The Federal Reserve Board

Meeting of the Federal Open Market Committee
August 9, 2005 Presentation Materials -- Text Version

Presentation Materials (749 KB PDF)

Pages 95 to 110 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: Implied Rates on Euro-dollar Futures Contracts
Series: December 2005 and December 2006
Horizon: May 1, 2005 - August 5, 2005
Description: The implied rates on euro-dollar futures contracts increased.

Bottom panel

Title: 2- and 10-year Treasury Yields
Series: 2-Year Treasury Yield and 10-Year Treasury Yield
Horizon: June 29, 2005 - August 5, 2005
Description: The 2-year and 10-year Treasury yields increased.

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Top-left panel

Title: Conventional 30-year MBS Option Adjusted Spread to Treasuries
Series: 30-year MBS option adjusted spread to Treasuries
Horizon: January 3, 2005 - August 5, 2005
Description: 30-year MBS option adjusted spread to Treasuries widened.

Source: Lehman Brothers

Top-right panel

Title: June 30-Yr MBS Coupon Composition
Series: 4.5 - 8.5+ MBS coupons
Horizon: August 5, 2005
Description: Most MBS holdings have a 5.0 and 5.5 coupon.

Source: Lehman, FHLMC

Bottom-left panel

Title: Fannie Mae and Freddie Mac Mortgage Portfolios
Series: Fannie Mae and Freddie Mac
Horizon: January 2002 - June 2005
Description: Fannie Mae and Freddie Mac portfolios increased.

Source: Fannie Mae, Freddie Mac

Bottom-right panel

Title: Foreign Central Bank* Holdings of GSE Securities in Custody at FRBNY
Series: Direct Obligation and MBS
Horizon: January 2002 - June 2005
Description: Holdings on direct obligation and MBS increased.

* Excludes FMS and Collateral Accounts Return to text

Source: Internal FRBNY Custody Data

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Top-left panel

Title: High Yield Index Debt Spread
Series: High yield debt spread
Horizon: January 3, 2000 - August 5, 2005
Description: High yield index debt spread narrowed.

Source: Merrill Lynch

Top-right panel

Title: High Yield Index Debt Spread
Series: High yield debt spread
Horizon: January 3, 2005 - August 5, 2005
Description: Narrowing in on this time frame, the high yield index debt spread widened.

Source: Merrill Lynch

Middle panel

Title: High Yield Debt Issuance Rated B- and Below
Series: High yield debt issuance rated B- and below
Horizon: 1987 - 2005
Description: The percent of high yield debt issuance rated B- and below increased.

Source: SDC, Merrill Lynch

Bottom panel

Title: Use of Proceeds High Yield Issuance
Series: LBO, Acquisitions, Refinancing, CAPEX, Other (includes general corporate purposes, recapitalization, dividends and stock repurchases)
Horizon: 1987 - 2005
Description: The percent of LBO increased, acquisitions decreased, refinancing decreased, CAPEX

did not change, and other increased.

Source: Merrill Lynch

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Title: Euro-Area 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: Euro LIBOR fixed, 3-month forward, and 9-month forward
Horizon: March 1, 2005 - August 5, 2005
Description: The 3-month forward and 9-month forward for euro-area decreased.

Top-right panel

Title: UK 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: LIBOR fixed, 3-month forward, and 9-month forward
Horizon: March 1, 2005 - August 5, 2005
Description: The 3-month forward and 9-month forward for the UK decreased.

Middle-left panel

Title: Dollar-Yen
Series: Yen Dollar
Horizon: December 31, 2004 - August 5, 2005
Description: The dollar appreciated against the Yen.

Middle-right panel

Title: 10-Year JGB Yield
Series: 10-year JGB yield
Horizon: December 31, 2004 - August 5, 2005
Description: The 10-year JGB yield decreased.

Bottom panel

Title: Yuan Spot and NDFs
Series: Yuan spot, 1-month NDF, 6-month NDF, and 12-month NDF
Horizon: May 9, 2005 - August 5, 2005
Description: The Yuan spot, 1-month NDF, 6-month NDF, and 12-month NDF decreased.

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Top panel

Title: SOMA Changes Over Half-Year Intervals
Series: SOMA holdings changes
Horizon: June 2000 - June 2005
Description: SOMA holdings increased about $7 billion from December 2004 to June 2005.

Bottom panel

Title: Factor Changes over Half-Year Intervals (Impact on Need for Open Market Operations)
Series: Required operation balances, all other autonomous factors, and currency in circulation
Horizon: June 2000 - June 2005
Description: Required operation balances decreased about $3 billion, while all other autonomous factors increased about $1 billion and currency in circulation increased about $7 billion.

* SOMA changes are based on values on half-year end dates.

* The change for June 2000 is based on factor movements following the unwinding of the Y2K effects.

Appendix 2: Materials used by Mr. Ferguson

Root Mean Square Prediction Error of Alternative Forecasts of One-year-ahead CPI Inflation

(in percentage points)

Sample Period	81Q3-04Q1	81Q3-92Q4	93Q4-04Q1	99Q1-04Q1
Greenbook	1.20	1.44	0.89	1.10
SPF CPI forecast	1.22	1.50	0.84	0.88
CPI random walk	1.51	1.91	0.93	1.18
Median CPI random walk	1.43	1.74	1.01	1.24
Raw TIPS				
One-year TIPS compensation	NA	NA	NA	1.17
Five-year TIPS compensation	NA	NA	NA	1.11
Adjusted TIPS				
One-year TIPS compensation	NA	NA	NA	0.80
Five-year TIPS compensation	NA	NA	NA	0.76

Indicator Forecasts of One-year-ahead CPI Inflation

Indicator	Forecast of CPI inflation
Greenbook (05Q2-06Q2)	2.45
SPF CPI forecast	2.40
CPI random walk (Q2)	2.55

Indicator	Forecast of CPI inflation
Median CPI random walk	2.33
Raw TIPS	
One-year TIPS compensation	2.53
Five-year TIPS compensation	2.39
Adjusted TIPS	
One-year TIPS compensation	2.37
Five-year TIPS compensation	2.42

Appendix 3: Materials used by Mr. Madigan

Material for **Briefing on Monetary Policy Alternatives**
August 9, 2005

Class I FOMC -- Restricted Controlled (FR)

Exhibit 1
Financial Market Developments

Exhibit 1 reports on recent financial market developments.

Top-left panel
Nominal Treasury Yields*

A line chart plots the two- and ten-year Treasury yields since the beginning of 2004. The ten-year yield has been fairly steady over this period while the two-year yield has risen more than 200 basis points. As a result, the spread between the ten-year and two-year yields is now fairly narrow.

* Par yields from an estimated off-the-run Treasury yield curve. Return to text

Top-right panel
One-year Forward Rates: Change Since June 29, 2005

A bar chart shows the revisions of one-year Treasury forward rates over the intermeeting period. The chart indicates that the upward revision in forward rates has been most pronounced in forward rates at horizons of 1 to 5 years.

Middle-left panel
TIPS Yields*

A line chart plots five- and ten-year Treasury TIPS yields. Both real yields have risen significantly since the June meeting.

* Estimates are from a smoothed inflation-indexed yield curve. Return to text

Middle-right panel

Inflation Compensation*

A line chart plots the time series for five-year inflation compensation and inflation compensation five to ten years ahead. Both series moved down from the beginning of the year but have edged up since the June meeting.

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

Bottom-left panel
Oil Price

A line chart plots the spot and long-dated futures prices for WTI oil. Both series have risen substantially since the beginning of 2004 and have increased again, on net, over the period since the June meeting.

Bottom-right panel
Stock Prices

A line chart plots the time series for the Wilshire and NASDAQ stock price series. Both series climbed over the intermeeting period.

Exhibit 2
Policy Expectations

Exhibit 2 reports on policy expectations.

Top-left panel
Expected Federal Funds Rates*

A line chart reports the expected path of the funds rate as of the June FOMC meeting and most recently. The expected policy path shifted up sharply since the June meeting.

* Estimates from federal funds and eurodollar futures, with a 1 basis point per month allowance for term premia and other adjustments. Return to text

Top-right panel
Expected Federal Funds Rates*

A chart displays the expected rate after upcoming FOMC meetings. As of June, market participants seemed to expect little if any additional tightening beyond October of this year The most recent reading of the data suggests that market participants anticipate continued tightening at upcoming meetings through early next year.

* Estimates assume a 1 basis point per month term premium and zero probability of intermeeting moves. Return to text

Trading Desk's Survey of Primary Dealers

Bottom-left panel
Fed Funds Target Rate

Average subjective probabilities
Percent

	Aug.	Sept.	Nov.
+0 b.p.	3	7	14
+25 b.p.	93	84	76
+50 b.p.	4	6	9

Bottom-center panel
Expectations for August FOMC Statement

	Percent of dealers
Policy accommodative	95
Balanced risks to growth	100
Balanced risks to inflation	100
Measured pace	100

Bottom-right panel
Average Estimates of Neutral Nominal Funds Rate

	Percent
Low	3.82
Neutral	**4.24**
High	4.65

Exhibit 3
Equilibrium Real Federal Funds Rate

Top panel
Short-Run Estimates with Confidence Bands

A chart displays the current level of the real federal funds rate relative to a range of model estimates of the equilibrium real rate. 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.

Notes: The real federal funds rate is constructed as the difference between the quarterly average of the actual nominal funds rate and the log difference of the core PCE price index over the previous four quarters. For the current quarter, the nominal funds rate used is the target federal funds rate as of the Bluebook publication date.

Bottom panel
Short-Run and Medium-Run Measures

	Current Estimate	*Previous Bluebook*
Short-Run Measures		
Greenbook-consistent measure	1.9	*1.5*

	Current Estimate	*Previous Bluebook*
Single-equation model	1.9	*1.9*
Small structural model	2.2	*2.8*
Large model (FRB/US)	2.3	*2.1*
Confidence intervals for three model-based estimates		
70 percent confidence interval	0.7 - 3.6	
90 percent confidence interval	-0.2 - 4.4	
Medium-Run Measures		
TIPS-based measure	1.9	*1.7*
Single-equation model	2.1	*2.2*
Small structural model	2.4	*2.7*
Confidence intervals for two model-based estimates		
70 percent confidence interval	1.4 - 3.2	
90 percent confidence interval	0.7 - 3.7	
Memo		
Actual real federal funds rate	1.19	*1.26*

Notes: Confidence intervals and bands reflect uncertainties about model specification, coefficients, and the level of potential output. The final column indicates the values for the current quarter based on the estimation for the previous Bluebook, except that the TIPS-based measure and the actual real funds rate are the values published in the previous Bluebook.

Exhibit 4
Optimal Policy with Alternative Scenarios

Exhibit 4 reports on optimal policy in alternative scenarios. The exhibit reports results for a benchmark scenario and for two alternative scenarios--one involving higher term premiums and another involving higher aggregate demand.

Top-left panel
Nominal Federal Funds Rate

A line chart plots the level of the nominal funds rate corresponding to each scenario. In the benchmark scenario, the nominal funds rate increases to about 4-1/2 percent by late 2006 and then edges down to 4 percent over the next few years. Under the higher term premium scenario, the funds rate path is lower, moving up to only about 4 percent in late 2006 and then declining to about 3 percent farther out. Under the stronger aggregate demand scenario, the level of the nominal funds rate moves substantially higher, peaking at almost 7 percent in 2007 and then gradually falling toward 4 percent by the end of 2012.

Top-right panel
Nominal Ten-Year Treasury Yield

A line chart displays the nominal ten-year Treasury yield corresponding to these alternatives. The benchmark ten-year yield rises gradually from a level of about 4-1/4 percent to about 4-3/4 percent by the end of 2012. Under the higher term premium scenario, the level of rates is similar to the benchmark case because the lower funds rate path roughly offsets the increase in the term premium. In the stronger aggregate demand scenario, the sharply higher funds rate path results in a much higher ten-year Treasury yield that peaks at about 5-1/4 percent in late 2006 and early 2007 before gradually falling to about 5 percent.

Middle panel
Civilian Unemployment Rate

A line chart reports the projection for the unemployment rate in each of these scenarios. In the benchmark case, the unemployment rate rises gradually to about 5-1/4 percent and then falls toward 5 percent by the end of 2012. Under the higher term premium scenario, the unemployment rate follows a similar pattern but tracks a little higher than the benchmark case. In the stronger demand scenario, the unemployment rate moves lower through the end of 2005 to a level of about 4-3/4 percent and then increases gradually over subsequent years to a level of about 5-1/4 percent by the end of 2012.

Bottom panel
PCE Inflation (ex. food and energy)

A line chart reports the projections for core PCE inflation (four-quarter percent change) in these three scenarios. For the benchmark scenario, core PCE inflation is projected to gradually drift lower over the next several years to reach a level of about 1-3/4 percent by the end of 2012. The path for core PCE inflation under the higher term premium scenario is nearly identical to the benchmark case. For the stronger demand scenario, core PCE inflation edges lower over the next couple years to a level of about 1-3/4 percent but then picks up in 2009 and 2010 to a level of about 2 percent.

Table 1: Alternative Language for the August FOMC Announcement

[Note: In Appendix 3, Table 1, emphasis (strike-through) has been added to indicate strike-through text in the original document. Strong emphasis (bold) indicates bold red text in the original document.]

	June 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 3-1/4 percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to **3-1/2** percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to **3-1/2** percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by **50** basis points to **3-3/4** 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~~,~~ ~~even after this action, the stance~~ **the degree** of monetary policy ~~remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.~~ **accommodation has been substantially reduced.**	[no change]	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.
	3. Although energy prices have risen further, the expansion remains firm and labor market conditions continue to improve	~~Although energy prices have risen further, t~~The expansion remains firm **despite high energy prices,** and labor market conditions continue to	~~Although energy prices have risen further, the expansion remains firm~~ **Aggregate spending, despite high energy prices, appears to**	~~Although energy prices have risen further, the expansion remains firm~~ **Aggregate spending appears to be expanding briskly despite**

	June FOMC	Alternative A	Alternative B	Alternative C
	gradually.	improve gradually.	**have strengthened since late winter,** and labor market conditions continue to improve gradually.	**high energy prices**, and labor market conditions continue to improve gradually.
	4. Pressures on inflation have stayed elevated, but longer-term inflation expectations remain well contained.	~~Pressures on inflation have stayed elevated, but~~ **Core inflation has been relatively low in recent months, and** longer-term inflation expectations remain well contained.	~~Pressures on inflation have stayed elevated, but~~ **Core inflation has been relatively low in recent months and** longer-term inflation expectations remain well contained, **but pressures on inflation have stayed elevated.**	~~Pressures on inflation have stayed elevated, but~~ **Core inflation has been relatively low in recent months and** longer-term inflation expectations ~~remain~~ **seem** well contained, **but pressures on business costs and inflation appear to be increasing.**
Assessment of Risk	5. The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal.	[no change]	[no change]	[none]
	6. With underlying inflation expected to be contained, 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 contained, the Committee believes that **remaining** 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.	[no change]	[none]

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