Meeting of the Federal Open Market Committee
March 22, 2005 Presentation Materials -- Text Version

Presentation Materials (1.63 MB PDF)

Pages 104 to 116 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: Implied Rates on Eurodollar Futures Contracts
Series: June 2005, December 2005, and June 2006 Contracts
Horizon: December 31, 2004 - March 18, 2005
Description: Forward contracts rose.

Middle-left panel

Title: 2-Year Treasury Yield and Target Fed Funds Rate
Series: 2-Year Treasury Yield and target fed funds rate
Horizon: June 15, 2004 - March 18, 2005
Description: Both the 2-year treasury yield and the target fed funds rate increased.

Middle-right panel

Title: 10-Year Treasury Yield
Series: 10-Year Treasury Yield
Horizon: June 15, 2004 - March 18, 2005
Description: The 10-year Treasury yield has decreased slightly.

Bottom panel

Title: Yield Spread Between 2- and 10-Year Treasury Notes
Series: 2-year and 10-year Treasury Notes
Horizon: December 31, 2004 - March 18, 2005
Description: Treasury yield curve flattened.

Page 2

Top panel

Title: CRB Commodities Index
Series: CRB index

Horizon: January 1, 2004 - March 18, 2005
Description: The CRB commodities index increased.

Middle panel

Title: Crude Oil Futures Curve
Series: 10/26/2004 and 3/18/2005 crude oil futures
Horizon: Front-month, 6th month, 11th month, 16th month, 21st month
Description: The West Texas Intermediate crude oil futures curve revised up significantly since October.

Bottom panel

Title: Inflation Expectation Measures Derived from TIPS
Series: Implied 5-year breakeven inflation rate 5 years forward and 5-year TIPS breakeven rate
Horizon: January 1, 2004 - March 18, 2005
Description: The 5-year TIPS breakeven rate increased, while the 5y5y forward breakeven inflation rate declined slightly.

Source: Barclays, FRBNY Research

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Top-left panel

Title: Investment Grade Corporate Debt Spread
Series: Investment grade corporate index option-adjusted spread
Horizon: July 1, 2004 - March 18, 2005
Description: Investment grade corporate debt spreads narrowed.

Source: Lehman Brothers

Top-right panel

Title: High Yield Debt Spread
Series: High yield bond index option-adjusted spread
Horizon: July 1, 2004 - March 18, 2005
Description: High yield bond debt spread narrowed.

Source: Merrill Lynch

Bottom-left panel

Title: Investment Grade Spreads by Rating Category
Series: BBB, A, and AA
Horizon: July 1, 2004 - March 18, 2005
Description: The investment grade spreads have narrowed.

Source: Lehman Brothers

Bottom-right panel

Title: Select Investment Grade Sector and Company Spreads

Series: GMAC 2014 Bond, GM 2013 Bond, Automotive, Industrial, and Financial
Horizon: July 1, 2004 - March 18, 2005
Description: Investment grade sector rose, but industrial and financial spreads narrowed.

Source: Lehman Brothers

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Title: Emerging Market Debt Spreads
Series: EMBI+ spread
Horizon: July 1, 2004 - March 18, 2005
Description: The EMBI+ spread narrowed.

Middle panel

Title: Select Emerging Market Currencies: Performance Against the Dollar
Series: Dollar foreign exchange rate against the Brazil Real, Mexican Peso, South African Rand, Czech Crown, Polish Zloty, Turkish Lira, and South Korean Won
Horizon: 10/01/04 - 03/07/05 and 03/08/05 - 03/18/05
Description: The US dollar depreciated against the Brazil Real, Mexican Peso, South African Rand, Polish Zloty and Turkish Lira during the 03/08/08 - 03/18/05 time frame.

Bottom panel

Title: Changes in Select Emerging Market Equity Indices
Series: Brazil, Mexico, South Africa, Czech Republic, Poland, Turkey and South Korea
Horizon: 10/01/04 - 03/07/05 and 03/08/05 - 03/18/05
Description: Indices have decreased for Brazil, Mexico, Czech Republic, Poland, Turkey and South Korea during the 03/08/05 - 03/18/05 time frame.

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Top panel

Title: Implied Volatility on S&P 500 Index
Series: VIX Index of Implied Volatility on S&P 500
Horizon: January 1, 2004 - March 18, 2005
Description: The volatility has decreased.

Middle panel

Title: Implied Volatility of Major Currency Pairs
Series: 1-month implied volatility in dollar-yen and 1-month implied volatility in euro-dollar
Horizon: January 1, 2004 - March 18, 2005
Description: The volatilities for dollar-yen and euro-dollar decreased.

Bottom panel

Title: Implied Swaption Volatility
Series: 1-month volatility on 10-year swaption
Horizon: January 1, 2004 - March 18, 2005
Description: Implied swaption volatility has decreased.

Appendix 2: Materials used by Mr. Reinhart

Material for **FOMC Briefing on Monetary Policy Alternatives**
Vincent R. Reinhart
March 22, 2005

Restricted Controlled (FR) Class I (FOMC)

Exhibit 1
Recent Market Developments

Exhibit 1 reviews recent market developments.

Top-left panel
Expected Federal Funds Rates Based on Federal Funds Futures*

A chart displays the expected path of the funds rate based on futures quotes as of the last FOMC meeting and most recently. The chart indicates that investors marked up the expected path of the federal funds rate significantly over the intermeeting period.

* Based on federal funds futures rates at the close of trading. Estimates assume a 1.0 basis point per month term premium and zero probability of intermeeting moves. Return to text

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

A bar chart displays the probability distribution of the federal funds rate about six months ahead based on options on Eurodollar futures as of the February FOMC meeting and the most recent date. The chart indicates that the distribution has shifted to the right and some of the weight of the distribution has been shifted toward the upper tail of the distribution.

* 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

Middle-left panel
Eurodollar Implied Volatility 120 Days Ahead

A line chart displays implied volatility from Eurodollar futures options with expirations about 4 months ahead. By this measure, uncertainty about the path of policy rose significantly from February to March.

Middle-right panel
Average Absolute Daily Change in the Expected Federal Funds Rate

A bar chart displays the average absolute daily change in the expected funds rate path at various horizons over two periods--from September 1998 to September 2003 and from October 2003 to present. In general, the observed volatility over the more recent period has been a bit lower, especially at the shorter horizons.

Bottom panels
Corporate Yields, Wilshire 5000, and Major Currencies Index

Three line charts--one on corporate yields, one on stock prices, and one on the exchange value of the dollar. Both investment- and speculative-grade bond yields have risen significantly since the February FOMC meeting. Stock prices were about flat over the period since the last meeting, while the dollar depreciated slightly.

Exhibit 2
The Case for Tightening 25 Basis Points

Exhibit 2 reviews the case for tightening by 25 basis points.

Top-left panel
Output Gap

A line chart plots a current measure of the output gap along with the estimates of the gap at the time of the previous meeting. The chart indicates that current estimates suggest that the magnitude of the output gap is smaller now than previously thought and is expected to narrow significantly by the end of 2006.

Top-right panel
Core PCE Inflation*

A line chart shows the staff's current forecast for core PCE inflation and the forecast prepared for the previous meeting. The current forecast for core PCE inflation over the next two years is significantly higher than at the time of the last meeting.

* Four-quarter percent change. Return to text

Middle panel
Values from Policy Rules and Futures Markets

A chart compares the current level of the federal funds rate along with a range of prescriptions from simple policy rules. The chart indicates that the current level of the federal funds rate is consistent with the rule prescriptions. The funds rate based on these rules would be expected to increase about 100 basis points over the course of 2005 based on the staff's forecast for output and inflation.

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

Bottom panel
Range of Estimated Equilibrium Real Rates

A chart plots the current level of the real federal funds rate along with a range of model estimates of the equilibrium real rate over the period from 1990 to present. The current level of the real federal funds rate is below the range of model-based estimates, suggesting that the stance of monetary policy is accommodative. Tightening the policy rate by 25 basis points at this meeting would push the real federal funds rate up toward the range of equilibrium real rates, but the level of the real rate would still remain accommodative by this measure.

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

Exhibit 3
The Policy Outlook

Exhibit 3 focuses on the outlook for policy.

Top-left panel
Expected Federal Funds Rates*

A line chart shows the expected funds rate path derived from futures quotes currently and as of the time of the last meeting. The chart indicates that investors revised up the expected path of the funds rate over the next three years quite substantially over the intermeeting period.

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

Top-right panel
Ten-year-ahead Expected Short Rate*

A line chart displays an estimate of the expected short-rate ten years ahead derived from a three-factor model of the Treasury yield curve. The chart indicates that the distant horizon expected short rate has been drifting lower since 2000, but has moved up appreciably over recent months.

* Based on an estimated three-factor model of the term structure. Return to text

Middle-left panel
Blue Chip Three-rnonth Treasury Bill Forecast, Six-to-Ten Years Ahead

A line chart plots forecasts of the three-month Treasury bill yield six to ten years ahead from the Blue Chip survey. The consensus forecast of the distant horizon Treasury bill yield moved substantially lower since 2000. The chart also displays the averages of the ten lowest individual forecasts and the ten highest individual forecasts. The time-series for the average of the ten lowest individual forecasts moved up significantly since early 2004.

Middle-right panel
Oil Price and NFIB Survey Results

A line chart displays time-series of the real WTI oil price** and results from the NFIB survey regarding firms that intend to raise selling prices over the next three months*. Both series increased markedly since 2003, suggesting that firms may be beginning to pass through cost increase to prices.

* Percentage of respondents that plan to raise average selling prices over the next three months less the percentage that plan to lower average selling prices. Return to text

** WTI spot price deflated by the CPI. Return to text

Bottom-left panel
Inflation Compensation

A line chart displays series for inflation compensation derived from Treasury Inflation Protected Securities (TIPS) over the next five years and five-to-ten years ahead. Inflation compensation over the next five years has risen notably since the beginning of 2004. The five-year forward measure of inflation compensation has been fairly steady over this period, suggesting that longer-term inflation expectations have been well anchored.

Bottom-right panel
PCE Prices Excluding Food and Energy*

A chart displays a time series for core PCE inflation (four-quarter change) along with the staff's projection for core PCE inflation and confidence intervals around this forecast. The chart indicates that core PCE inflation is projected to remain fairly steady between 1-1/2 and 2 percent over the next two years. However, the confidence interval surrounding this forecast is very wide.

* Confidence intervals based on FRB/US stochastic simulations. Return to text

February 2005 FOMC Statement

[Note: Footnotes have been added to represent color-coded notes in the original document.]

The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 2-1/2 percent.

The Committee believes that, even after this action, **the stance of monetary policy remains accommodative**[red] and, coupled with **robust underlying growth in productivity**,[blue] is providing ongoing support to economic activity. Output appears to be growing at a moderate pace despite the rise in energy prices, and labor market conditions continue to improve gradually. **Inflation and longer-term inflation expectations remain well contained.**[green]

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.[orange] **With underlying inflation expected to be relatively low**,[green] the Committee believes that **policy accommodation**[red] can be removed at a pace that is likely to be **measured.**[purple] Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

[red] Is policy still accommodative? Return to text

[blue] Is productivity growth still robust? Return to text

[green] Is inflation well-contained and expected to be relatively low? Return to text

[orange] Are the risks still balanced? Return to text

[purple] Will the pace of firming remain 'measured'? Return to text

Table 1: Alternative Language for the March FOMC Announcement

[Note: In Appendix 2, Table 1, emphasis (strike-through) has been added to indicate strike-through text in the original document. Strong emphasis (bold) indicates bold text in the original document.]

	February FOMC	Alternative A	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 2-1/2 percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to **2-3/4** percent. **This action brings the cumulative increase since June 2004 to 1-3/4 percentage points.**	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to **2-3/4** percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by **50** basis points to **3** percent.

	February FOMC	Alternative A	Alternative B	Alternative C
	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, ~~even~~ after this action, the stance of monetary policy remains **somewhat** accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.	[no change]	[no change]
Rationale	3. Output appears to be growing at a moderate pace despite the rise in energy prices, and labor market conditions continue to improve gradually.	[no change]	Output **evidently continues to grow** ~~appears to~~ ~~**continue to**~~ ~~be growing~~ at a **solid** ~~moderate~~ pace despite the rise in energy prices, and labor market conditions continue to improve gradually.	Output ~~appears to be growing at a moderate pace despite the rise in energy prices, and labor market conditions continue to improve gradually.~~**continues to grow at a pace sufficient to eliminate any remaining resource slack.**
	4. Inflation and longer-term inflation expectations remain well contained.	**Although month-to-month movements in inflation have been volatile of late, underlying** inflation and longer-term inflation expectations remain well contained.	~~Inflation and.~~ **Though** longer-term inflation expectations remain well contained**, pressures on inflation have picked up** ~~**modestly**~~ **in recent months and pricing power is more evident. The rise in energy prices, however, has not notably fed through to** ~~**wages or**~~ **core consumer prices.**	**While** ~~Inflation and~~ longer-term inflation expectations remain ~~well~~ contained, **pressures on inflation have intensified in recent months.**
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.	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~~ **that, if the current target for the federal funds rate were maintained for the next few quarters, it is more likely than not that output would grow at a pace faster than is sustainable and that inflation pressures would pick up.**	The Committee perceives **that, with appropriate policy action,** the upside and downside risks to the attainment of both sustainable growth and price stability ~~for the next few quarters to be~~ **should be kept** roughly equal.	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~~ **that, if the current target for the federal funds rate were maintained for the next few quarters, it is more likely than not that output would grow at a pace faster than is sustainable and that inflation pressures would pick up.**
	6. With underlying inflation expected to be 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.	~~With underlying inflation expected to be 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.~~ **However, the pace at which**	With underlying inflation expected to be **contained** ~~relatively low~~, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured~~;~~**. N** ~~n~~onetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.	~~With underlying inflation expected to be 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.~~ **However, the pace at which**

February FOMC	Alternative A	Alternative B	Alternative C
	policy accommodation will be removed to contain those risks will depend on economic prospects.		**policy accommodation will be removed to contain those risks will depend on economic prospects.**

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