

## Meeting of the Federal Open Market Committee December 11, 2007 Presentation Materials -- Text Version

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

Pages 127 to 138 of the Transcript

### Appendix 1: Materials used by Mr. Dudley

Class II FOMC - Restricted FR

#### Page 1

##### Top panel

(1)

**Title:** Subprime Mortgage Performance Continues to Worsen

**Series:** Percent of subprime mortgages that are 60+ days delinquent and percent of subprime mortgages that have entered foreclosure

**Horizon:** January 1998 - September 2007

**Description:** The percentages of subprime mortgages that are 60+ days delinquent or entered foreclosure are near or above their highs since 1998.

Source: Mortgage Bankers Association and Economy.com

##### Middle panel

(2)

**Title:** Subprime 60 Day+ Delinquency Rate by Vintage

**Series:** ABX 06.01, 06.02, 07.01, 07.02, and average 2000-2005 ARMs

**Horizon:** Loan Age from 5 to 28 months

**Description:** The ABX 07.02 vintage has been experiencing a sharper increase in 60 day+ delinquencies earlier in the vintage as compared to past ABX vintages.

Source: Merrill Lynch, Intex

##### Bottom panel

(3)

**Title:** Prime Mortgage Performance Also Worsens

**Series:** Percent of prime mortgages that are 60+ days delinquent and percent of prime mortgages that have entered foreclosure

**Horizon:** January 1998 - September 2007

**Description:** The percentages of prime mortgages that are 60+ days delinquent or entered foreclosure has increased in recent months.

Source: Mortgage Bankers Association and Economy.com

## Page 2

### Top panel

(4)

**Title:** Average Loss Estimated for 2006/07 ABS CDOs Based on Underlying Mortgage Loan Losses

**Series:** Base case and 150 percent X base case losses estimates for mezzanine and high grade 2006/07 ABS CDOs and for the super senior tranche of the mezzanine and high grade 2006/07 ABS CDOs

**Horizon:** N/A

**Description:** In the base case, the percent loss for mezzanine and high grade 2006/07 ABS CDOs and for the super senior tranche of the mezzanine and high grade 2006/07 ABS CDOs are expected to be relatively small as compared to 150 percent X base case where they are expected to be substantial.

Source: UBS

### Middle panel

(5)

**Title:** Estimated Losses for Super Senior Tranches of 2006/07 Mezzanine ABS CDOs

**Series:** Base case and 150 percent X base case losses for super senior tranches of 2006/07 mezzanine ABS CDOs

**Horizon:** N/A

**Description:** In the base case, the number of super senior tranches of 2006/07 mezzanine ABS CDOs that are expected to experience significant losses is minimal but in the 150 percent X base case a large portion of the sample bonds will experience substantial losses.

Source: UBS

### Bottom panel

(6)

**Title:** Financial Guarantors' CDS Spreads and Equity Prices

**Series:** Credit default swap spreads and equity prices for Ambac and MBIA

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** While credit default swap spreads widened for Ambac and MBIA, their equity prices declined.

Source: Markit

## Page 3

### Top panel

(7)

**Title:** Outstanding ABCP Volume Contraction Accelerates Again

**Series:** Outstanding volume of ABCP and average 30-day and overnight rates on ABCP

**Horizon:** January 1, 2007 - December 5, 2007

**Description:** While rates on ABCP decline, the outstanding ABCP volume has been declining.

Source: Federal Reserve Board

### **Middle panel**

**(8)**

**Title:** Fannie Mae and Freddie Mac's CDS Spreads and Equity Prices

**Series:** Credit default swap spreads and equity prices for Fannie Mae and Freddie Mac

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** While credit default swap spreads widened for Fannie Mae and Freddie Mac, their equity prices declined.

Source: Markit

### **Bottom panel**

**(9)**

**Title:** Mortgage Insurers' CDS Spreads and Equity Prices

**Series:** Credit default swap spreads and equity prices for MGIC Investment Corp, PMI Group, and Radian

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** While credit default swap spreads widened for MGIC Investment Corp, PMI Group, and Radian, their equity prices declined.

Source: Markit

## **Page 4**

### **Top panel**

**(10)**

**Title:** Corporate Credit Spreads Widen

**Series:** Investment grade and high-yield debt spreads

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** Investment grade and high-yield debt spreads widened over the intermeeting period.

Source: Bloomberg

### **Middle panel**

**(11)**

**Title:** Probabilities for Policy Rate Outcomes for December FOMC Meeting

**Series:** Probabilities for a 4.00, 4.25, or 4.50 percent target rate at the December 11 FOMC meeting

**Horizon:** November 1, 2007 - December 7, 2007

**Description:** In the days leading up to the December FOMC meeting, probabilities for 4.25 percent target rate increased sharply while probabilities declined significantly for 4.50 percent target rate.

Source: Cleveland Fed

### **Bottom panel**

**(12)**

**Title:** Fed Funds Futures Rate Expectations Shift Lower

**Series:** Eurodollar futures curve as of 9/17/2007, 10/30/2007, and 12/7/2007

**Horizon:** September 17, 2007 - December 7, 2007

**Description:** The fed funds futures curve has shifted lower since the last FOMC meeting.

Source: Bloomberg

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### Top panel

(13)

**Title:** Eurodollar Futures Curve Shifts Lower

**Series:** Eurodollar futures curve as of 9/17/2007, 10/30/2007, and 12/7/2007

**Horizon:** September 17, 2007 - December 7, 2007

**Description:** The Eurodollar futures curve has shifted lower since the last FOMC meeting.

Source: Bloomberg

### Middle panel

(14)

**Title:** Distribution of Expected Policy Target Among Primary Dealers Prior to December 11 FOMC Meeting

**Series:** Dealer expectations for policy target rate by quarter, average forecast for policy target by quarter, and market rate for policy expectation by quarter as of 12/3/2007

**Horizon:** Q4 2007 - Q4 2008

**Description:** There is less dispersion regarding where dealers expect the policy rate to be in Q4 2007. Dealers on average expect higher rates than what is currently priced into Eurodollar futures for 2008.

Source: Dealer Policy Survey

### Bottom panel

(15)

**Title:** Distribution of Expected Policy Target Among Primary Dealers Prior to October 31 FOMC Meeting

**Series:** Dealer expectations for policy target rate by quarter, average forecast for policy target by quarter, and market rate for policy expectation by quarter as of 10/23/2007

**Horizon:** Q4 2007 - Q4 2008

**Description:** Compared to the December policy survey, there is more dispersion of policy rate expectation for Q4 2007. Dealers on average expect slightly higher rates than what is currently priced into Eurodollar futures for 2008.

Source: Dealer Policy Survey

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### Top panel

(16)

**Title:** TIPS Inflation Compensation: 5-10 Year Horizon

**Series:** Federal Reserve Board's 5-10 Year horizon TIPS inflation compensation and Barclays 5-10 Year horizon TIPS inflation compensation

**Horizon:** June 1, 2006 - December 7, 2007

**Description:** TIPS inflation compensation over a 5-10 year horizon has increased since June as measured by both the Federal Reserve Board and Barclays.

Source: Federal Reserve Board and Barclays Capital

### **Middle panel**

(17)

**Title:** Day-to-Day Effective Rate Remains Volatile, But Cumulatively Close to Target Rate

**Series:** Rolling cumulative effective rate since 11/1, target fed funds rate, and effective fed funds rate

**Horizon:** November 1, 2007 - December 7, 2007

**Description:** The rolling cumulative effective rate since 11/1 has been trending closer to the target rate during the intermeeting period.

Source: Federal Reserve Bank of New York

## **APPENDIX: Reference Exhibits**

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#### **Top panel**

(18)

**Title:** Demand for Downside Protection on S&P 500

**Series:** Put-Call Equity Risk Reversal

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** Demand for downside protection on the S&P 500 equity index has declined in the intermeeting period.

Source: OptionMetrics

#### **Middle panel**

(19)

**Title:** U.S. Equity Indices Partially Reverse Sharp Decline

**Series:** S&P 500 index, Nasdaq index, and Russell 2000 index

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** U.S. equity indices have partially reversed the sharp decline seen soon after the October FOMC meeting.

Source: Bloomberg

#### **Bottom panel**

(20)

**Title:** Equity Earning Expectations

**Series:** 2007 and 2008 S&P 500 bottom-up equity analyst forecasts

**Horizon:** January 1, 2007 - November 30, 2007

**Description:** While equity earning expectations have declined for 2007, the earning forecast for 2008 has risen.

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### Top panel

(21)

**Title:** Global Credit Default Swap Spreads

**Series:** ITRAXX Crossover Series 7 spread and LCDX spread

**Horizon:** March 1, 2007 - December 7, 2007

**Description:** ITRAXX crossover spreads and LCDX spreads have widened modestly since the October FOMC meeting.

Source: Bloomberg

### Middle panel

(22)

**Title:** Implied Volatility Stays High

**Series:** VIX index, SMOVE 1-month index, 1-month Euro-Dollar volatility index, and 1-month Dollar-Yen volatility index

**Horizon:** January 1, 2007 - December 7, 2007

**Description:** During the inter-meeting period, implied volatility across asset classes has increased slightly in recent weeks.

Source: Bloomberg

### Bottom panel

(23)

**Title:** Treasury Yield Curve Shifts Lower and Continues to Steepen

**Series:** Constant maturity Treasury yield curve as of 9/17/2007, 10/30/2007 and 12/7/2007

**Horizon:** September 17, 2007 - December 7, 2007

**Description:** The Treasury yield curve has shifted lower and steepened since the last FOMC meetings.

Source: Bloomberg

## Appendix 2: Materials used by Mr. Madigan

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

Brian Madigan

December 11, 2007

**Class I FOMC - Restricted Controlled (FR)**

### Table 1:

**Alternative Language for the December 2007 FOMC Announcement**

	October FOMC	Alternative A	Alternative B	Alternative C
<b>Policy Decision</b>	1. The Federal Open Market Committee decided today to lower its target for the federal funds rate 25 basis points to 4-1/2 percent.	The Federal Open Market Committee decided today to lower its target for the federal funds rate <b>50</b> basis points to <b>4</b> percent.	The Federal Open Market Committee decided today to lower its target for the federal funds rate 25 basis points to <b>4-1/4</b> percent.	The Federal Open Market Committee decided today to <b>keep</b> its target for the federal funds rate <b>at</b> 4-1/2 percent.
<b>Rationale</b>	2. Economic growth was solid in the third quarter, and strains in financial markets have eased somewhat on balance. However, the pace of economic expansion will likely slow in the near term, partly reflecting the intensification of the housing correction. Today's action, combined with the policy action taken in September, should help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and promote moderate growth over time.	<b>Incoming information suggests that</b> the housing correction <b>has intensified and that growth in business and consumer spending is softening. Moreover,</b> strains in financial markets <b>have increased in recent weeks. Overall, the outlook for the economy has weakened somewhat, and downside risks to growth have increased.</b> Today's action, combined with the policy actions <b>taken earlier,</b> should help promote moderate growth over time.	<b>Incoming information suggests that</b> economic growth <b>is slowing,</b> reflecting the intensification of the housing correction <b>and some softening in business and consumer spending. Moreover,</b> strains in financial markets <b>have increased in recent weeks.</b> Today's action, combined with the policy actions <b>taken earlier,</b> should help promote moderate growth over time.	<b>As the Committee had anticipated,</b> economic growth <b>appears to be slowing,</b> partly reflecting the intensification of the housing correction. <b>Although</b> strains in financial markets <b>have increased in recent weeks and now pose greater downside risks to growth, the monetary policy actions taken earlier are expected to help</b> promote moderate growth over time.
	3. Readings on core inflation have improved modestly this year, but recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.	Readings on core inflation have improved modestly this year, but <b>elevated</b> energy and commodity prices, among other factors, may put upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.	Readings on core inflation have improved modestly this year, but <b>elevated</b> energy and commodity prices, among other factors, may put upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.	Readings on core inflation have improved modestly this year, but <b>elevated</b> energy and commodity prices, among other factors, may put upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully.
<b>Assessment of Risk</b>	4. The Committee judges that, after this action, the upside risks to inflation roughly balance the downside risks to growth. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth.	The Committee judges that, after this action, the upside risks to inflation roughly balance the downside risks to growth. The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth.	<b>Recent developments, including the deterioration in financial market conditions, have increased the uncertainty surrounding the outlook for economic growth and inflation.</b> The Committee will continue to assess the effects of financial and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth.	The Committee <b>views the</b> downside risks to growth <b>as the predominant policy concern. Future policy adjustments will depend on the outlook for both inflation and economic growth, as implied by incoming information.</b>

