

Meeting of the Federal Open Market Committee November 10, 2004 Presentation Materials -- Text Version

[Presentation Materials \(1.31 MB PDF\)](#)

Pages 93 to 107 of the Transcript

Appendix 1: Materials used by Mr. Kos

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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: August 2, 2004 - November 8, 2004

Description: Forward rate agreements and LIBOR increase slightly.

Middle-left panel

Title: 2-Year Treasury Yield

Series: Yield for the 2-year Treasury note

Horizon: August 2, 2004 - November 8, 2004

Description: Yield on 2-year Treasury note increases sharply.

Middle-right panel

Title: 10-Year Treasury Yield

Series: Yield for the 10-year Treasury note

Horizon: August 2, 2004 - November 8, 2004

Description: Yield on 10-year Treasury note increases sharply.

Bottom panel

Title: Yield Spread between 2- and 10-Year Treasury Notes

Series: Spread between the 2-year and 10-year Treasury note yields

Horizon: August 2, 2004 - November 8, 2004

Description: The Treasury yield curve flattens.

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Title: 10-Year TIPS Breakeven Inflation Rate

Series: July 2014 TIPS breakeven inflation rate
Horizon: August 2, 2004 - November 8, 2004
Description: 10-year TIPS breakeven inflation rate increases.

Source: Barclays

Top-right panel

Title: WTI Crude Oil Futures
Series: Front-month WTI contract and twelfth-month WTI contract
Horizon: August 2, 2004 - November 8, 2004
Description: Oil futures prices decline.

Middle-left panel

Title: Investment Grade Corporate Debt Spreads
Series: Investment grade corporate index option-adjusted spread
Horizon: August 2, 2004 - November 8, 2004
Description: Investment grade corporate debt spread narrows.

Source: Lehman Brothers

Middle-right panel

Title: High Yield and Emerging Market Spreads
Series: EMBI+ spread and high yield bond index option-adjusted spread
Horizon: August 2, 2004 - November 8, 2004
Description: High yield and EMBI+ spreads narrow.

Source: Merrill Lynch & JP Morgan

Bottom-left panel

Title: GSE Equity Performance
Series: S&P 500 Index, Freddie Mac equity, and Fannie Mae equity
Horizon: August 2, 2004 - November 8, 2004
Description: GSE equity slightly underperforms the S&P 500 index.

Bottom-right panel

Title: Fannie Mae 10-Year Debt Performance
Series: Fannie Mae 10-year debt spread to Treasuries and Fannie Mae 10-year debt spread to swaps
Horizon: August 2, 2004 - November 8, 2004
Description: Fannie Mae 10-year debt spreads narrow.

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Title: Select Foreign Currencies Against Dollar
Series: Foreign exchange rates against the U.S. dollar for Canadian dollar, Japanese Yen, Australian dollar, Swiss franc, British pound, euro, and Mexican peso
Horizon: September 1, 2004 - November 8, 2004

Description: Dollar depreciates against foreign currencies.

Middle panel

Title: Dollar-Yuan Exchange Value Implied by the NDF Market

Series: Dollar-yuan 1-month NDF, 6-month NDF, and 12-month NDF

Horizon: January 1, 2004 - November 8, 2004

Description: Implied dollar-Yuan exchange rate declines.

Bottom panel

Title: Select Asian Currencies Against the Dollar

Series: Dollar foreign exchange rate against the South Korean won, Singapore dollar, Taiwan dollar, Indian rupee, Thai baht, and Philippine peso

Horizon: August 2, 2004 - November 8, 2004

Description: U.S. dollar depreciates against Korean won, Singapore dollar, Taiwan dollar, Indian rupee and Thai baht.

Appendix 2: Materials used by Mr. Ferguson

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Table 1 - Employment Performance by Industry

Relative Performance Rank (Worst to Best)	Industry	Absolute Performance Rank (Worst to Best)
1	Professional and Technical Services	6
2	Information	3
3	Durable Manufacturing	1
4	Construction	12
5	Transportation and Warehousing	5
6	Admin Support and Waste	14
7	Company Management	8
8	Arts, Entertainment and Recreation	11
9	Retail Trade	4
10	Utilities	10
11	Natural Resources and Mining	9
12	Real Estate and Leasing	13
13	Education	17
14	Nondurable Manufacturing	2
15	Wholesale Trade	7
16	Finance and Insurance	15

Relative Performance Rank (Worst to Best)	Industry	Absolute Performance Rank (Worst to Best)
17	Other	16
18	Accommodations and Food Services	18
19	Health Care and Social Assistance	19

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Table 4A. Job Creation

Contribution to Decrease in Job Creation Rank	Industry
1	Manufacturing
2	Professional and Business Services
3	Retail Trade
4	Information
5	Leisure and Hospitality
6	Construction
7	Wholesale Trade
8	Financial Activities
9	Transportation and Warehousing
10	Education and Health Services
11	Natural Resources and Mining
12	Other
13	Utilities

Bottom panel

Table 4B. Job Destruction

Contribution to Decrease in Aggregate Job Destruction Rank	Industry
1	Professional and Business Services
2	Construction
3	Information

Contribution to Decrease in Aggregate Job Destruction Rank	Industry
4	Transportation and Warehousing
5	Manufacturing
6	Wholesale Trade
7	Leisure and Hospitality
8	Other
9	Utilities
10	Financial Activities
11	Retail Trade Natural
12	Education and Health Services
13	Resources and Mining

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Chart 5. Relative Change in Value Added vs. Relative Change in Employment (2000 - 2002)

The period covered is from 2000 through 2002. The figure is a scatter-plot graph. The x-axis is labeled employment, and the range for that axis is between 0.7 and 1.4. The y-axis is labeled value added, and the range for that axis is between 0.7 and 1.4. A vertical line is drawn at 1.0 on the x-axis, and a horizontal line is drawn at 1.0 on the y-axis; these two lines divide the figure into four quadrants.

Sixty-one data points are plotted and are indicated by Rs and asterisks. The Rs denote restructuring industries. Going clockwise, the lower-left quadrant contains 19 Rs and 11 asterisks, located between about 0.77 and 1.0 on the x-axis and approximately 0.7 and 1.0 on the y-axis. The upper-left quadrant contains 3 Rs and 3 asterisks, located between about 0.85 and 1.0 on the x-axis and approximately 1.0 and 1.14 on the y-axis. The upper-right quadrant contains 2 Rs and 15 asterisks, located between about 1.0 and 1.15 on the x-axis and approximately 1.0 and 1.12 on the y-axis. The lower-right quadrant contains 3 Rs and 5 asterisks, located between about 1.0 and 1.23 on the x-axis and approximately 0.74 and 1.0 on the y-axis.

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Chart 4. Relative Productivity Growth vs. Relative Change in Employment (2000 - 2002)

The period covered is from 2000 through 2002. The figure is a scatter-plot graph. The x-axis is labeled employment, and the range for that axis is between 0.7 and 1.4. The y-axis is labeled productivity, and the range for that axis is between 0.7 and 1.4. A vertical line is drawn at 1.0 on the x-axis, and a horizontal line is drawn at 1.0 on the y-axis; these two lines divide the figure into four

quadrants.

Sixty-one data points are plotted and are indicated by Rs and asterisks. The Rs denote restructuring industries. Going clockwise, in the lower-left quadrant, 13 Rs and 7 asterisks are clustered between about 0.82 and 1.0 on the x-axis and between approximately 0.84 and 1.0 on the y-axis. The upper-left quadrant contains 9 Rs and 7 asterisks, located between about 0.77 and 1.0 on the x-axis and between approximately 1.0 and 1.34 on the y-axis. The upper-right quadrant contains 1 R and 7 asterisks, located between about 1.0 and 1.12 on the x-axis and approximately 1.0 and 1.07 on the y-axis. The lower-right quadrant contains 4 Rs and 13 asterisks, located between about 1.0 and 1.22 on the x-axis and between approximately 0.7 and 1.0 on the y-axis.

Appendix 3: Materials used by Mr. Reinhart

Material for **FOMC Briefing on Monetary Policy Alternatives**

Vincent R. Reinhart

November 10, 2004

Strictly Confidential (FR) Class I - FOMC

Exhibit 1 Market Developments

Top-left panel

Expected Federal Funds Rates*

The line chart displays the expected path of the federal funds rate embedded in futures quotes as of September 20 and November 9, 2004. This chart indicates the slight upward 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 3½ percent by the fourth 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

Market Quotes

	Change from Sept. 20	Memo: Level
Nominal Treasuries	Basis Points	
Two-Year	38	2.81
Five-Year	23	3.50
Ten-Year	14	4.35
TIPS		
Five-Year	-14	0.98
Ten-Year	-5	1.75
Stocks	Percent	
Wilshire 5000	4.2	11397
Foreign Exchange		

	Change from Sept. 20	Memo: Level
Major Currencies Index	-5.9	81.41

Middle-left panel

Desk Survey

- Primary dealers confident of 25 bp tightening
- Statement expected to retain both an assessment of balanced risks and "measured" language
- Some anticipate a suggestion of a pause

Bottom-left panel

Oil Price*

A line graph of the daily price of oil in U.S. dollars per barrel. Oil prices saw a sharp rise from about \$48 per barrel to \$55 per barrel in the weeks immediately following the September FOMC meeting, but have since dropped back down to a level consistent with oil prices at the start of the intermeeting period.

* Spot price of West Texas Intermediate crude oil. [Return to text](#)

Bottom-right panel

Intermeeting Oil Price Correlations*

The panel consists of three bar charts, representing three different oil price correlations.

With S&P 500

This chart shows the correlation between the price of oil and the S&P 500. For all prior intermeeting periods in 2004, the correlation has not been statistically significant; in the September-November intermeeting period, however, the correlation was statistically significant (red) and negative, about -0.4, suggesting an inverse correlation between oil prices and share prices.

With Ten-Year Treasury Yields

This chart shows the correlation between the price of oil and ten-year Treasury yields. For all prior intermeeting periods in 2004, the correlation has not been statistically significant; in the September-November intermeeting period, however, the correlation was statistically significant (red) and negative, about -0.4, suggesting an inverse correlation between oil prices and ten-year Treasury yields.

With Five-Year Inflation Compensation

This chart shows the correlation between the price of oil and five-year inflation compensation. This correlation was statistically significant (red) in the May-June intermeeting period, at about 0.6, and in the August-September intermeeting period, at about 0.4. It was not statistically significant in the September-November intermeeting time period, indicating that inflation compensation over the next five years (as derived from the Treasury market) was not correlated with oil price movements.

* Correlations based on daily changes in the log WTI spot oil price. Red denotes statistically significantly different from zero. [Return to text](#)

The Case for Tightening 25 Basis Points

Top-left panel

Employment Growth

A chart showing bars for monthly nonfarm payroll levels and a line representing the three-month moving average of the nonfarm payrolls. The chart shows a significant gain in payrolls in October 2004, increasing from about 130 thousand in September to over 300 thousand in October. The solid increase in employment is one possible indication that financial conditions are supporting a durable economic expansion, strengthening the case for firmer monetary policy.

Top-right panel

Inflation Compensation

A line graph of TIPS-based inflation compensation measures over the period from January 2001 until November 2004. There are two series shown, inflation compensation over the next five years and over the next five to ten years. The longer-term series has remained well-contained within the 2.7-2.8 percent range over the last few months. The shorter-term, five year series, however, shows a notable increase in recent weeks, climbing from about 2.1 percent at the start of October to just over 2.5 percent in early November.

Middle panel

Range of Values from Policy Rules and Futures Markets

A line charts the actual federal funds rate, with the November Greenbook assumption of 2 percent going forward into 2005. A shaded region indicates the possible range of federal funds rates resulting from applying standard policy rules. The actual federal funds rate mostly remains in the shaded region. Also charted are the market expectations for the federal funds rate over the next year or so, as estimated from futures quotes. Raising the target funds rate from 1¾ percent to 2 percent would put the funds rate at roughly the middle of the range defined by standard policy prescriptions and about ¼ to ½ percentage point below market expectations going forward.

An explanatory note is provided in Chart 5 of the Bluebook.

Bottom panel

Range of Estimated Equilibrium Real Rates

A line chart shows the actual real federal funds rate and the range of estimates for the equilibrium real federal funds rate. The historical average calculated over the 1964:Q1-2004:Q3 period is plotted as a horizontal line at 2.7 percent. 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. Since late 1999, the actual real funds rate remained within the shaded region or just outside the region's lower bound. The chart shows that the current level of the actual real federal funds rate is already at the low end of the range of estimates of the equilibrium real funds rate. A ¼ percentage point hike in the target federal funds rate would have the effect of making the real funds rate more decidedly positive and thus raising it further above the lower limit of its equilibrium value.

An explanatory note is provided in Chart 6 of the Bluebook.

Options for the Statement

Top-left panel

The Case for B

- The Committee may want to indicate that a pause could be appropriate in December
- Opportunity to assess the expansion
- Limit the risk of inappropriate extrapolation

Top-right panel

Monetary Policy Decisions and Surprises*

A bar chart plots the changes in the FOMC policy rates over the past five years as hollow bars and the relative surprises (as judged from futures quotes) from these changes as blue bars. The last three rate decisions have been met with little or no surprise in the futures market.

* Policy surprises are based on intraday data on federal funds futures. All FOMC meeting and intermeeting moves since 2000, except September 17, 2001. [Return to text](#)

Middle-left panel

The Case for B'

- The current language provides scope for a pause
- Desire to remain flexible
- Investor expectations allow for the possibility of a pause

Middle-right panel

Implied Distribution of Federal Funds Rate about Six Months Ahead*

A probability density function plot with the implied distribution of the fed funds rate six months ahead as of November 9, 2004. The chart shows the greatest probability attached to funds rates in the neighborhood of 2½ to 2¾ percent; however, the probability density is fairly spread out, suggesting that market participants place a wide band of uncertainty around where the funds rate will be six months from now.

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

Bottom-left panel

The Case for C

- Higher oil prices and a weaker dollar may boost inflation pressures
- Structural productivity growth may be slowing
- Implying a rise in unit labor costs

Bottom-right panel

Productivity and Unit Labor Costs

A line chart plots the four-quarter growth rate of output per hour in the nonfarm business sector along with unit labor costs from 2000 to present. The growth rate of output in the nonfarm business sector has been steadily falling since the beginning of 2004, putting upward pressure on unit labor costs, which reflect an uptick in recent months.

Table 1: Alternative Language for the November FOMC Announcement (Revised)

	September FOMC	Alternative B	Alternative B'	Alternative C
Policy Decision	1. The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 1¾ percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 2 percent, bringing the cumulative increase in the target rate over the past several months to 1 percentage point.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 2 percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 2 percent.
Rationale	2. The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.	The Committee believes that the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.	[Unchanged from September statement]	[Unchanged from September statement]
	3. After moderating earlier this year partly in response to the substantial rise in energy prices, output growth appears to have regained some traction, and labor market conditions have improved modestly.	Output appears to be growing at a moderate pace, and labor market conditions have improved.	Output appears to be growing at a moderate pace despite the rise in energy prices , and labor market conditions have improved.	Output appears to be growing at a moderate pace, and labor market conditions have improved.
	4. Despite the rise in energy prices, inflation and inflation expectations have eased in recent months.	Despite the rise in energy prices, inflation and longer-term inflation expectations remain well contained.	Despite the rise in energy prices; Inflation and longer-term inflation expectations remain well contained.	Although longer-term inflation expectations seem to remain well contained, rising energy prices and an escalation of business costs have the potential to contribute to upward pressure on prices.
Assessment of Risk	5. The Committee perceives the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters to be roughly equal.	[Unchanged from September statement]	[Unchanged from September statement]	[Unchanged from September statement]
	6. With underlying inflation expected to be	[Unchanged from September statement]	[Unchanged from September statement]	[Unchanged from September statement]

	September FOMC	Alternative B	Alternative B'	Alternative C
	relatively low, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.			

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