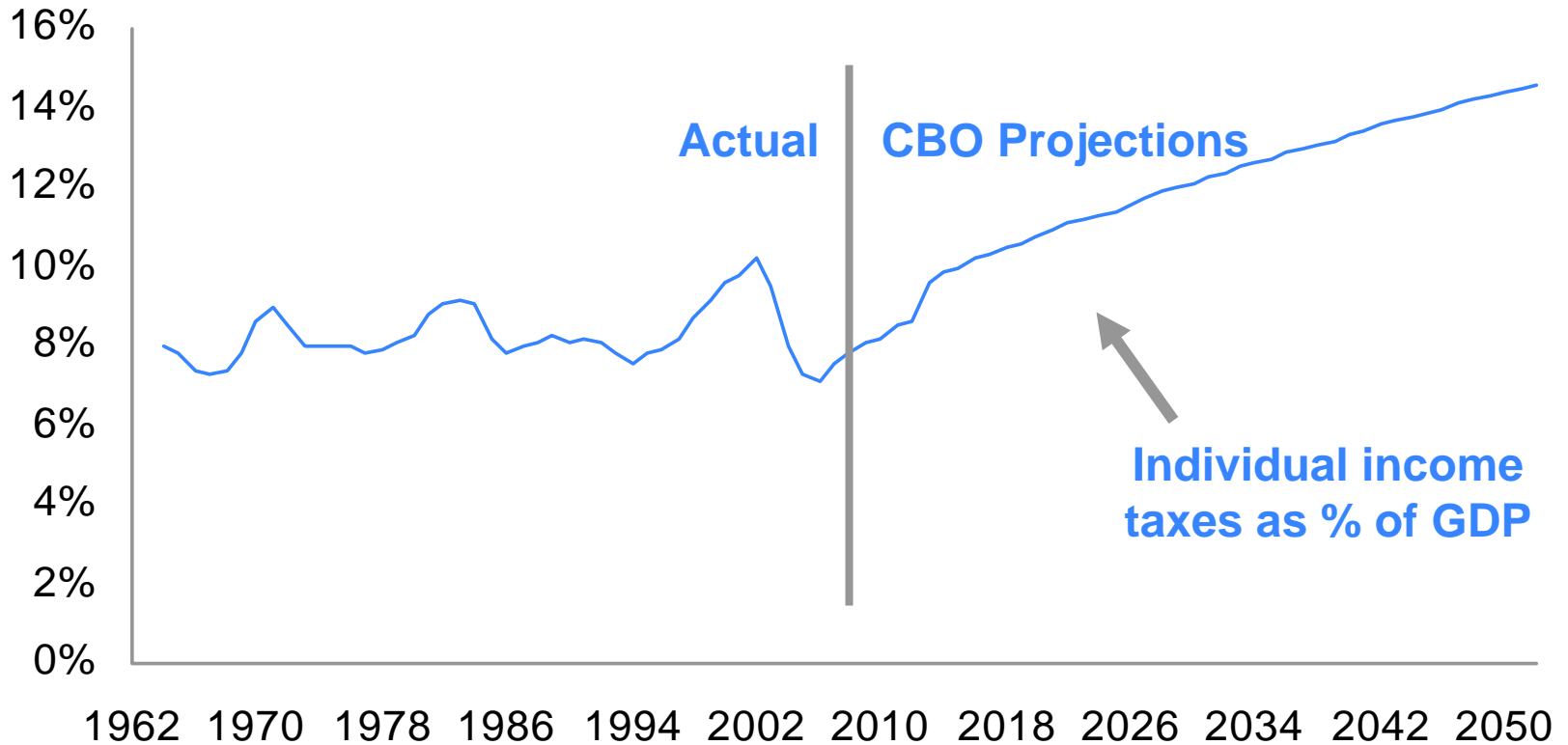


Source: Office of Tax Analysis (Dept. of Treasury), UBS WMR



The Future: Municipals and the Baby Boomers

Federal spending priorities will pressure future tax rates

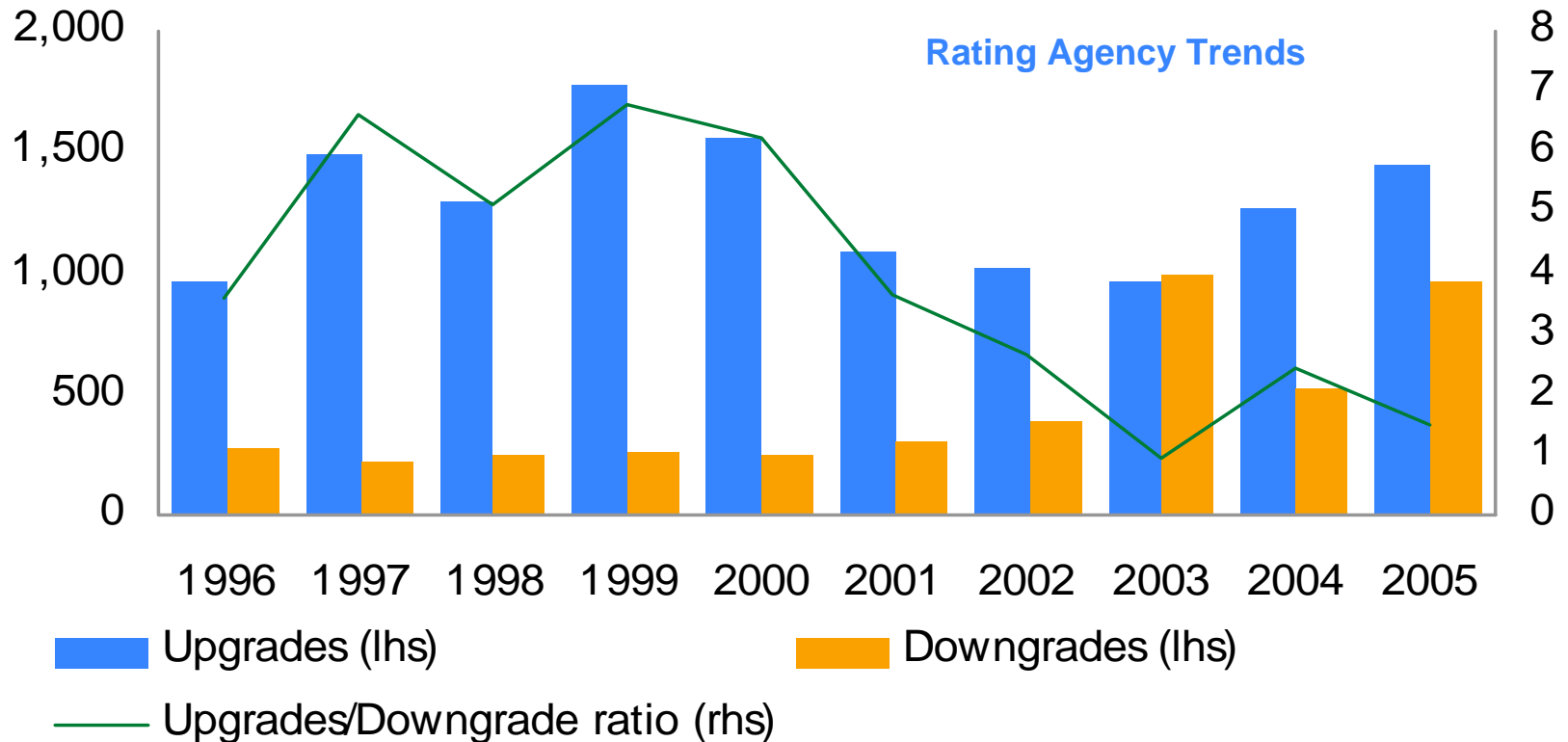


Source: The Congressional Budget Office, UBS WMR



The Future: Municipals and the Baby Boomers

Municipal credit quality should remain strong, supporting yields



Source: S&P, Moody's, and UBS WMR



The Future: Municipals and the Baby Boomers

Conclusion

**It is reasonable to expect
municipal bond yields will remain low
over the next decade**



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Contact Information

Matt Fabian

212-713-4385

Matt.Fabian@ubs.com

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www.ubs.com/financialservicesinc

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