Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

September 2011

Responses to the Primary Dealer Policy Expectations Survey
Distributed: 9/8/2011 – Received by: 9/12/2011

For most questions, median responses across dealers, along with the 25th and 75th percentiles, are reported. For questions that ask respondents to give a probability distribution, the average response across dealers for each potential outcome is reported.[1] For multiple choice questions, the number of responses for each option is reported. Brief summaries of the comments received in free response form have also been provided.

Except where noted, all primary dealers responded to each question. In some cases, dealers may not have forecasts extending to the same time horizon as requested in the survey. In these instances, the number of respondents who fully answered all parts of the question is provided.

Monetary Policy Expectations

1. Of the possible outcomes below, please indicate the percent chance you attach to the indicated policy target range or target rate following each of the next 3 FOMC meetings:

	Policy Target Range or Rate						
	0 - .25%	**0.25%**	**0.50%**	**0.75%**	**1.00%**	**1.25%**	**>1.25%**
Average:							
One Meeting Ahead (September)	99%	1%	0%	0%	0%	0%	0%
Two Meetings Ahead (November)	99%	1%	0%	0%	0%	0%	0%
Three Meetings Ahead (December)	99%	1%	0%	0%	0%	0%	0%

2. Do you expect any changes in the FOMC statement and, if so, what changes?

Most dealers expected the FOMC to take action to ease policy at the September meeting, with most anticipating a lengthening of the SOMA portfolio's average maturity. Other possible policy actions mentioned were a cut to the rate of interest on excess reserves (IOER) and an additional large scale asset purchase program, cited by a few and a couple of dealers, respectively. A couple of dealers expected no policy action.

In terms of the economic outlook, a few economists expected the Committee's assessment of economic conditions to be downgraded and for downside risks to growth to be noted. A couple of dealers each expected the Committee to note weakening labor market conditions and the subsiding of inflation pressures. Finally, a couple of dealers expected the reference to temporary factors accounting for some of the weakness in economic activity to be removed.

3. Of the possible outcomes below, please indicate the percent chance you attach to the timing of the first federal funds target rate increase.

	Q3 2011	**Q4 2011**	**Q1 2012**	**Q2 2012**	**Q3 2012**	**Q4 2012**	**Q1 2013**	**Q2 2013**	**Q3 2013**	**Q4 2013**	**≥ Q1 2014**
Average	0%	0%	0%	1%	2%	3%	5%	11%	16%	18%	45%

[1] Answers may not sum to 100 due to rounding.

	Most likely quarter and year of first target rate increase:
25th Pctl	*Q4 2013*
Median	Q4 2013
75th Pctl	*Q1 2014*

4. Provide your firm's estimate of the most likely outcome (i.e. the mode) for the federal funds target rate or range at the end of each quarter:

	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013
25th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.31%
75th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.22%*	*0.56%*

5. Of the possible outcomes below, please indicate the percent chance you attach to the federal funds target rate or range 12 months from now:

	0.00 - 0.25%	0.26 - 0.50%	0.51 - 1.00%	1.01 - 1.50%	1.51 - 2.00%	2.01 - 2.50%	≥2.51%
Average	93%	5%	2%	1%	0%	0%	0%

6. How would you grade the Federal Reserve System's communication with the markets and with the public since the last policy survey on 8/1/11? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness.

	Number of Respondents
1 - Very Ineffective	0
2	2
3	7
4	8
5 - Very Effective	3

A few dealers viewed the “mid-2013” forward guidance introduced in the August 2011 FOMC statement as clear. Several dealers noted that the disparity of views expressed by FOMC participants generated confusion at times. Some discussed a lack of clarity regarding the policy options under consideration by the FOMC. A few discussed media articles that had generated confusion over the intermeeting period. Finally, a couple of dealers noted a lack of clarity on the theory behind recent policy changes.

7. **Recent FOMC communication has discussed several different ways monetary policy could be altered to provide either less or more accommodation.**

a) For each listed policy tool, please indicate the probability the tool will be used to signal future policy tightening or to tighten policy within the next 1 and 2 years. Please comment.

		Probability within 1 year	Probability within 2 years
	25th Pctl	*0%*	*5%*
Raise interest on excess reserves	Median	1%	18%
	75th Pctl	*6%*	*61%*
	25th Pctl	*0%*	*10%*
Drain reserves through temporary tools	Median	4%	23%
	75th Pctl	*11%*	*66%*
	25th Pctl	*0%*	*15%*
Halt reinvestments	Median	5%	35%
	75th Pctl	*16%*	*75%*
	25th Pctl	*0%*	*1%*
Reduce size of SOMA portfolio through selling securities	Median	0%	5%
	75th Pctl	*2%*	*21%*
	25th Pctl	*0%*	*3%*
Reduce duration of portfolio*	Median	2%	8%
	75th Pctl	*6%*	*26%*
	25th Pctl	*1%*	*15%*
Change guidance on the period over which the target rate will remain in effect	Median	5%	35%
	75th Pctl	*25%*	*75%*

*i.e. a deliberate action to decrease the duration of the SOMA portfolio, independent of other policy changes

(17 primary dealer comments)

Several dealers noted low expectations for policy tightening over the next year, and some thought tightening was also unlikely within 2 years. A few mentioned that from the time of the last survey, they had pushed their forecasts for the timing of policy tightening out into the future. Some dealers commented on their expectations for the sequence of policy tightening steps, with a few expecting tightening to begin with a change to the forward guidance on the federal funds rate, while a couple thought a halt to reinvestments would come first. A couple of dealers expected that changes to IOER and the federal funds target rate would be made in tandem.

b) For each listed policy tool, please indicate the probability the tool will be used to signal future policy easing or to ease policy within the next 1 and 2 years. Please explain.

		Probability within 1 year	Probability within 2 years
	25th Pctl	*20%*	*22%*
Lower interest on excess reserves	Median	25%	28%
	75th Pctl	*50%*	*53%*
	25th Pctl	*34%*	*34%*
Expand SOMA portfolio through security purchases	Median	40%	50%
	75th Pctl	*50%*	*56%*
	25th Pctl	*64%*	*70%*
Increase duration of portfolio*	Median	75%	78%
	75th Pctl	*90%*	*90%*
	25th Pctl	*21%*	*34%*
Change the forward guidance on the path of the federal funds rate	Median	28%	50%
	75th Pctl	*50%*	*66%*
	25th Pctl	*25%*	*25%*
Provide guidance on the period over which the SOMA portfolio will remain at the current level	Median	45%	47%
	75th Pctl	*50%*	*60%*

*i.e. a deliberate action to decrease the duration of the SOMA portfolio, independent of other policy changes

(16 primary dealer comments)

Some dealers considered an extension of the SOMA portfolio's duration to be the most likely next easing action; a couple of dealers also noted that the probability of this form of easing had increased since the time of the last survey. A few dealers indicated that if the FOMC were to signal easing or take any additional easing actions, it would likely do so sooner, such as over the next year, rather than later. Finally, a couple of dealers viewed additional easing in the form of a reduction to IOER as unlikely.

8. The August FOMC minutes discussed the range of policy tools available to the Committee should it decide that providing additional monetary accommodation was warranted. How do you think these tools might be structured, were they to be used?

a) If the FOMC were to change the forward guidance about the likely path of monetary policy, how would you expect this guidance to change?

Many dealers thought the forward guidance could be changed to condition an increase in the federal funds target rate on certain levels of unemployment and/or inflation. A few within this group highlighted Federal Reserve Bank of Chicago President Evans' proposal on conditioning the level of the federal funds rate on unemployment and inflation as a way the forward guidance could be changed. Some dealers thought the guidance could be extended to discuss the likely size and/or composition of the SOMA portfolio over time. A few dealers thought the calendar date associated with the forward guidance could also be altered.

b) If the Committee were to conduct additional SOMA-expanding asset purchases, what size would you expect a purchase program to be? Over what horizon would you expect the program to be completed? What range of maturities would you expect to be purchased?

	Expected Size (Billions)	Time Horizon (Months)	Range of Maturities (Start)	Range of Maturities (End)
25th Pctl	*495*	*6*	*2*	*10*
Median	550	6	5	30
75th Pctl	*750*	*8*	*5*	*30*

(18 primary dealer comments)

Several dealers commented on the likely structure of a SOMA-expanding asset purchase program. Some dealers noted the possibility of a more flexible program allowing the Committee to review purchase amounts and other design features on a monthly or meeting-to-meeting basis. A couple of dealers mentioned that purchases would likely be concentrated in the 7- to 10-year sector. A couple of dealers noted that the threshold for the introduction of a SOMA-expanding asset purchase program was high.

c) If the committee were to increase the average maturity of the System's portfolio through selling securities with relatively short remaining maturities and purchasing securities with relatively long remaining maturities, what size would you expect this program to be? Over what horizon would you expect the program to be completed? What range of maturities would you expect to be purchased and sold?

	Expected Size (Billions)	Time Horizon (Months)	Purchases: Range of Maturities (Start)	Purchases: Range of Maturities (End)	Sales: Range of Maturities (Start)	Sales: Range of Maturities (End)
25th Pctl	*300*	*6*	*5*	*30*	*0*	*2*
Median	325	6	7	30	0	3
75th Pctl	*463*	*6*	*7*	*30*	*1*	*3*

(18 primary dealer comments)

A few dealers noted that they expected purchases to be concentrated in the 7- to 10-year sector, and a few noted sales might be concentrated in the 1- to 3- year sector.

d) If the FOMC were to lower the interest rate paid on excess reserves, what would you expect the new interest rate on excess reserves to be?

	Expected IOER
25th Pctl	*0.09%*
Median	0.10%
75th Pctl	*0.13%*

(18 primary dealer comments)

Several dealers commented that if the FOMC were to lower IOER, it would likely want to keep the rate positive, while a few expected the FOMC to cut the rate to zero. Some noted that cutting IOER would have a negative impact on money market mutual funds, while a few stated that the cut would negatively affect money markets more broadly. A few stated that a cut to IOER would likely have a small impact on the broader economy.

9. a and b) Provide your firm's estimate of the most likely outcome (i.e. the mode) for output, inflation and unemployment. Are the risks to output, inflation and unemployment skewed to the downside, balanced or skewed to the upside relative to your forecast? Please comment on any risks you see to your forecast.

(12 complete primary dealer responses)

		Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q4/Q4 2011	Q4/Q4 2012	Q4/Q4 2013
	25th Pctl	*1.50%*	*1.45%*	*1.48%*	*2.20%*	*1.15%*	*2.18%*	*2.48%*
GDP	Median	1.80%	2.00%	2.05%	2.50%	1.25%	2.40%	2.60%
	75th Pctl	*2.00%*	*2.28%*	*2.43%*	*2.63%*	*1.43%*	*2.60%*	*2.85%*
	25th Pctl	*1.50%*	*1.70%*	*1.68%*	*1.68%*	*1.70%*	*1.45%*	*1.48%*
Core PCE	Median	1.60%	1.80%	1.80%	1.70%	1.80%	1.60%	1.60%
	75th Pctl	*1.70%*	*1.93%*	*2.03%*	*1.93%*	*1.93%*	*1.85%*	*2.00%*
	25th Pctl	*2.58%*	*2.50%*	*1.98%*	*1.50%*	*2.50%*	*1.50%*	*1.70%*
Headline PCE	Median	2.80%	2.65%	2.15%	1.70%	2.65%	1.80%	2.00%
	75th Pctl	*2.90%*	*2.83%*	*2.40%*	*2.03%*	*2.83%*	*2.30%*	*2.35%*
	25th Pctl					*9.00%*	*8.60%*	*8.00%*
Unemployment Rate*	Median					9.10%	8.75%	8.25%
	75th Pctl					*9.20%*	*9.03%*	*8.65%*

*Average level over Q4 in the case of the unemployment rate.

2011 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	8	10	2
Core PCE	1	16	3
Headline PCE	2	15	2
Unemployment Rate	1	12	7

2012 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	11	7	2
Core PCE	1	15	4
Headline PCE	1	16	2
Unemployment Rate	1	12	7

2013 Forecasts

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	9	3	0
Core PCE	2	9	1
Headline PCE	1	10	0
Unemployment Rate	0	8	4

(17 primary dealer comments)

Some dealers cited downside risks to growth generally, with some highlighting the sovereign debt and banking crisis in Europe as a downside risk. A few dealers also viewed upcoming fiscal policy changes as a downside risk to their growth forecasts, though a few dealers thought fiscal policy could result in higher growth if a stimulus package was passed. A couple of dealers also saw upside risk to their forecasts from incoming activity data, which had not weakened as much as expected. Finally, decreasing returns to growth from monetary policy easing was also noted by a couple of dealers.

c) Do you feel more, less or equally uncertain regarding your economic forecasts since the last survey on 8/1/11?

Number of Dealers:

	Less Uncertain	Equally Uncertain	More Uncertain
GDP Uncertainty	0	8	12
Core PCE Uncertainty	2	15	3

10. What percent chance do you attach to the 4-quarter change in the core PCE deflator falling below zero by the end of Q3 2012?

	Probability
25th Pctl	*5%*
Median	5%
75th Pctl	*10%*

11. For the outcomes below, please indicate the percent chance you attach for the annual average CPI inflation rate from 2016 - 2021. Please also indicate your point estimate for the most likely outcome (i.e. the mode).

	≤1.0%	1.01-1.5%	1.51-2.0%	2.01-2.5%	2.51-3.0%	≥3.01%
Average	5%	10%	21%	32%	22%	10%

	Point Estimate
25th Pctl	*2.00%*
Median	2.30%
75th Pctl	*2.50%*

12. a and b) What percent chance do you attach to the US economy currently being in a recession (NBER-defined)? What percent chance would you attach to the US economy being in a recession in 6 months (NBER-defined)?

	Currently in NBER Recession
25th Pctl	*7%*
Median	18%
75th Pctl	*25%*

	NBER Recession in 6 Months
25th Pctl	*25%*
Median	33%
75th Pctl	*36%*

13. a) Please provide your firm's estimate of the most likely outcome (i.e., the mode) for the unemployment rate and headline 12-month PCE inflation at the time of your estimate for the first target rate increase.

	Unemployment Rate	Headline PCE
25th Pctl	*7.50%*	*1.70%*
Median	8.00%	2.00%
75th Pctl	*8.50%*	*2.35%*

b) Given the levels of headline 12-month PCE inflation listed below, at what level of the unemployment rate would you expect the Committee to increase its target for the federal funds rate?

	1% Inflation	2% Inflation	3% Inflation
25th Pctl	*6.00%*	*7.00%*	*8.00%*
Median	6.95%	7.50%	8.50%
75th Pctl	*7.00%*	*8.00%*	*8.85%*

(16 primary dealer comments)

Some dealers commented that their numerical responses to this question depended on whether the changes in inflation were expected to be transitory or persistent. A few dealers noted that if inflation increased to 3%, the FOMC would likely tighten policy even if the unemployment rate remained high. Additionally, a few dealers noted that the FOMC would likely refrain from tightening policy if inflation was notably below its mandate-consistent level. A few dealers stated that they used Taylor-type rules in calculating their answers.

14. Please comment on any changes to your macroeconomic assessments since the last FOMC meeting.

(18 primary dealer comments)

Many dealers noted that they had downgraded their outlook for growth since the last FOMC meeting. Each of the following factors were mentioned by a few dealers as contributing to their downgrades: the sovereign debt and banking crisis in Europe, U.S. fiscal policy, the labor market, and low consumer confidence. Some dealers noted that the downside risks to the economy were increasing in general, and a couple of dealers cited higher recession probabilities. Finally, a few dealers stated that they did not significantly alter their macroeconomic assessment since the August FOMC meeting.