Meeting of the Federal Open Market Committee
November 1, 2005 Presentation Materials -- Text Version

Presentation Materials (1.74 MB PDF)

Pages 103 to 114 of the Transcript

Appendix 1: Materials used by Mr. Kos

Page 1

Top panel

Title: Current US 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements
Series: LIBOR fixed, 3-month forward, and 9-month forward
Horizon: June 1, 2005 - October 28, 2005
Description: The US 3-month forward and 9-month forward rates increased.

Middle panel

Title: 2- and 10-Year Treasury Yields and Target Fed Funds
Series: 2-Year Treasury Yield, 10-Year Treasury Yield and target Fed Funds rate
Horizon: June 1, 2005 - October 28, 2005
Description: The 10-year Treasury yield, the 2-year Treasury yield, and the target Fed Funds rate increased.

Bottom panel

Title: Implied Breakeven Inflation Rates from TIPS
Series: 2-year and 10-year
Horizon: June 1, 2005 - October 28, 2005
Description: The 2-year breakeven rate and the 10-year breakeven rate increased.

Source: Barclays

Page 2

Top-left panel

Title: Select 10-Year Sovereign Debt Yields
Series: UK, US, Canada, and Germany
Horizon: June 1, 2005 - October 28, 2005
Description: Sovereign debt yields increased for all four countries.

Top-right panel

Title: 10-Year JGB Yields
Series: 10-Year JGB yield
Horizon: June 1, 2005 - October 28, 2005
Description: The 10-year JGB yield increased.

Middle-left panel

Title: Implied Rates on March-06 Futures Contracts
Series: Sterling, Eurodollar, Canadian Bankers Acceptance, and Euribor
Horizon: June 1, 2005 - October 28, 2005
Description: Implied rates on March-06 futures contracts for Sterling, Eurodollar, Canadian Bankers Acceptance, and Euribor increased.

Middle-right panel

Title: Implied Rates on Dec-06 Euro-Yen Futures Contract
Series: Implied rate on Dec-06 Euro-Yen futures contract
Horizon: June 1, 2005 - October 28, 2005
Description: The implied rate on Dec-06 Euro-Yen futures contract increased.

Bottom-left panel

Title: Brazilian Daily Interbank Deposit Futures
Series: One-month futures on Brazilian overnight interbank deposits
Horizon: June 1, 2005 - October 28, 2005
Description: The one-month futures on Brazilian overnight interbank deposits decreased.

Bottom-right panel

Title: Mexican 1-Month T-Bill Rate
Series: Mexican 1-month T-Bill rate
Horizon: June 1, 2005 - October 28, 2005
Description: The Mexican 1-month T-Bill rate decreased.

Page 3

Top-left panel

Title: Investment Grade Debt Spread
Series: Investment grade debt spread
Horizon: June 1, 2005 - October 28, 2005
Description: The Investment grade debt spread narrowed.

Source: Lehman Brothers

Top-right panel

Title: High Yield Debt Spread
Series: High yield debt spread
Horizon: June 1, 2005 - October 28, 2005
Description: The High yield debt spread narrowed.

Source: Merrill Lynch

Middle panel

Title: Auto Sector Credit Default Swaps and CDX High Yield Index
Series: General Motors, Ford Motor, CDX High Yield Index
Horizon: June 1, 2005 - October 28, 2005
Description: The auto sector credit default swaps increased.

Source: Morgan Stanley

Bottom panel

Title: Credit Default Swap Rates for Select Financial Institutions
Series: Lehman, Bear Sterns, Morgan Stanley, Merrill Lynch, Goldman Sachs, Citigroup, JP Morgan, and Bank of America
Horizon: January 3, 2005 - October 28, 2005
Description: The Credit default swap rates for these select financial institutions have returned to January 2005 levels.

Source: Lehman Brothers

Appendix 2: Materials used by Mr. Reinhart

Material for **FOMC Briefing on Monetary Policy Alternatives**
Vincent R. Reinhart
November 1, 2005

Class I FOMC - Restricted Controlled FR

Exhibit 1
Policy Background

Exhibit 1 provides information on recent financial market developments.

Top panel
Eurodollar Futures

A line chart plots time series for the December 2005 and December 2006 Eurodollar futures rates. These series both dropped sharply in the aftermath of Hurricane Katrina but have since more than reversed those declines.

Middle-left panel
Estimated Expected Federal Funds Rate

A line chart displays the expected path of policy derived from federal funds futures on the dates just prior to the August and September FOMC meetings and most recently. The chart shows a sharp downward revision in the expected path of policy from August to September and then a sharp upward revision in the policy path from September to October. On net, the expected policy path in October stands well above the level of the policy path in early August.

Note. Estimates from federal funds and eurodollar futures, with an allowance for term premia and other adjustments.

Middle-right panel

Long-term Federal Funds Expectations

A line chart displays information on long-term federal funds expectations from the Blue Chip Survey. The data show that the consensus estimate has been fairly steady since 2004 and there has been a significant narrowing in the dispersion of estimates for long-term federal funds expectations across forecasters over this period.

Source. Blue Chip Survey.

Note. Approximately 40 respondents. Top/bottom 10 is the average of the highest/lowest 10 responses. Consensus is the average of all responses. Adjusted for difference between three-month bill rate and effective federal funds rate

Bottom panels

Three line charts display time-series for the ten-year Treasury yield, the Wilshire 5000 stock price index, and the exchange value of the dollar, respectively, over the period since the beginning of 2004.

Bottom-left panel
**Ten-Year Treasury*
**

The series for the ten-year Treasury yield has fluctuated between 4 and 5 percent over this period and rose significantly over the intermeeting period to reach a current level of about 4-3/4 percent.

* Par yields from a smoothed nominal off-the-run Treasury yield curve. Return to text

Bottom-center panel
Wilshire 5000

The Wilshire stock price index edged a little lower over the intermeeting period.

Bottom-right panel
Nominal Major Currencies Dollar Index

The exchange value of the dollar was little changed, on net, over the intermeeting period.

Exhibit 2
Policy Alternatives

Exhibit 2 focuses on the policy alternatives. The charts in the left column present arguments for easing policy. The charts in the right column present arguments for leaving policy on hold or tightening.

Top-left panel
Arguments for A

- Staff growth forecast has been marked down fairly consistently.
- Real estate values could stop escalating.
- Consumer confidence could sink further.

Middle-left panel
Staff Forecast of GDP Growth for 2006

A line chart displays the evolution of the staff forecast for GDP growth (percent, Q4/Q4) in 2006. On balance, the staff has been marking down its outlook for GDP growth in 2006 since the beginning of 2004.

Source. Greenbook projections.

Bottom-left panel
Consumer Confidence

A line chart displays the Conference Board and Michigan survey measures of consumer confidence. Both series moved sharply lower in the late summer and fall following the hurricanes.

Top-right panel
Arguments for B and C

- Staff inflation forecast has been marked up fairly consistently.
- Inflation may already be at top of comfort zone.
- Inflation expectations could increase further.

Middle-right panel
Staff Forecast of Core PCE Inflation for 2006

A line chart displays the evolution of the staff forecast for core PCE inflation (percent, Q4/Q4) in 2006. The forecast has been steadily revised up over time from about 1-1/2 percent in late 2004 to about 2-1/4 percent at present.

Source. Greenbook projections.

Bottom-right panel
Expected Inflation

A line chart displays time series for inflation expectations from the Michigan survey. The series for long-term inflation expectations has remained fairly steady although it has edged up over the last few months. The series for inflation expectations over the next 12 months moved sharply higher in September and increased further in October.

Source. Michigan SRC.

Exhibit 3
Questions on the Statement Language

September Statement

[Note: Footnote links have been added to represent color-coding 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 3¾ percent.

Output appeared poised to continue growing at a good pace before the tragic toll of Hurricane Katrina. The widespread devastation in the Gulf region, the associated dislocation of economic activity, and the boost to energy prices imply that spending, production, and employment will be set back in the near term. In addition to elevating premiums for some energy products, the disruption to the production and refining infrastructure may add to energy price volatility.

While these unfortunate developments have increased uncertainty about near-term economic performance, it is the Committee's view that they do not pose a more persistent threat. Rather, **monetary policy accommodation**,[green] coupled with **robust underlying growth in**

productivity,[red] is providing ongoing support to economic activity. Higher energy and other costs have the potential to add to inflation pressures. However, core inflation has been relatively low in recent months, and longer-term inflation expectations remain contained.

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

[red] 1. Is productivity growth still robust? Return to text

[green] 2. Will monetary policy still be accommodative? Return to text

[blue] 3. Are you likely to remove policy accommodation at a measured pace? Return to text

[purple] 4. Is there a policy path that will balance the risks to your dual objectives? Return to text

Exhibit 4
Language Considerations

Exhibit 4 discusses some considerations for the language in the FOMC statement.

Top-left panel
Productivity Growth

(Four-quarter Change)

Period Ending	Percent
2001 Q4	3.2
2002 Q4	2.9
2003 Q4	5.0
2004 Q4	2.6
2005 Q3	2.9 p

Note. Nonfarm Business Sector

p - projection Return to table

Top-right panel
Blue Chip Forecast for Long Run Real GNP/GDP Growth

A line chart displays the time-series of Blue Chip forecasts for long-run GDP growth over the period from 1986 to present. The chart indicates that long-run GDP growth forecasts were revised up significantly beginning in 2000 to a level of about 3-1/4 percent.

Note. Approximately 40 respondents. Top/bottom 10 is the average of the highest/lowest 10 responses. Consensus is the average of all responses. Long run growth is for six to eleven years ahead.

Middle panel
Range of Estimated Equilibrium Real Rates

A chart plots the current level of the real federal funds rate and a range of estimates of the equilibrium real rate. The current level of the real funds rate is very close to the center of the range of model based estimates of the equilibrium real rate.

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

Bottom-left panel
Why "Accommodative" May Still Be Appropriate

- Greater vigor of aggregate demand.
- Forward-looking inflation expectations.
- Path for output may imply undesirably high inflation.

Bottom-right panel
Energy Prices

A line chart displays time-series of the spot prices for WTI oil and natural gas* over the period from January 2005 to present. Both series have moved up sharply relative to early this year but edged lower over the intermeeting period.

* National average Return to text

Exhibit 5
Assessment of Risks

[Note: In Appendix 2, Exhibit 5, emphasis (strike-through) has been added to indicate strike-through text in the original document, and strong emphasis (bold) has been added to indicate red text in the original document.]

Top panel
Alternative B

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. 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.

Top-middle panel
Shift to Change in the Funds Rate

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. With underlying inflation expected to be contained, the Committee believes that policy ~~accommodation can be removed~~ **firming can continue** 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.

Bottom-middle panel
Formulaic Language

~~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. 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.~~

The Committee's ecomomic outlook is such that, if the federal funds rate were maintained at its current level for the next several quarters, output growth is more likely to be above than below its sustainable pace. Inflation over the same period is more likely to increase than decrease. [As a result, the Committee views the near-term risks to its dual objectives as tilted to the upside.] In any event, the Committee is prepared to take the steps necessary to maintain price stability and sustainable economic growth.

Bottom panel
No Risk Assessment

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Table 1: Alternative Language for the November FOMC Announcement

	September 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 3¾ percent.	The Federal Open Market Committee decided today to leave its target for the federal funds rate unchanged.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4 percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4 percent.
Rationale	2. Output appeared poised to continue growing at a good pace before the tragic toll of Hurricane Katrina. The widespread devastation in the Gulf region, the associated dislocation of economic activity, and the boost to energy prices imply that spending, production, and employment will be set back in the near term. In addition to elevating premiums for some energy products, the disruption to the production and refining infrastructure may add to energy price volatility. While these unfortunate developments have increased uncertainty about near-term economic performance, it is the Committee's view that they do not pose a more persistent threat. Rather, monetary policy accommodation, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.	Elevated energy prices and hurricane-related disruptions in economic activity seem to have slowed the growth of spending, set back employment, and weakened consumer and business confidence. The persistence of such effects is uncertain, but robust underlying growth of productivity and monetary policy accommodation are providing support to economic activity.	Elevated energy prices and hurricane-related disruptions in economic activity have temporarily depressed output and employment. However, monetary policy accommodation, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity that will likely be augmented by planned rebuilding in the hurricane-affected areas.	The disruptive effects of recent hurricanes seem likely to be temporary, especially in light of increased spending associated with rebuilding efforts. Economic growth continues to be supported by robust underlying growth in productivity.
	3. Higher energy and other costs have the potential to add to inflation pressures. However,	High energy and other costs have added to inflation pressures. However, core	The cumulative rise in energy and other costs have the potential to add to	Core inflation and longer-term inflation expectations remain

	September FOMC	Alternative A	Alternative B	Alternative C
	core inflation has been relatively low in recent months, and longer-term inflation expectations remain contained.	inflation has been relatively low in recent months, and longer-term inflation expectations remain contained.	inflation pressures; however, core inflation has been relatively low in recent months and longer-term inflation expectations remain contained.	contained. However, high energy and other costs have boosted near-term inflation expectations and price pressures, likely making further policy firming necessary.
Assessment of Risk	4. 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]
	5. 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]

Return to top