Meeting of the Federal Open Market Committee
March 16, 2004 Presentation Materials -- Text Version

Presentation Materials (656 KB PDF)

Pages 94 to 107 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: Current U.S. 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: 3-month USD Libor, USD 3-month forward rate agreement, USD 6-month forward rate agreement, USD 9-month forward rate agreement
Horizon: November 1, 2003 - March 12, 2004
Description: Forward rate agreements decline.

Middle panel

Title: 10-year Treasury Yield and Fed Custody Holdings of Treasury Securities
Series: Yield for 10-year Treasury note and Federal Reserve custody holdings of Treasury securities
Horizon: January 1, 2003 - March 12, 2004
Description: 10-year Treasury note yield declines while Federal Reserve custody holdings of Treasury securities increases.

Bottom panel

Title: Spread between Treasury 10-Year Note and 3-Month Bill
Series: Spread between Treasury 10-year note and 3-month bill
Horizon: January 1, 1990 - March 12, 2004
Description: Treasury yield curve steepens.

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Top panel

Title: Breakeven Inflation Rates on TIPS: Spreads between U.S. Nominal and Inflation-Indexed Treasury Yields
Series: 10-year and 5-year TIPS breakeven spreads to 10-year and 5-year nominal Treasury note yields
Horizon: January 1, 2003 - March 12, 2004
Description: TIPS breakeven spreads to nominal securities widen.

Source: Barclays

Middle-left panel

Title: Investment Grade Corporate Debt Spread
Series: Investment grade corporate debt index OAS
Horizon: November 1, 2003 - March 12, 2004
Description: Investment grade corporate debt spread widens.

Source: Lehman Brothers

Middle-right panel

Title: High Yield and EMBI+ Spreads
Series: High yield bond index OAS, EMBI Plus, EMBI Plus Brazilian Component
Horizon: November 1, 2003 - March 12, 2004
Description: Brazilian component of EMBI+ widens.

Source: Merrill Lynch, JP Morgan

Bottom panel

Title: Current Euro Area 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: 3-month Euro Libor, Euro 3-month forward rate agreement, Euro 6-month forward rate agreement, Euro 9-month forward rate agreement
Horizon: November 1, 2003 - March 15, 2004
Description: Euro forward rate agreements decline.

Page 3

Top panel

Title: Select Foreign Currencies Versus U.S. Dollar
Series: U.S. Dollar versus Australian Dollar, British Pound, Canadian Dollar, Japanese Yen and Euro
Horizon: November 1, 2003 - March 12, 2004
Description: Foreign currencies appreciate versus the USD.

Middle-left panel

Title: Interest Rate Differentials: Select 3-Month Government Yields Less U.S. Treasuries Yields
Series: 3-month sovereign debt yield spreads to Treasuries for Australia, Great Britain, Canada and Germany
Horizon: November 1, 2003 - March 12, 2004
Description: 3-month interest rate differentials for Canada and Germany narrow.

Middle-right panel

Title: Interest Rate Differentials: Select 10-Year Government Yields Less U.S. Treasury Yields
Series: 10-year sovereign debt yield spreads to Treasuries for Australia, Great Britain, Canada, and Germany
Horizon: November 1, 2003 - March 12, 2004
Description: 10-year interest rate differentials narrow.

Bottom panel

Title: IMM Commitment of Traders Report: Net Non-Commercial Positions in the Yen and Euro against the Dollar
Series: Net non-commercial positions against dollar for Yen and Euro
Horizon: September 2, 2003 - March 12, 2004
Description: Non-commercial positions for Yen shifts to long dollar.

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Top panel

Title: Japanese Yen Versus U.S. Dollar
Series: Dollar-yen FX rate, daily Japanese intervention
Horizon: December 1, 2003 - March 12, 2004
Description: Dollar appreciates versus Yen in March.

Japanese Intervention in the Intermeeting Period: $69.7 bn

Middle panel

Title: Select Foreign Currencies Versus U.S. Dollar
Series: U.S. Dollar versus Australian Dollar, British Pound, Canadian Dollar, Japanese Yen and Euro
Horizon: Intra-day Trading on March 5, 2003
Description: On March 5, USD appreciates versus Yen and depreciates versus AUD, CAD, Eur, and GBP.

Bottom-left panel

Title: Japanese Equity Indices
Series: Japanese Topix Index and Topix Bank Sub-Index
Horizon: May 1, 2003 - March 12, 2004
Description: Topix and Topix Bank sub-index increase.

Bottom-right panel

Title: 10-Year Japanese Sovereign Yield
Series: 10-year Japanese government bond yield
Horizon: May 1, 2003 - March 12, 2004
Description: 10-year Japanese sovereign yield decreases slightly.

Appendix 2: Materials used by Mr. Reinhart

Page 1

Top panel
Treasury Yield Curve Slope

A line chart displays daily time series for two spreads--the ten-year Treasury yield minus the three-month bill yield and the one-year forward Treasury rate ten years ahead minus the one-year Treasury yield--over the period from 1990 to 2004. In general, the two series move together fairly closely, although the spread of the one-year forward rate ten years ahead over the current one-year rate tends to be more variable than the spread of the ten-year Treasury rate over the three-month bill rate. Both series show a recent peak in late 2003 and a drop of about a percentage point since then.

Appendix 3: Materials used by Mr. Reinhart

Exhibit 1
Policy Expectations

Top-left panel
Expected Federal Funds Rates*

A line chart displays the expected path of the federal funds rate embedded in futures quotes as of January 27, 2004 and March 15, 2004. The chart indicates a downward revision of the expected path of the federal funds rate over the intermeeting period. Current futures quotes suggest that the federal funds rate will rise to around 2.75 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
Probability Distribution of Time to the Beginning of Tightening

A line chart shows a probability distribution of the time to the beginning of tightening of monetary policy as of January 27, 2004 and March 15, 2004. The distribution shifted to the right during the intermeeting period and suggests that expectations for the onset of policy tightening have shifted out five months into the future, from five months on average to nearly ten months.

Middle-left panel
Primary Dealer Survey Results: Date of Onset of Tightening

A bar graph reflects the views of primary dealers about when policy tightening would begin. The results of the March survey indicate that the majority of primary dealers now expect the onset of tightening to occur between the third quarter of 2004 and the first quarter of 2005, which is slightly later than at the time of the January FOMC primary dealer survey.

Middle-right panel
Eurodollar Implied Volatility*

A line graph shows six-month Eurodollar implied volatility between January 1, 2002 and January 27, 2004. Volatility has remained at its current low levels, indicating that market participants are fairly confident about the near-term path of short-term interest rates.

* Eurodollar volatility is calculated on a notional contract with 120 days to expiration. Return to text

Bottom panel
Estimated Effects on the Two-Year Treasury Yield of FOMC Policy Actions and Statements

A bar chart estimating the effect of FOMC policy actions and statements on two-year Treasury yields between May 18, 1999 and January 28, 2004. The bars indicate that FOMC statements have caused as much movement in two-year Treasury yields as have FOMC policy actions.

Note. Effect of policy actions is estimated by regressing the change in the on-the-run two-year Treasury yield from 15 minutes before to 1 hour after the FOMC decision on the monetary policy surprise measured from federal funds futures. Effect of policy statement is measured by the residual from the regression.

Table 1: FOMC Statement Alternatives as of March 11

	January FOMC	Alternative A	Alternative B	Alternative C
Policy Decision	The Federal Open Market Committee decided today to keep its target for the federal funds rate at 1 percent.	Unchanged	Unchanged	Unchanged
Rationale	The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity.	Unchanged	Unchanged	Unchanged
	The evidence accumulated over the intermeeting period confirms that output is expanding briskly.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand briskly.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand briskly.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand briskly.
	Although new hiring remains subdued, other indicators suggest an improvement in the labor market.	New hiring has been disappointing and resource utilization generally appears likely to remain somewhat below levels consistent with the economy operating at its productive potential for some time.	Although new hiring has been disappointing, other indicators suggest continued improvement in the labor market.	Although new hiring remains subdued, other indicators suggest continued improvement in the labor market.
	Increases in core consumer prices are muted and expected to remain low.	Unchanged	Unchanged	To date, increases in core consumer prices have been muted, and inflation expectations remain contained.
Assessment of Risks	The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal.	Unchanged	Unchanged	Unchanged

	January FOMC	Alternative A	Alternative B	Alternative C
	The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation.	The probability, though minor, of an unwelcome fall in inflation has diminished in recent months but likely exceeds that of a rise in inflation.	Unchanged	The probability of a rise in inflation about equals that of an unwelcome decline in inflation.
	With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation.	Unchanged	Unchanged	The Committee recognizes that the stance of monetary policy has been quite accommodative for some time. Nonetheless, with inflation low and resource use slack, the Committee believes that it can still be patient in removing its policy accommodation.

Exhibit 2
Alternative B

Top-left panel
Economic News Index

A line graph plots the estimated cumulative impact of economic releases on two-year Treasury yields between June 2, 2003 and March 15, 2004. The line drops consistently from January through March, indicating that recent economic data releases have been disappointing as of late.

Top-right panel
Changes in Financial Conditions

	Change since Jan. 27
	--basis points--
Two-Year Treasury	-14
Ten-Year Treasury	-33
Ten-Year TIIS	-35
Ten-Year AA	-33
Ten-Year BBB	-31
	--percent--
Wilshire	-3.4
Yen/Dollar	4.7

	Change since Jan. 27
	--basis points--
Euro/Dollar	3.1

Middle-left panel
Real GDP Growth

A bar chart displays real GDP growth rates for half-year intervals between 2003 and 2005. Real GDP growth is projected at around 5 percent during 2004 and 4 percent in 2005.

Middle-right panel
January Statement

> "With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation."

Bottom panel
Statement Language Changes

Rationale

- The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace.
- Although job losses have slowed, new hiring has lagged.

Exhibit 3
Alternative A

Top panel
GDP Gap

A line graph shows the GDP gap from 1960 to 2005, including projections. The output gap is projected to decline from about 2.5 percent to almost zero by the end of the forecast period.

Middle-left panel
Nonfarm Payrolls

A bar chart shows monthly nonfarm payroll data from March 2003 to February 2004. Nonfarm payrolls only increased by about 25,000 in March versus around 100,000 in February.

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

A bar graph shows the implied distribution of the federal funds rate six-months ahead as of January 27, 2004 and March 15, 2004. Over the intermeeting period the weight of this distribution shifted to the left slightly, with slightly more probability attached to a federal funds rate in the neighborhood of ¾ percent and less probability associated with federal funds rates in the neighborhood of 1¼ percent.

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

Bottom panel
Statement Language Changes

Rationale

- **The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace.**
- New hiring has lagged and resource utilization generally appears likely to remain somewhat below levels consistent with the economy operating at its productive potential for some time.

Risk Assessment

- The probability, though minor, of an unwelcome fall in inflation has diminished in recent months but likely exceeds that of a rise in inflation.

Exhibit 4
Alternative C

Top panel
Real Federal Funds Rate

A line chart displays the real federal funds rate, an estimated range of the equilibrium real federal funds rate based on staff models (depicted by the shaded region), and an estimate derived from financial markets all at a quarterly frequency from 1990 to the current quarter. The chart shows that the real federal funds rate has been negative for the past 10 quarters, and a few staff models suggest that the equilibrium short rate may well be negative, which is indicated by the lower bound of the shaded region. Market derived estimates of the equilibrium real short rate have been well above the real federal funds rate for some time. The historical average of the real federal funds rate from 1966:Q1 to 2003:Q4 is 2.67.

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 2004:Q1.

Middle-left panel
Blue Chip Long Range Real GDP Growth Forecast*

A line chart shows the median Blue Chip Long Range Real GDP growth forecast at a semi-annual frequency, along with a shaded region whose upper and lower bounds show the averages of the ten highest and lowest individual forecasts respectively, from 1988 to 2003. The forecast currently has a median of just above 3 percent with a confidence range from 2.75 to nearly 3.5 percent, possibly meaning that pressures on resources could emerge more quickly than staff forecasts indicate.

* Forecasts of real GDP growth 5 to 10 years ahead. Return to text

Middle-right panel
Blue Chip Long Range CPI Forecast*

A line chart shows the median Blue Chip Long Range CPI forecast at a semi-annual frequency, along with a shaded region whose upper and lower bounds show the averages of the ten highest and lowest individual forecasts respectively, from 1988 to 2003. The graph shows that longer-term inflation expectations may remain above the Committee's longer-run target and may not be firmly anchored.

* Forecasts of CPI inflation 5 to 10 years ahead. Return to text

Bottom panel
Statement Language Changes

Rationale

- The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace.
- Although new hiring has lagged, other indicators suggest an improvement in the labor market.
- To date, increases in core consumer prices have been muted, and inflation expectations remain contained.

Risk Assessment

- The probability of a rise in inflation about equals that of an unwelcome decline in inflation.
- The Committee recognizes that the stance of monetary policy has been quite accommodative for some time. Nonetheless, with inflation low and resource use slack, the Committee believes that it can still be patient in removing its policy accommodation.

Table 1: FOMC Statement Alternatives: Revised as of March 15

	January FOMC	Alternative A	Alternative B	Alternative C
Policy Decision	The Federal Open Market Committee decided today to keep its target for the federal funds rate at 1 percent.	Unchanged	Unchanged	Unchanged
Rationale	The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity.	Unchanged	Unchanged	Unchanged
	The evidence accumulated over the intermeeting period confirms that output is expanding briskly.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace.
	Although new hiring remains subdued, other indicators suggest an improvement in the labor market.	New hiring has lagged and resource utilization generally appears likely to remain somewhat below levels consistent with the economy operating at	Although job losses have slowed, new hiring has lagged.	Although new hiring has lagged, other indicators suggest an improvement in the labor market.

	January FOMC	Alternative A	Alternative B	Alternative C
		its productive potential for some time.		
	Increases in core consumer prices are muted and expected to remain low.	Unchanged	Unchanged	To date, increases in core consumer prices have been muted, and inflation expectations remain contained.
Assessment of Risks	The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal.	Unchanged	Unchanged	Unchanged
	The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation.	The probability, though minor, of an unwelcome fall in inflation has diminished in recent months but likely exceeds that of a rise in inflation.	Unchanged	The probability of a rise in inflation about equals that of an unwelcome decline in inflation.
	With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation.	Unchanged	Unchanged	The Committee recognizes that the stance of monetary policy has been quite accommodative for some time. Nonetheless, with inflation low and resource use slack, the Committee believes that it can still be patient in removing its policy accommodation.

Last update: April 30, 2010