The Federal Reserve Board

Meeting of the Federal Open Market Committee
November 6, 2002 Presentation Materials -- Text Version

Presentation Materials (1.19 MB PDF)

Pages 112 to 122 of Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: U.S. Current Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: U.S. Libor fixing, and three-month, six-month, and nine-month forward rate agreements
Horizon: June 3, 2002 - November 4, 2002
Description: Since June, Libor and short-term forward rate agreement rates decline

Source: Bloomberg

Middle panel

Title: Duration of Lehman Brothers Mortgage Index and 10-Year Treasury Yield
Series: Duration of Lehman Brothers mortgage index and 10-Year Treasury yield
Horizon: June 3, 2002 - November 4, 2002
Description: Duration of Lehman Brother mortgage index declines while 10-Year Treasury yields decline.

Source: Lehman Brothers, Bloomberg

Bottom panel

Title: S&P 500 Price and 10-Year Note Yield Changes
Series: 100-day rolling correlation between S&P 500 index and 10-year Treasury yield
Horizon: January 1, 1988 - November 4, 2002
Description: The 100-day rolling correlation between S&P 500 index and 10-year Treasury yield has increased in recent months.

Source: Bloomberg

Page 2

Top-left panel

Title: U.S. Investment Grade Option-Adjusted Spread
Series: U.S. Investment Grade option-adjusted spread
Horizon: January 2, 2002 - November 4, 2002
Description: The U.S. Investment Grade option-adjusted spread has widened over the year.

Source: Lehman Brothers

Top-right panel

Title: U.S. High-Yield Option-Adjusted Spread
Series: U.S. High-Yield Option-Adjusted Spread
Horizon: January 2, 2002 - November 4, 2002
Description: The U.S. High-Yield option-adjusted spread has widened over the year.

Source: Merrill Lynch

Middle panel

Title: Percent of Investment Grade Debt Outstanding Categorized by Option-Adjusted Spread to Comparable Treasuries
Series: Percent of Investment Grade debt outstanding categorized by option-adjusted spread to comparable Treasuries on 10/25/2000, 10/25/2001, and 10/25/2002
Horizon: October 25, 2000 - October 25, 2002
Description: A large percent of investment grade outstanding on 10/25/2000, 10/25/2001, and 10/25/2002 had a spread between 100-200 basis points to Treasuries.

Source: Merrill Lynch Investment Grade Index

Bottom panel

Title: Select Large Corporate Bond Issuers: 10-Year Spreads to Treasuries
Series: Spread to Treasuries on Ford, GM, Household Finance, and AT&T bonds
Horizon: January 2, 2002 - November 4, 2002
Description: Debt spreads on large corporate bond issuers have widened over the year.

Source: Lehman Brothers

Page 3

Top panel

Title: Euro-Area Current Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: Euro-Area Libor fixing, and three-month, six-month, and nine-month forward rate agreements
Horizon: June 3, 2002 - November 4, 2002
Description: Since June, Euro-Area Libor and short-term forward rate agreement rates decline

Source: Bloomberg

Middle panel

Title: Index of Euro Corporate Spreads to Comparable German Government Debt
Series: Index of AAA, AA, A, and BBB-rated Euro corporate spreads to comparable German government debt
Horizon: January 2, 2001 - November 4, 2002
Description: BBB-rated Euro corporate spreads to comparable German government debt have widen slightly since January 2001

Source: JP Morgan

Bottom panel

Title: Monthly Euro-Denominated Investment Grade Corporate Issuance
Series: Monthly Euro-Denominated Investment Grade corporate issuance
Horizon: January 2001 - October 2002
Description: Monthly Euro-Denominated Investment Grade corporate issuance has declined in recent months.

Source: Morgan Stanley

Page 4

Top panel

Title: Japanese Government 10-Year Benchmark Yield
Series: Japanese government 10-Year benchmark yield
Horizon: June 3, 2002 - November 5, 2002
Description: Japanese government 10-Year benchmark yield have declined since June.

Source: Bloomberg

Bottom panel

Title: Japanese Bank Stocks
Series: Topix Bank Index price, and stock prices for MTFG, Mizuho, UFJ, and Sumitomo
Horizon: June 3, 2002 - November 5, 2002
Description: The stock prices of MTFG, Mizuho, UFJ, and Sumitomo have declined since June. The Topix Bank Index has also declined.

Source: Bloomberg

Page 5

Top panel

Title: Total Domestic Portfolio: Permanent SOMA Holdings, Long-Term RPs, and Short-term Operations (RPs less Matched Sale-Purchase Agreements)
Series: Permanent SOMA Holdings, Long-Term RPs, and Short-term operations (RPs less Matched Sale-Purchase Agreements)
Horizon: February 6, 2002 - February 5, 2003
Description: The domestic portfolio has grown since February 2002 and is projected to continue to grow through February 2003.

Appendix 2: Materials used by Mr. Reinhart

Exhibit 1

Exhibit 1 includes five charts and tables that provide information on monetary policy expectations based on both financial market quotes as well as surveys.

Top-left panel
Expected Federal Funds Rates on August 12, 2002

Top-center panel
Expected Federal Funds Rates on September 23, 2002

Top-right panel
Expected Federal Funds Rates on November 5, 2002

The top-left panel is a line chart of the term structure of expected federal funds rates on August 12, 2002 derived from federal funds and Eurodollar futures with an allowance for term premia and other adjustments. The horizontal axis ranges from the fourth quarter of 2002 through the further quarter of 2005. The top-center panel is a similar line chart for expected funds rates constructed similarly for September 23, 2002, and the top-right panel is a similar line chart for expected funds rates constructed similarly for November 5, 2002. Each of these three charts shows that investors expected the federal funds rate to turn a bit lower before moving higher later in 2003. However, the nadir of the expected path of the federal funds rate on the most recent date is a touch lower than in August and September.

Middle panel
Probability of Policy Actions

The middle panel is a line chart of the probability of policy actions based on near-term federal funds futures contracts from June 26 through November 5. Vertical lines denote the August 13 FOMC meeting and the September 24 FOMC meeting. The chart shows two regions of alternative funds rates, stacked horizontally, 1.25 percent vs. 1.50 percent and 1.50 percent vs. 1.75 percent.

Bottom panel
MMS Survey

(Number of Respondents)

		November Meeting		**December Meeting**		**January Meeting**	
		Weakness	**Neutral**	**Weakness**	**Neutral**	**Weakness**	**Neutral**
Target	1.75	**11**	**0**	8	0	7	1
	1.50	**15**	**0**	11	0	9	1
	1.25	**10**	**0**	16	0	15	1
	1.00	**0**	**0**	1	0	2	0

The bottom panel is a table that summaries responses to the MMS Survey. The table has four rows corresponding to 1.00, 1.25, 1.50, and 1.75 percent target funds rates. There are three columns that correspond to the November, December, and January FOMC meetings, each with two subheadings that denote the number of respondents to the survey who expect the FOMC statement to cite "weakness" or "neutral." The table therefore has 24 entries. The first two columns of the table indicate that twenty-five of the thirty-six respondents expect policy easing, with fifteen anticipating a cut of 25 basis points and ten looking for a 50 basis point move. Also, the majority of respondents expect the funds rate to be at least as low as 1¼ percent in late January, with the balance of risks still pointing toward economic weakness.

Exhibit 2

Top panel
Actual Real Federal Funds Rate and Range of Estimated Equilibrium Real Rates

A line time-series chart of the actual real federal funds rate and the range of estimate equilibrium real rates from 1996 through 2002 at a quarterly frequency. The vertical axis ranges from -1 to 5 percent.

The lines include the actual real funds rate as well as the rate implied by a two-sided FRB/US model based on historical data and the staff forecast. The shaded range represents the maximum and the minimum values each quarter of six estimates of the equilibrium real federal funds rate based on a statistical filter and the FRB/US model. Real federal funds rates employ four-quarter lagged core PCE inflation as a proxy for inflation expectations, with the staff projection used for 2002:Q3-2002:Q4. The chart shows that aggressive policy actions in 2001 moved the real federal funds rate from around 4¾ percent at the beginning of the year, to about zero by year-end, where it has been held since. Although estimates of the equilibrium real federal funds rate have also moved down, the real rate is below the lower bound of that range. The spread of the actual real rate below the FRB/US model's view of the real short rate, which is ultimately consistent with sending aggregate demand to the level of potential output, has been sizable for some time.

Bottom panel
Cumulative Monetary Policy Effect on Quarterly Real GDP Growth (at an Annual Rate)

A line chart that depicts the cumulative monetary policy effect on quarterly real GDP growth at an annual rate derived from the two-sided FRB/US model based on historical data and the staff forecast. The horizontal range of the series cover goes from 1996 through 2004, and the vertical axis ranges from less than -1 to 3 percent. The chart shows that according to this estimate, monetary policy stimulus began to kick in only by the middle of last year, as policy easing was initially only offsetting the cumulative effect of the real rate running above its equilibrium value for much of the second half of the 1990s. The staff model would suggest that policy easing thus far has been adding about 1¾ percentage points to real GDP growth this year.

Exhibit 3
(Chart 7 from Bluebook)

Exhibit 3 shows Chart 7 from the Bluebook, which reports on the "policymaker perfect foresight" strategy simulations for monetary policy. These simulations take the staff outlook and the FRB/US model as assured representations of how the world will evolve over the next five years and assume that policymakers care equally about deviations of unemployment from its natural rate and core inflation from an assumed target.

Top-left panel
Nominal Federal Funds Rate

A chart of three lines depicting the nominal federal funds rate path under the baseline assumption, a one percent inflation goal, and a 1½ percent inflation goal. The horizontal axis ranges from 2001 through the end of the 2008, and the vertical axis runs from zero to 7 percent. For the remainder of 2003 and the first quarter of 2004, the baseline or Greenbook path lies above the paths implied by the 1 percent and the 1½ percent inflation goals, respectively. At the end of the forecast horizon, the funds rate under the 1½ percent goal is slightly greater than that for the 1 percent objective, at close to 3 percent.

Top-right panel
Real Federal Funds Rate[1]

A chart of three lines depicting the real federal funds rate path under the Greenbook assumption, a one percent inflation goal, and a 1½ percent inflation goal. The horizontal axis ranges from 2001 through the end of the 2008, and the vertical axis runs from -1 to 6 percent. For the remainder of 2003 and in early 2004, the Greenbook path lies above the paths implied by the 1 percent and 1½ percent inflation goals, respectively. From the middle of 2004 through the end of 2007, the funds rates under 1½ percent and 1 percent goal are largely similar and increase to around 2 percent at the end of the forecast.

Middle panel
Civilian Unemployment Rate

A chart of three lines depicting the civilian unemployment rate under the Greenbook assumption, a one percent inflation goal, and a 1½ percent inflation goal. The horizontal axis ranges from 2001 through the end of the 2008, and the vertical axis runs from 3.5 to 6.5 percent. For the entire forecast period, the Greenbook path lies above the paths implied by the 1 percent and 1½ percent inflation goals, respectively.

Bottom panel
PCE Inflation (ex. food and energy)

A chart of three lines depicting the core PCE rate, excluding food and energy and expressed as a four-quarter percent change, under the Greenbook assumption, a one percent inflation goal, and a 1½ percent inflation goal. The horizontal axis ranges from 2001 through the end of the 2008, and the vertical axis runs from 0.8 to 2 percent. For the entire forecast period, the path implied by the 1½ inflation goal lies above that implied by the 1 percent goal, which in turn is greater than the baseline.

The perfect foresight simulations extend the key assumptions of the staff outlook (other than the path for monetary policy) through 2008:

- potential output grows at about 3-1/2 percent per year
- the relative price of oil stabilizes at its 2005 level
- the exchange value of the dollar measured in real terms falls at a 3 percent clip
- modest growth in federal expenditures allows an improvement in the federal budget balance

Return to text

1. The real federal funds rate is calculated as the quarterly average nominal funds rate minus the four-quarter lagged core PCE inflation rate as a proxy for inflation expectations. Return to text

Exhibit 4

Top panel
Balance-of-Risks Statement

- "The new language is designed to express the Committee's sense of risks to the attainment of its long-run goals of stable prices and sustainable economic growth."
- "Although 'the foreseeable future' is intended to convey a length of time extending beyond the next FOMC meeting, this concept is necessarily elastic, given that the relevant horizon may depend on economic conditions."

Text regarding the balance-of-risks assessment. The panel lists how the Committee described its disclosure policy when it was introduced in January 2000. As noted in the first bullet, the Committee has promised that its statement will express its "sense of risks to the attainment of its long-run goals of stable prices and sustainable economic growth." However, as in the second bullet, that attainment is assessed over the "foreseeable future," admittedly an elastic concept about a "relevant" period that may depend on economic conditions.

Bottom-left panel
Lower Funds Rate Path Scenario

Three bar charts that characterize the lower funds rate path scenario of 50 basis points that cover real

GDP, the civilian unemployment rate, and PCE prices excluding food and energy. The bars for each of these three series denote the first and second halves of 2002, 2003, and 2004 as a whole. The charts also include a line that depicts the baseline outcomes, again for each of the three series.

Middle-right panel

The Committee might retain unbalanced risks if:

- In the near term resource slack is expected to build.
- Uncertainty surrounding the forecast might seem to weigh particularly heavily on the down side.

The text notes that, even after ½ point of ease, the Committee might indicate that the risks were still tilted toward weakness because in the near term--that is, before any effects of action today would plausibly leave an imprint on the economy--resource slack builds.

Bottom-right panel

The Committee might switch to balanced risks if:

- Aggregate demand is expected to expand considerably faster than aggregate supply in the second half of 2003 and 2004.
- Action today may better balance the odds of future action.

The text notes that the Committee might put particular weight on the observation that, after policy action, aggregate demand is expected to expand considerably faster than aggregate supply in the second half of 2003 and in 2004, an outcome that might be seen to offset the prospect of declining core inflation if the "foreseeable future" stretches sufficiently far. Also, the text notes that "action today may better balance the odds of future action," despite whether it saw the macroeconomic consequences of an adverse outcome for spending as worse than would attend a positive surprise.

Return to top
