Meeting of the Federal Open Market Committee
October 28, 2003 Presentation Materials -- Text Version

Presentation Materials (2.12 MB PDF)

Pages 112 to 126 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: Current U.S. and Euro-area 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: U.S. and Euro Area LIBOR fixings, U.S. and Euro Area 3-, 6-, and 9-Month Forward Rate Agreements
Horizon: August 1, 2003 - October 24, 2003
Description: U.S. and euro area forward rate agreements increased following the September employment report.

Bottom-left panel

Title: U.S. Treasury Yields: 2-Year Note
Series: 2-Year Treasury Yield
Horizon: August 1, 2003 - October 24, 2003
Description: Two-year Treasury yields increased following the September employment report.

Bottom-right panel

Title: U.S. Treasury Yields: 10-Year Note
Series: 10-Year Treasury Yield
Horizon: August 1, 2003 - October 24, 2003
Description: Ten-year Treasury yields increased following the September employment report.

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Top-left panel

Title: Investment Grade Corporate Debt Spread
Series: U.S. Investment Grade Corporate Option-Adjusted Spread
Horizon: August 1, 2003 - October 24, 2003
Description: The U.S. investment grade corporate option-adjusted spread has narrowed since the September FOMC meeting.

Lehman Brothers Investment Grade Corporate Index OAS. Source: Lehman Brothers

Top-right panel

Title: High Yield and EMBI+ Spreads
Series: EMBI+ Sovereign Debt Spread, U.S. High Yield Corporate Option-Adjusted Spread
Horizon: August 1, 2003 - October 24, 2003
Description: The U.S. high yield corporate option-adjusted spread has narrowed since the September FOMC meeting.

Merrill Lynch High Yield Bond Index OAS; EMBI+. Source: Merrill Lynch, JP Morgan

Middle panel

Title: VIX Index
Series: VIX Index
Horizon: August 1, 2003 - October 24, 2003
Description: Implied volatility in equity markets has declined.

Bottom panel

Title: Euro-Dollar and Dollar-Yen 1-Month Option Implied Volatility
Series: 1-Month Option Implied Volatility for Euro-Dollar and Dollar-Yen Exchange Rates
Horizon: August 1, 2003 - October 24, 2003
Description: One-month option implied volatility for euro-dollar and dollar-yen have declined since the September G-7 communiqué.

Page 3

Top panel

Title: Euro-Dollar Exchange Rate
Series: Euro-USD
Horizon: August 1, 2003 - October 24, 2003
Description: The U.S. dollar has depreciated against the euro.

Middle panel

Title: Select Asian Currencies Against U.S. Dollar
Series: USD-Yen, THB-USD, KRW-USD, HKD-USD, CNY-USD
Horizon: August 1, 2003 - October 24, 2003
Description: Since the beginning of August, the U.S. dollar has depreciated against the Japanese yen, Thai Baht, and Hong Kong dollar, but is relatively unchanged against the Korean Won.

Bottom panel

Title: Dollar-Yen Exchange Rate
Series: USD-Yen.
Horizon: August 1, 2003 - October 24, 2003
Description: The yen has appreciated against the U.S. dollar.

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Top panel

Title: Japanese Net Yearly Intervention in Dollar-Yen
Series: Japanese Net Yearly Intervention Volume in Dollar-Yen
Horizon: January 1, 1989 - October 24, 2003
Description: The amount of net yearly intervention in dollar-yen has risen sharply in 2003.

Middle panel

Title: Japanese Daily Intervention in Dollar-Yen
Series: Dollar Amount of Individual Dollar-Yen Interventions
Horizon: January 1, 1989 - October 24, 2003
Description: The number of interventions in dollar-yen has risen sharply in 2003. Most of the interventions this year have been less than 4 billion U.S. dollars.

Bottom panel

Title: Average Dollar-Yen Intraday Spread for Intervention and Non-Intervention Days: Major Intervention Episodes Since 1994
Series: Average Intraday Spread between the Highest and Lowest Dollar-Yen Levels for Intervention and Non-Intervention Days
Horizon: February 1994 - October 2003
Description: The average intraday spread between the highest and lowest dollar-yen levels for intervention and non-intervention days has declined.

Appendix 2: Materials used by Mr. Reinhart

Material for Briefing on Monetary Policy Alternatives
October 28, 2003

STRICTLY CONFIDENTIAL (FR)
CLASS I FOMC

Exhibit 1
Financial Market Conditions

Exhibit 1 includes charts and tables that provide information on expected federal funds rates and policy uncertainty as well as selected financial market data.

Top-left panel
Expected Federal Funds Rates*

A line chart in the top-left panel displays the expected path of the federal funds rate embedded in futures quotes as of September 15 and October 27, 2003. This chart indicates the slight upward revision of the expected path of the fed funds rate over the intermeeting period. Current futures quotes suggest that the federal funds rate will rise to around 3½ percent by the first quarter of 2006.

* Estimates from federal funds and eurodollar futures, with an allowance for term premia and other adjustments. Return to text

Top-right panel
Primary Dealers' Expectation of Risk Assessment (FRBNY Survey, as of October 20)

	Balance		
Objectives	**Downside**	**Balanced**	**Upside**
Growth	0	20	2
Price Stability	22	0	0
Predominant Risk	21	1	0

Middle-left panel
Policy Uncertainty*

The middle-left line chart plots the time-series of option-implied measures of policy uncertainty six- and twelve-months ahead over the period from January 2001 to present. Both series show a sharp increase in uncertainty over the intermeeting period, perhaps suggesting that investors sense that a change in the policy outlook may be imminent.

* Width of a 90 percent confidence interval computed from the term structures for the expected federal funds rate and implied volatility. Return to text

Middle-right panel
Implied Distribution of Federal Funds Rate About 6 Months Ahead*

The middle-right panel shows a bar graph with the implied distribution of the fed funds rate six months ahead. Over the intermeeting period, the weight in this distribution shifted to the right significantly, with greater probability attached to funds rates in the neighborhood of 1½ to 1¾ percent and less probability associated with funds rates in the neighborhood of ¾ to 1 percent.

* Based on the distribution of the three-month eurodollar rate five months ahead (adjusted for a risk premium), as implied by options on eurodollar futures contracts. Return to text

Bottom panels

The bottom panels include plots of data focusing on broad financial conditions. On balance, these charts suggest that financial conditions have eased a bit further since the last meeting.

Bottom-left panel
Weighted-Average Corporate Yield

In the bottom-left panel there is a line graph of the weighted average yield on outstanding corporate bonds. Since the September FOMC meeting, this yield has edged a little lower and is substantially below the peak reached in 2002.

Bottom-center panel
Wilshire 5000

The bottom-center panel is a line graph of the Wilshire 5000. The Wilshire 5000 moved slightly higher over the intermeeting period and is up more than 20 percent from February of this year.

Bottom-right panel
Nominal Trade-Weighted Major Currency Index

The bottom-right panel is a line graph of the Nominal Trade-Weighted Major Currency Index. The index continued its steep slide since the September FOMC meeting, falling from around 90 to around 85.

Exhibit 2
The Case for an Unchanged Target Federal Funds Rate

Top panel

- Financial market conditions have eased.
- Policy is accommodative.
- Pressures on resources may emerge.

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

In the middle panel there is a line graph of the actual real federal funds rate and the range of estimates for the equilibrium real federal funds rate. The historical average calculated over the 1966:Q1-2003:Q3 period is plotted as a horizontal line at 2.64 percent. The chart shows that the current level of the actual real federal funds rate is already below the lower bound of the range of estimates of the equilibrium real funds rate, and these estimates are generally expected to move higher over the forecast period; a further quarter point easing at this meeting would thus add significantly to the degree of monetary policy accommodation.

Note: The shaded range represents the maximum and the minimum values each quarter of four estimates of the equilibrium real federal funds rate based on a statistical filter and the FRB/US model. Real federal funds rates employ a four-quarter moving average of core PCE inflation as a proxy for inflation expectations, with the staff projection used for 2003:Q4.

Bottom-left panel
Real GDP

The bottom-left panel displays the Greenbook projections for real GDP in the September and October Greenbooks. The October Greenbook projection is noticeably above the September Greenbook projection--a factor that could foreshadow pressures on resources in the future.

Bottom-right panel
Inflation Compensation*

The bottom-right panel displays a line graph of TIPS-based inflation compensation measures over the period from January 2002 until October 2003. There are two series shown--inflation compensation over the next five years and over the next ten years. Both of these series have risen significantly in recent months. Although some of this increase could reflect the influence of special factors, the recent trends in these series hint at some pickup in inflation pressures.

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

Exhibit 3
The Case for Easing 25 Basis Points

Top panel

- Resource slack lingers in the outlook.
- A durable expansion is not yet assured.
- Financial flows have not yet revived.

Middle-left panel
Unemployment Rate

The middle-left panel plots the unemployment rate in the Greenbook baseline projection and in two alternative economic scenarios--a "faltering economic recovery" scenario and an "adverse market reaction" scenario. In the baseline projection, the unemployment rate drops from around 6 percent to about 5 percent by the end of 2005. In contrast, under the two alternative scenarios, the unemployment rate remains elevated and even edges higher in the adverse market reaction scenario.

Middle-right panel
Inflation Rate

The middle-right panel displays the corresponding paths of core PCE inflation in these three scenarios--the Greenbook baseline projection, the "faltering economic recovery" scenario, and the "adverse market reaction" scenario. In the baseline scenario, inflation edges lower over the forecast horizon to about 1 percent. Under the alternative scenarios, inflation moves down more noticeably to about ½ percent by the end of the forecast period.

Note: PCE prices excluding food and energy.

Bottom panels

The bottom panels of the exhibit present some information on financial flows.

Bottom-left panel
M2

The bottom-left panel plots historical growth rates of M2 from 1999 to present. The graph shows that recent money growth has slowed sharply in the last month. Some of the deceleration in money of late may owe to a drop off in the pace of mortgage refinancings, but underlying weakness in the economy could also be a factor.

Bottom-right panel
Net Debt Financing of Nonfinancial Businesses

	2003		
	H1	Q3	Oct
	--- $ billions ---		
C&I Loans	-4.5	-6.9	-0.8
CP	-4.3	-1.9	2.5
Net Bond Issuance	20	7.3	1.7

CP Commercial paper Return to table

Exhibit 4
As Time Goes By

Exhibit 4 examines issues associated with the FOMC statement.

Top panel
Possible Configurations of the Risks to Economic Growth, the Risks to Inflation, and the Balance of Risks

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="3">Risks to Inflation</th></tr>
<tr><th>Unwelcome fall</th><th>Balanced</th><th>Unwelcome rise</th></tr>
<tr><td rowspan="3">Risks to Sustainable Economic Growth</td><td>Weighted to the downside</td><td></td><td></td><td></td></tr>
<tr><td>Balanced</td><td>Inflation undesirably low
(blue)</td><td>Balanced
(red)</td><td></td></tr>
<tr><td>Weighted to the upside</td><td>Inflation undesirably low
-or-
balanced
(yellow)</td><td>Upside risks to sustainable growth
(light yellow)</td><td></td></tr>
</table>

The wording from the most recent statement is consistent with the blue-shaded configuration. The most likely transition in the near term might be to the configuration with yellow shading.

Middle-left panel

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

Middle-right panel
Forecast of Federal Funds Rate

The middle-right panel plots three paths of expected future federal funds rates over the period of 2003:Q4 through 2004:Q4 based on futures quotes, surveys of primary dealers, and the Greenbook. Futures contracts indicate that the federal funds rate is expected to move up to slightly below 2 percent by 2004:Q4. Primary dealers also expect some firming in the policy path, but the tightening is delayed relative to the expected path embedded in futures quotes. In contrast, the Greenbook forecast assumes that the funds rate target will remain at 1 percent through the end of 2004.

Bottom-left panel

- Dropping the sentence may risk an outsized market reaction.
- Market participants may expect policy to be more aggressive than currently expected.

Bottom-right panel

"…the Committee believes that policy accommodation can be maintained for the considerable period it currently assesses will be required to foster the moderation of disinflationary pressures."

Appendix 3: Materials used by Mr. Reinhart

Exhibit 1
Alternative Assessments of the Outlook

1. The Balance-of-Risks Assessment

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks ARE BALANCED

WITH RESPECT TO PROSPECTS FOR BOTH GOALS / ARE WEIGHTED MAINLY TOWARD CONDITIONS THAT MAY GENERATE HEIGHTENED INFLATION PRESSURES / ARE WEIGHTED MAINLY TOWARD CONDITIONS THAT MAY GENERATE ECONOMIC WEAKNESS in the foreseeable future.

2. The Current Language

The Committee perceives that the upside and downside risks to the attainment of sustainable economic growth for the next few quarters are roughly equal. In contrast, the probability, though minor, of an unwelcome fall in inflation exceeds that of a rise in inflation from its already low level. The Committee judges that, on balance, the risk of inflation becoming undesirably low remains the predominant concern for the foreseeable future.

3. Reinhart memo (October 22, 2003)

The probability of economic growth running above its long-run sustainable pace is BELOW / ABOUT EQUAL TO / ABOVE that of it falling short over the next few quarters. Over the same period, the probability of inflation rising is BELOW / ABOUT EQUAL TO / ABOVE that of it declining. In light of this assessment and against the backdrop of its long-run goals of price stability and maximum employment, the Committee judges that

> *EITHER*
>
> > the risk(s) of INCREASING PRESSURE ON RESOURCES / DECREASING PRESSURE ON RESOURCES / *(AND)* / INFLATION RUNNING UNDESIRABLY HIGH / INFLATION RUNNING UNDESIRABLY LOW is (are) the more pressing concern(s)
>
> *OR*
>
> > THE RISKS TO BOTH OF ITS LONG-RUN GOALS ARE BALANCED

for the foreseeable future.

4. Gramlich memo (October 22, 2003)

The probability that economic growth will proceed over the next few quarters at a rate consistent with the attainment of maximum sustainable employment is BELOW / EQUAL TO / ABOVE the probability of it falling short. Over the same period, the probability that inflation will be undesirably high is BELOW / EQUAL TO / ABOVE the probability that it will be undesirably low. Overall, the Committee judges that the risks to the attainment of MAXIMUM SUSTAINABLE EMPLOYMENT ARE THE MORE PRESSING CONCERN / PRICE STABILITY ARE THE MORE PRESSING CONCERN / BOTH GOALS ARE ABOUT EQUAL.

Exhibit 2
Some Questions

1. Do you have a clear preference as to the basic structure of the assessment of the outlook?

2. Do you want to follow a bilateral or multilateral approach to arrive at new language?

3. How much importance do you place on wrapping up this issue quickly?

4. When do you want to talk about this next?

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