

Meeting of the Federal Open Market Committee May 6, 2003 Presentation Materials -- Text Version

[Presentation Materials \(1.65 MB PDF\)](#)

Pages 105 to 115 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Title: U.S. Current Deposit Rates and Rates Implied by Traded Forward Rate Agreements

Series: U.S. LIBOR fixing, 3-month forward rate agreement, 6-month forward rate agreement, 9-month forward rate agreement

Horizon: January 1, 2003 - May 5, 2003

Description: Since the last FOMC meeting, 9-month forward rate agreements have declined, while three-month forward rate agreements remain relatively unchanged.

Title: U.S. Government Yields: 2-Year

Series: 2-Year Treasury Yield, Fed Funds Target Rate

Horizon: January 1, 2003 - May 5, 2003

Description: Two-year Treasury yields are relatively unchanged since the March FOMC meeting.

Title: U.S. Government Yields: 10-Year

Series: 10-Year Treasury Yield

Horizon: January 1, 2003 - May 5, 2003

Description: Ten-year Treasury yields are relatively unchanged since the March FOMC meeting.

Title: U.S. Corporate and Emerging Market Debt Spreads to U.S. Treasuries: U.S. Investment Grade Option-Adjusted Spread

Series: U.S. Investment Grade Corporate Option-Adjusted Spread to Treasury Yield

Horizon: January 1, 2003 - May 5, 2003

Description: The U.S. investment grade corporate option-adjusted spread has narrowed.

Title: U.S. Corporate and Emerging Market Debt Spreads to U.S. Treasuries: U.S. High Yield and EMBI+ Spreads

Series: EMBI+ Sovereign Debt Spread, U.S. High Yield Corporate Option-Adjusted Spread

Horizon: January 1, 2003 - May 5, 2003

Description: The EMBI+ sovereign debt spread and U.S. high yield corporate option-adjusted spread have narrowed.

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Title: Implied Volatility on the S&P 100

Series: VIX Index

Horizon: January 3, 2000 - May 5, 2003

Description: Implied volatility in equity markets declines during the intermeeting period.

Title: Foreign Exchange 1-Month Option Implied Volatilities

Series: 1-Month Option-Implied Volatility for Euro-USD and USD-Yen Exchange Rates

Horizon: January 3, 2000 - May 5, 2003

Description: One-month option-implied volatility for Euro-USD and USD-Yen exchange rates remains relatively unchanged during the intermeeting period.

Title: Implied Volatility on 10-Year Treasury Futures

Series: Implied Volatility on 10-Year Treasury Futures

Horizon: January 3, 2000 - May 5, 2003

Description: Implied volatility on 10-year Treasury futures declined during the intermeeting period.

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Title: Euro-Area Current Deposit Rates and Rates Implied by Traded Forward Rate Agreements

Series: Euribor fixing, 3-month forward rate agreement, 6-month forward rate agreement, 9-month forward rate agreement

Horizon: January 1, 2003 - May 5, 2003

Description: Forward rate agreements and Euribor have been relatively unchanged since the European Central Bank cut the minimum refinancing rate in March.

Title: Index of Euro Corporate Spreads to Comparable German Government Debt

Series: AAA-Rated, AA-Rated, A-Rated, and BBB-Rated Index of Euro Corporate Spreads to Comparable German Government Debt

Horizon: January 1, 2001 - May 5, 2003

Description: BBB-rated Euro corporate spreads to German government debt narrows. AA-rated and A-rated spreads also narrow, but to a lesser extent. AAA-rated spread remains relatively unchanged.

Title: Monthly Euro-Denominated Investment Grade Corporate Issuance

Series: Size of Monthly Euro-Denominated Investment Grade Corporate Issuance

Horizon: January 2001 - April 2003

Description: Monthly euro-denominated investment grade corporate debt issuance declines from the recent high observed in January 2003.

Title: Euro-Dollar Exchange Rate

Series: Euro-USD

Horizon: January 1, 2003 - May 5, 2003

Description: The U.S. dollar has depreciated against the euro.

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Title: Equity Indices

Series: S&P Index, Nikkei Index, DAX Index

Horizon: January 1, 2003 - May 5, 2003

Description: The S&P and DAX indices rise during the intermeeting period, while the Nikkei remains relatively unchanged.

Title: 10-Year JGB Yield

Series: 10-Year JGB Yield

Horizon: January 1, 2003 - May 5, 2003

Description: Ten-year JGB yield declines.

Title: Japanese Corporate Spreads to 5-Year JGB

Series: AAA-Rated, AA-Rated, A-Rated, and BBB-Rated Japanese Corporate Debt Spreads to 5-Year JGB

Horizon: January 1, 2003 - May 5, 2003

Description: BBB-rated and A-rated Japanese corporate debt spreads to five-year JGB yields narrow, while AAA-rated and AA-rated spreads remain relatively unchanged.

Title: Japanese Bank Stocks

Series: Topix Bank Index and Equity Prices for Mizuho, UFJ, MTFG, and Sumitomo

Horizon: January 1, 2003 - May 5, 2003

Description: The equity prices of Japanese banks decline.

Title: Japanese Bank Debt Spreads to 5-Year JGB

Series: UFJ, Mizuho, Sumitomo, and MTFG's Debt Spread to 5-Year JGB

Horizon: January 1, 2003 - May 5, 2003

Description: UFJ, Mizuho, Sumitomo, and MTFG's debt spreads to the five-year JGB narrow.

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Title: Canadian Dollar Exchange Rate

Series: CAD-USD

Horizon: January 1, 2003 - May 5, 2003

Description: The U.S. dollar has depreciated against the Canadian dollar.

Title: U.S. and Canadian 10-2-Year Spreads

Series: Spread between 10- and 2-Year Sovereign Debt Yields for the U.S. and Canada

Horizon: January 1, 2003 - May 5, 2003

Description: The spread between 10- and 2-Year Canadian sovereign debt yields narrows as the Bank of Canada increases the Bank Rate.

Title: Hong Kong Current and Forward Exchange Rates

Series: HKD-USD, 1-Year Forward HKD-USD

Horizon: January 1, 2003 - May 5, 2003

Description: The one-year forward HKD-USD exchange rate increases, while the current HKD-USD exchange rate remains fixed.

Title: Chinese Current and Forward Exchange Rates

Series: Yuan-USD, 1-Year Forward NDF-USD

Horizon: January 1, 2003 - May 5, 2003

Description: The one-year forward NDF-USD exchange rate increases, while the current Yuan-USD exchange rate remains fixed.

Appendix 2: Materials used by Mr. Reinhart

Exhibit 1

Policy Expectations

Exhibit 1 includes five charts on policy expectations based on inferences from financial market data.

Top panel

Probability of 1.00% target as opposed to 1.25% target

The top chart is a line chart that plots the probability that the target federal funds rate will be 1.00 percent following the upcoming May 6, 2003 FOMC meeting using data from federal funds futures contracts. The horizontal axis contains data in five minute intervals from March 12, 2003 through May 2, 2003. Early in the period the probability of a 25 basis point reduction in the target rate to 1 percent ranges between 80 and 100 percent, but then gradually declines to a range of 20 to 25 percent by the end of the period.

Middle-left panel

Expected Federal Funds Rates

The middle-left panel is a line chart of the expected path of the federal funds rate over a period beginning May 2003 and ending in October 2005 using information from federal funds and Eurodollar futures markets. The chart plots the expected path on two different dates, March 17, 2003 and May 5, 2003. The expected federal funds path on May 5, 2003 reflects a downward shift in the expected federal funds path relative to March 17. The path on May 5 shows that the federal funds rate is expected to decline to 1.0 percent by September of 2003 and remain steady through the first quarter of 2004, before rising and eventually reaching a 3.0 percent federal funds rate by October 2005.

Middle-right panel

Implied Distribution of the Federal Funds Rate Derived from Options Prices

The middle-right panel is a bar chart plotting the May 5, 2003 market implied probability distribution of the federal funds rate 150 days ahead, with a single solid line outlining the same on March 17, 2003, using data from constant maturity Eurodollar options. The horizontal axis is divided into 25 basis point intervals between 0.25 percent and 3.0 percent, while the vertical axis contains the probability that the future federal funds rate will fall into each interval. The mode of the probability distribution on May 5, 2003 is 1.25 percent, and the distribution is skewed to the left in the direction of a lower federal funds rate. The probability distribution on March 17, 2003, shown as the solid line, is also centered around 1.25 percent though with roughly equal weight on a lower or higher rate.

Bottom-left panel

Market Uncertainty Regarding the Federal Funds Rate*

The bottom-left panel shows a time series of the width of the market implied 90 percent confidence interval surrounding federal funds rate expectations six-months ahead and twelve-months ahead. The horizontal axis ranges from January 2000 through May 2003 and the vertical axis ranges from 0 to 400 basis points. The width for the six month-ahead 90 percent confidence interval fluctuated within a range between 100 to 180 basis points from January 2000 to July 2002, before declining to around 100 basis points by January 2003. The width for the twelve month-ahead confidence interval fluctuated within a band of 200 to 300 basis points throughout the entire period, but declined steadily to a low of just under 200 basis points by the end of the period in May 2003.

* Width of 90 percent confidence interval computed from futures rates and implied volatility. [Return to text](#)

Note: Solid vertical line indicates March 17, 2003.

Bottom-right panel Market Uncertainty Regarding Swap Rates Six Months Ahead*

The bottom-right panel shows a time series of the width of the market implied 90 percent confidence interval surrounding the ten-year and the one-year interest rate swap rates, six months ahead. The horizontal axis ranges from January 2000 through May 2003 and the vertical axis ranges from 60 to 200 basis points. The width of the confidence interval surrounding the ten-year rate six months ahead rose steadily from 100 basis points at the beginning of the period to 160 basis points by July 2002, before falling to 120 basis points by the end of the period. The width of the confidence interval surrounding the one-year rate six months ahead follows a similar pattern, rising to nearly 180 basis points in mid-2002 before declining rapidly to around 90 basis points by May 2003.

* Width of 90 percent confidence interval computed from swap rates and implied volatility. [Return to text](#)

Note: Solid vertical line indicates March 17, 2003.

Exhibit 2 The Case for Holding Policy Unchanged

Exhibit 2 contains four panels outlining the case for keeping the target federal funds rate at the current level.

Top panel

- The staff forecast is likely and, over the period policy action would take effect, acceptable.
- Economic slack may be worked down sooner and disinflation less likely than in the staff forecast.
- Financial market participants might react adversely to action.

Middle-left panel Real GDP Growth

The middle-left panel is a bar chart that plots quarterly real GDP growth on an annualized basis under two scenarios, a baseline forecast and a second forecast with additional fiscal stimulus. The horizontal axis ranges from 2003:Q1 to 2004:Q4 and the vertical axis ranges from 0 to 5 percent. Both scenarios show a gradual rise from roughly 1.5 percent to 4 percent growth from 2003:Q1 to 2003:Q4 and forecasts between 4.5 and 5 percent for 2004. The additional fiscal stimulus scenario implies a notably faster GDP growth rate in 2003:Q2, and a slightly faster growth rate thereafter.

Middle-right panel Change in Selected Financial Quotes Since March 12

Ten-year Treasury Yield (basis points)	26
Wilshire 5000 (percent)	16
Ten-Year BBB (basis points)	-24
Five-year High Yield (basis points)	144

Bottom panel Policy Surprises at FOMC Meetings

The chart at the bottom of the page is a bar chart plotting the policy surprise at recent FOMC meetings. The horizontal axis ranges from February 2000 to March 2003 and the vertical axis ranges from -30 to 20 basis points. A policy surprise is defined as the actual intended rate after the meeting less the expected rate inferred from futures quotes. The data shows a variation between ± 10 basis points, with the only exception being a roughly 20 basis point surprise on the downside at the November 6, 2002 meeting.

Exhibit 3

The Case for Easing Policy

Exhibit 3 contains four panels outlining the case for reducing the target federal funds rate.

Top panel

- Resources are underused over the projection period.
- Downside risks to demand are more likely or more costly.
- Inflation may fall further from its already low level.

Middle-left panel

Unemployment Rate*

The middle-left panel plots a line showing the staff forecast of the unemployment rate from 2003:Q1 to 2004:Q4. The vertical axis ranges from 5 percent to 6.2 percent. The forecast for unemployment rises from 5.8 at the beginning of the period to a peak of 6.1 percent during the third quarter of 2003 and first quarter of 2004. Thereafter, the unemployment rate is expected to decline to 5.6 percent by the fourth quarter of 2004.

* Staff projections from Greenbook. [Return to text](#)

Middle-right panel

Probability of Federal Funds Rate below 1 percent and 0.5 percent by the fall

The middle-right panel contains a line plot of the probability that the federal funds rate drops below 1 percent and the probability of the rate falling below 0.5 percent by fall 2003, using data from 150-day constant maturity Eurodollar options. The below 1 percent reading fluctuates within a range of 30 and 50 percent probability, while the below 0.5 percent reading fluctuates between 0 and 10 percent probability.

Bottom panel

CPI Inflation

Four-quarter percent change

The bottom panel shows a time series of the four-quarter percent change in CPI inflation from 1949 through 2003. The vertical axis ranges from -5 percent to 15 percent. A horizontal line is drawn through the graph denoting a 1.4 percent CPI inflation rate. Over the 54-year period, the four-quarter percent change dipped below the horizontal line in the late 40's, mid-50's and fluctuated within a tight band around the 1.4 percent rate during the early 60's. Since 1964, however, the CPI inflation rate is generally well above the 1.4 percent level, but has trended back towards this level since 1997, indicating that inflation is currently low by historical standards.

Exhibit 4

The Balance of Risks Assessment

Exhibit 4 contains two panels outlining the assessment of the balance of risks according to a survey conducted with Primary Dealers on April 28-29, 2003.

Top panel

FRBNY Survey of Primary Dealers

Risks balanced	11
Risks toward weakness	5
No risk assessment	6

Middle panel

Three Options

1. Reinstate the balance-of-risks language.
2. Abandon the balance-of-risks language.
3. Augment the assessment of risks.

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