

## Meeting of the Federal Open Market Committee December 9, 2003 Presentation Materials -- Text Version

[Presentation Materials \(1.05 MB PDF\)](#)

Pages 120 to 133 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:** September 1, 2003 - December 5, 2003

**Description:** U.S. and Euro area Libor fixings are relatively unchanged since the October FOMC meeting.

##### Bottom panel

**Title:** 2-Year Treasury Note Yield and Federal Funds Rate Target

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

**Horizon:** July 1, 2002 - December 5, 2003

**Description:** Two-year Treasury yields have been increasing since July, while the fed funds target rate remains unchanged.

#### Page 2

##### Top panel

**Title:** 2-Year Treasury Note Yield Less Federal Funds Rate Target

**Series:** Spread between the 2-Year Treasury Yield and the Fed Funds Target Rate

**Horizon:** January 1, 1990 - December 5, 2003

**Description:** The spread between the two-year Treasury note and the fed funds target rate has been increasing recently.

##### Middle-left panel

**Title:** Investment Grade Corporate Debt Spread

**Series:** U.S. Investment Grade Corporate Option-Adjusted Spread

**Horizon:** September 1, 2003 - December 5, 2003

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

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

### **Middle-right panel**

**Title:** High Yield and EMBI+ Spreads

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

**Horizon:** September 1, 2003 - December 5, 2003

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

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

### **Bottom panel**

**Title:** Average Yield on Merrill Lynch High Yield Bond Index

**Series:** Average Yield on Merrill Lynch's High Yield Bond Index

**Horizon:** January 1, 1990 - December 5, 2003

**Description:** The average yield on Merrill Lynch's high yield bond index has declined.

## **Page 3**

### **Top panel**

**Title:** Select Foreign Currencies Versus U.S. Dollar

**Series:** EUR-USD, CAD-USD, GBP-USD, CHF-USD, AUD-USD, USD-YEN

**Horizon:** January 1, 2003 - December 5, 2003

**Description:** The U.S. dollar has depreciated against other major currencies.

### **Middle panel**

**Title:** Interest Rate Differentials: Select 5-Year Government Spreads to U.S. Treasuries

**Series:** Spread between the 5-Year Treasury Yield and the 5-Year Government Bond Yields for Great Britain, Germany, Canada, and Australia

**Horizon:** January 1, 2003 - December 5, 2003

**Description:** The spread between the 5-year Treasury yield and the 5-Year Government Bond Yields for Great Britain, Germany, Canada, and Australia have been widening since September.

### **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:** January 1, 2003 - December 5, 2003

**Description:** One-month option implied volatility for dollar-yen has declined sharply since the September G-7 communiqué.

## **Page 4**

### **Top panel**

**Title:** The History of SOMA Holdings of Federal Agency Securities

**Series:** SOMA Holdings of Federal Agency Securities

**Horizon:** 1970-2003

**Description:** SOMA holdings of federal agency securities have declined since the last outright purchase in 1981.

### **Bottom panel**

**Title:** Agency and MBS Collateral on Outstanding RPs

**Series:** Agency and MBS Collateral on Outstanding RPs

**Horizon:** 1976-2003

**Description:** Agency and MBS collateral on outstanding RPs have been increasing in recent years.

RP operations in Agency collateral began in 1966; Agency-Sponsored MBS collateral first accepted in Q4 October 1999.

## **Appendix 2: Materials used by Mr. Madigan**

Material for Briefing on Monetary Policy Alternatives  
December 9, 2003

**STRICTLY CONFIDENTIAL (FR)**  
**CLASS I FOMC**

### **Exhibit 1** **Market Developments**

Exhibit 1 presents information on recent market developments.

#### **Top-left panel**

##### **Expected Federal Funds Rates\***

The top-left panel displays the expected path of the funds rate embedded in futures markets as of three dates--October 27, December 4, and December 8, 2003. From October 27 to December 4, generally robust economic data led investors to revise up the expected path for policy. However, investors marked down the expected policy path significantly after the weaker-than-expected employment report for November. On balance, policy expectations ended the period a touch lower in the near term.

\* Estimates from federal funds and eurodollar futures, with an allowance for term premia and other adjustments. [Return to text](#)

#### **Top-right panel**

##### **Treasury Coupon Yields**

The top-right panel displays time-series for two-, five- and ten-year Treasury yields. These yields had edged higher over much of the period, but dropped following the employment report and finished the period largely unchanged.

#### **Bottom-left panel**

##### **Implied Distribution of the Federal Funds Rate about Six Months Ahead\***

The bottom-left panel displays the implied distribution of the federal funds rate about six months

ahead derived from options data, December 8, 2003. The mode of this distribution is at 1 percent, but there is considerable weight attached to higher rates.

\* 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-right panel**

**Expectations for the Upcoming FOMC Statement (FRBNY Survey of Primary Dealers)**

- 12 of 22 dealers expect the **considerable period** phrase to be dropped.
- 5 of 22 dealers expect the FOMC to alter the **individual risk assessments**.
  - 3 expect balanced inflation risks
  - 2 expect upside growth risks
- 5 of 22 dealers expect the FOMC to shift its **overall risk assessment** to balance.

**Exhibit 2  
Policy Choices**

Exhibit 2 presents information focusing on the policy choices at this meeting.

**Top-left panel**

**Policy Alternatives in the Bluebook**

- Unchanged stance of policy.
- Ease policy 25 basis points.
- No discussion of tightening.

**Top-right panel**

**Options for Revisions to Rationale Paragraph**

- Update language.
  - Output "expanding briskly" instead of "firming."
  - Labor markets "improving modestly" instead of "stabilizing."
- Other changes.

**Middle panel**

**Alternative Assessments of Balance of Risks**

		Risks to Inflation	
		Unwelcome Fall	Balanced
Risks to Sustainable Economic Growth	Balanced	Low inflation predominant concern	Balanced
	Weighted to the Upside	Low inflation predominant concern -or- Balanced	Balanced -or- Unsustainably rapid growth predominant concern

Possible variations: (1) Qualify any assessments. (2) Omit the overall balance.

## Bottom panel

### Options for "Considerable Period" Language

- Retain: "In these circumstances, the Committee believes that policy accommodation can be maintained for a considerable period."
- Substitute "for a while" for "a considerable period."
- Explain: "With inflation quite low and resource use slack,..."
- Recast in terms of "patience."
- Recast conditionally: "Policy accommodation can be maintained for the considerable period that..."
- Drop.

## Appendix 3: Materials used by Mr. Ferguson

### Status Report from the Working Group on Communications

1. The Working Group has reduced the many proposed alternatives for the risk assessment into three basic types
  - that differ according to their specificity, discussion of levels and changes of output and inflation, and length of the time horizon.
2. Reserve Bank and Board staff will stress test the alternatives
  - under six scenarios that include likely near-term course of economy and episodes that have proven challenging.
3. Board staff will prepare memos on expediting the release of the minutes and enhancing the role of the economic forecasts of the governors and Reserve Bank presidents, which the Committee may consider as a substitute or complement to the proposed risk assessments.
4. This material will be sent to the Committee in advance of the January meeting.

## Proposal A

The Committee believes that, for the foreseeable future, the risks to inflation relative to the Committee's long-run goal of price stability are [weighted toward the downside / balanced / weighted toward the upside]; the risks to real economic activity relative to the long-run goal of sustainable economic growth are [weighted toward the downside / balanced / weighted toward the upside]; and, taken together,

- the risks to its objectives are roughly in balance.
- the risk of inflation becoming undesirably [high / low] is the predominant concern.
- the risk of [unsustainable / weak] real economic activity is the predominant concern.

This version

- merges levels and changes
- alludes to benchmarks in the overall risk assessment
- uses the "elastic" notion of the foreseeable future

## Proposal B

*The incoming data over the intermeeting period suggests that output is expanding briskly but that resource slack remains considerable and inflation well contained.*

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 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)
- the risks to both of its long-run goals are balanced

for the foreseeable future.

This version

- is explicit about levels (in the first paragraph) and changes (in the second paragraph)
- alludes to benchmarks in the overall risk assessment
- uses a more specific time frame

## Proposal C

*The incoming data over the intermeeting period suggests that output is expanding briskly but that resource slack remains considerable and inflation well contained. The Committee anticipates that the stance of its policy, if maintained, should foster a working down of resource slack over the next two years and containment of inflation around its already low level.*

Going forward, the Committee's assessment of the risks to this outlook are such that its forecast of economic growth for the next two years is [more / equally / less] likely to be increased than decreased over the next few months. Over the same period, the Committee's longer-term outlook for inflation is [more / equally / less] likely to be increased than decreased. Against the backdrop of its goals of maximum sustainable economic growth and price stability, the Committee views the risks to its outlook [for economic activity / for inflation to be the predominant concern] / [as balanced].

This version

- is explicit about levels and changes
- alludes to benchmarks in the first paragraph
- uses two time spans (the longer forecast period and the shorter period over which that outlook might change)
- emphasizes the Committee's forecast of the economy

[▲ Return to top](#)

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