Meeting of the Federal Open Market Committee
September 16, 2003 Presentation Materials -- Text Version

Presentation Materials (2.14 MB PDF)

Pages 96 to 106 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: Current U.S. 3-Month Deposit Rate 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: May 1, 2003 - September 15, 2003
Description: Forward rate agreements and U.S. Libor remain relatively unchanged since the August FOMC meeting.

Middle-left panel

Title: U.S. Treasury Yields: 2-Year Note
Series: 2-Year Treasury Yield
Horizon: May 1, 2003 - September 15, 2003
Description: Two-year Treasury yields declined from the recent high.

Middle-right panel

Title: U.S. Treasury Yields: 10-Year Note
Series: 10-Year Treasury Yield
Horizon: May 1, 2003 - September 15, 2003
Description: Ten-year Treasury yields have declined modestly since the August FOMC meeting.

Bottom panel

Title: U.S. Nominal Treasury Yields Less Inflation-Indexed Treasury Yields
Series: 5- and 10-Year Spread between Nominal and Inflation Protected Treasury Yields
Horizon: May 1, 2003 - September 12, 2003
Description: The spread between five-year nominal and inflation-protected Treasury yields has risen modestly since the August FOMC meeting. The ten-year spread remains relatively unchanged.

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Top panel

Title: Current 3-Month Euro-Area Deposit Rate 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: May 1, 2003 - September 15, 2003
Description: The Euribor fixing and forward rate agreements are little changed since the August FOMC meeting.

Middle panel

Title: European 10-Year Government Yields
Series: 10-Year Government Bond Yields for the U.K., France, Germany, Spain, and Italy
Horizon: May 1, 2003 - September 15, 2003
Description: Ten-year government bond yields are little changed since the August FOMC meeting.

Bottom panel

Title: Select Global Equity Indices
Series: S&P 500 Index, DJ Euro Stoxx Index, Taiwan Weighted Index, Kospi Index, Hang Seng Index, Bolsa Index, Bovespa Index
Horizon: May 1, 2003 - September 12, 2003
Description: Global equity indices have been increasing since the beginning of May.

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Top panel

Title: Japanese Equities
Series: Nikkei Index, Topix Index, Topix Bank Index
Horizon: May 1, 2003 - September 12, 2003
Description: Japanese equity indices have been increasing since the beginning of May.

Middle panel

Title: Japanese Government Yield Curves
Series: Japanese Sovereign Debt Yield Curve as of 06/12/2003 and 09/12/2003
Horizon: June 12, 2003 and September 12, 2003
Description: The Japanese sovereign debt yield curve has steepened in the past three months.

Bottom-left panel

Title: Bank of Japan Current Account Balance
Series: Bank of Japan's Current Account Balance and Target Account Balance
Horizon: January 1, 2002 - September 12, 2003
Description: The Bank of Japan's current account balance declines after the fiscal year-end.

Bottom-right panel

Title: Dollar-Yen Exchange Rate
Series: USD-Yen.
Horizon: May 1, 2003 - September 12, 2003

Description: The yen has been appreciating against the U.S. dollar since August.

Intervention since August FOMC: $39.8 billion. Intervention YTD: $111.9 billion.

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Top panel

Title: Weekly FICC Fails Volume
Series: Fails Volume for Aggregate Treasury Securities and the May 10-Year Issue
Horizon: January 1, 2003 - September 12, 2003
Description: The volume of Treasury fails has increased, particularly in the May 10-year issue.

Bottom panel

Title: Weekly Aggregate SOMA Securities Lending Volume
Series: Weekly Aggregate SOMA Securities Lending Volume
Horizon: January 1, 2003 - September 12, 2003
Description: Weekly aggregate SOMA securities lending volume declined following the August 15 refunding settlement.

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Top panel

Title: Total Fed Balances: Nonborrowed and Borrowed
Series: Total NonBorrowed and Borrowed Fed Balances
Horizon: August 1, 2003 - September 12, 2003
Description: The borrowed portion of total Fed balances increased sharply during the Blackout Period, August 14-15.

Middle panel

Title: Federal Funds Market Conditions
Series: Fed Funds Trading Range, Intervention Level, and Effective Rate
Horizon: August 1, 2003 - September 12, 2003
Description: The high in the fed funds market exceeds the Primary Credit Rate for the first time ever on August 14.

Bottom panel

Title: Currency Component of M1 (s.a.)
Series: Currency Component of M1 (s.a.) 1-Month Annualized Growth Rate
Horizon: January 2001 - August 2003
Description: The currency component of M1 has declined.

Appendix 2: Materials used by Mr. Reinhart

Exhibit 1
Market Expectations about Policy

Exhibit 1 includes six panels that provide information on market expectations about policy.

Top-left panel
Expected Federal Funds Rates*

The line chart in the top-left panel shows the path of the expected federal funds rate on August 11, 2003 and September 15, 2003 and shows that market participants expect the rate to remain at 1 percent for the remainder of the year and to rise to about 3.5 percent by early 2006.

* Estimates from federal funds and eurodollar futures Return to text

Top-right panel
Primary Dealers' Expectation of Risk Assessment (FRBNY Survey, as of September 9)

	Balance		
Objectives	**Downside**	**Balanced**	**Upside**
Growth	0	20	2
Price Stability	22	0	0
Predominant Risk	20	1	1

Middle-left panel
Probability of Federal Funds Rate at or Below .50 Percent About Six Months Ahead

The line chart in the middle-left panel reveals that the probability that the nominal funds rate will reach a level of 50 basis points or lower in the next five months -- inferred from options on Eurodollar futures -- has decreased from 20 percent in June to about 5 percent in September.

Middle-right panel
Implied Distribution of Federal Funds Rate About Six Months Ahead*

The middle-right bar chart indicates that the implied distribution of the federal funds rate six months ahead places 40 percent probability on a 1 percent target rate (no change), with 20 and 25 percent probabilities on target rates of 0.75 percent and 1.25 percent, respectively.

* Estimates from options on eurodollar futures contracts, adjusted to estimate expectations for the federal funds rate. Return to text

Bottom panels

The bottom two panels highlight a decrease in the volatility of market expectations about the funds rate, despite recent surprises in the unemployment rate.

Bottom-left panel
Volatility of Federal Funds Rate, Average Absolute Daily Change

The bottom-left bar chart depicts the average of the absolute value of daily changes in futures rates -- with the horizontal axis marking 1-, 2-, 5-, 7-, and 10-month maturities. Two sets of bars are plotted, one for the most recent four months, May 2003 - September 2003, and the other for the previous ten years, November 1988 - May 2003. The recent values are much smaller than the prior ten years for short maturities and about the same for long maturities, pointing to a decrease in near-term volatility.

Bottom-right panel
Average Response of Futures Rates to Unemployment Rate Surprise*

The bottom-right bar chart compares the average responses of futures rates of various maturities to unemployment rate surprises between the June 2003 - September 2003 and January 1993 - September 2003 periods. The figures point to a recent decrease in the impact of unemployment surprises; in particular, for the 2-year horizon, the graph shows a decrease of 0.2 percentage points in the average response of federal funds futures rates in the recent period, whereas in the past the decrease was closer to 1.0 percentage points.

* Response to hypothetical one percentage point surprise increase in unemployment rate. Return to text

Exhibit 2
The Case for Easing 25 Basis Points

Exhibit 2 includes four panels outlining a case for easing policy by 25 basis points.

Top panel

- Considerable resource slack lingers in the staff projection.
- The neutral real funds rate may be above the equilibrium real funds rate.
- Capital spending may not recover.

Middle-left panel
Unemployment Rate

The first bullet in the top panel is supported by the middle-left line graph, displaying quarterly unemployment, with a projected decrease from the current 6 percent rate to about 5-1/4 percent by the end of 2005. The September Greenbook projects a more gradual decline in the unemployment rate than in the June Greenbook.

Middle-right panel
Unemployment Rate

The middle-right bar chart analyzes the Greenbook forecast unemployment rate relative to a "weak investment" scenario in which investment expands 4 percentage points less than the baseline Greenbook projection. With a 25 basis point cut, the unemployment rate decreases to about 5 percent by 2005 under the Greenbook baseline assumption, but increases to about 6-3/4 for the weaker investment assumption.

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

The bottom panel provides information on the equilibrium real federal funds rate and long-run inflation expectations, further highlighting lingering resource slack. The panel depicts the actual real federal funds rate starting in the first quarter of 1990, together with market-based and staff estimates of the equilibrium real funds rate and a historical average calculated over the 1966-2003 period. The historical average is plotted as a horizontal line at about 2.66 percent, while the staff estimates consist of a shaded region bounded by the maximum and minimum values for each quarter. This region spans about 100 to 200 basis points over the period covered and generally shows a rising trend during the second half of the 1990s. Beginning in about 1999, the range of estimated equilibrium real rates declines, and currently extends from about -0.5 percent to about 1.5 percent. Meanwhile, the current value of the real federal funds rate is at about -25 basis points, which is about unchanged over the last year but down substantially from the peak of around 4.5 percent in 2000. An additional 25 basis point cut would bring the rate to the bottom of the range of model-based estimates of the equilibrium real rate. Finally, the estimate of the equilibrium real rate based on TIIS rates is currently slightly above 3 percent, also down somewhat since the late 1990s.

Note: The shaded range represents the maximum and the minimum values each quarter of four estimates of the equilibrium.

Exhibit 3
The Case for an Unchanged Target Federal Funds Rate

Exhibit 3 outlines the case for an unchanged target federal funds rate, using four panels.

Top panel

- In the staff forecast, inflation holds fairly stable at around 1 percent.
- There may be other sources of impetus.
- Market participants may be right in expecting more pressure on inflation.

Middle panel
Slope of the Yield Curve: Ten-Year Treasury - Federal Funds Rate

The line graph in the middle panel displays the slope of the yield curve, measured as the distance between the ten-year Treasury and the federal funds rate, plotted from 1980 to 2003. The slope of the yield curve has increased since 2001. Some of the steepening in the yield curve may result from increased inflationary pressures.

Bottom-left panel
Inflation Compensation*

The bottom-left line graph shows an increase in inflation compensation of about 50 basis points since June 2003.

* Based on a comparison of an estimated TIIS yield curve to the nominal off-the-run Treasury yield curve. Return to text

Bottom-right panel
Investment Bank Economic Forecasts

2004: Q4 to Q4

	Real GDP Growth	CPI Inflation
1. Goldman Sachs	2.9	1.1
2. JP Morgan	3.5	1.4
3. Bear Stearns	4.2	2.0
4. Morgan Stanley	4.6	1.5
5. Merrill Lynch	3.5	0.9
Memo: Greenbook	*5.0*	*0.9*

Exhibit 4
Risk Assessment

The final exhibit provides an assessment of the balance of risks, using three figures.

Top panel
Possibilities for the Overall Risk Assessment

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="3">Risks to Price Stability</th></tr>
<tr><th>Downside</th><th>Balanced</th><th>Upside</th></tr>
<tr><td rowspan="3">Risks to Sustainable Economic Growth</td><td>Downside</td><td>Downside</td><td>Downside</td><td>?</td></tr>
<tr><td>Balanced</td><td>Downside (blue)</td><td>Balanced (red)</td><td>Upside</td></tr>
<tr><td>Upside</td><td>? (yellow)</td><td>Upside (red)</td><td>Upside</td></tr>
</table>

Blue shading indicates the assessment given at the August meeting. Yellow shading indicates a possible, though perhaps unlikely, alternative assessment for the current meeting. Red shading indicates an assessment that is perhaps less likely.

Bottom-left panel
August Announcement

"… the Committee believes that policy accommodation can be maintained for a considerable period."

Bottom-right panel
Intended Federal Funds Rate

The bottom-right graph displays the target federal funds rate since May 2001, with accommodative policy highlighted, from January 2002 through the present. Since accommodative policy does not imply decreases in the funds rate, but rather a funds rate below that which is considered the equilibrium, an increase in the rate could still be consistent with a level of the funds rate that is accommodative.

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