Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

June 2011

Responses to the Primary Dealer Policy Expectations Survey
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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 (June)	99%	1%	0%	0%	0%	0%	0%
Two Meetings Ahead (August)	99%	1%	0%	0%	0%	0%	0%
Three Meetings Ahead (September)	98%	2%	0%	0%	0%	0%	0%

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

Nearly all of the dealers expected that the economic assessment in the FOMC statement would note a weakening in U.S. economic data. Some of these dealers expected that the economic assessment would also note that various factors such as commodity price pressures and other headwinds to growth will be temporary. A couple of dealers expected the statement to acknowledge a slowing in labor market improvement.

On policy measures, some dealers expected the statement to note that the LSAP will end in June as scheduled, and a couple of these dealers also noted their expectations for the statement to include language that the FOMC will regularly review developments in the economy. Some dealers also expected the statement to note that the existing reinvestment policy would continue.

b) What additional information do you expect Chairman Bernanke to provide in his post-FOMC meeting press conference on June 22nd?

(19 primary dealer comments)

Some dealers expected that the Chairman would provide details on the FOMC's growth and unemployment forecasts. A few dealers expected the Chairman to note weakening in U.S. economic data, and a few dealers expected the Chairman to expand on the FOMC's view of the transitory nature of the slowdown. Some dealers expected that he would note that the threshold for additional easing is high. Some dealers provided no concrete expectations.

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

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

	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	≥ Q2 2013
Average	0%	1%	5%	15%	21%	21%	18%	10%	10%

	Most likely quarter and year of first target rate increase:
25th Pctl	*Q2 2012*
Median	Q3 2012
75th Pctl	*Q3 2012*

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:

(18 complete primary dealer responses)

	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013
25th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.50%*	*0.75%*	*1.00%*
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	0.75%	1.00%
75th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.75%*	*1.06%*	*1.31%*	*1.75%*

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	55%	25%	14%	5%	1%	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 4/18/11? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness.

	Number of Respondents
1 - Very Ineffective	0
2	1
3	2
4	13
5 - Very Effective	4

Some dealers noted that FOMC communication since the last meeting has been helpful or has provided clarity. In particular, some dealers noted that the Chairman's press conference successfully highlighted the consensus view among FOMC members. By contrast, a couple of dealers saw the press conference as adding little value beyond what is already included in existing FOMC communications. Some have noted that often contradictory comments by FOMC participants remains confusing, while an equal number stated that the level of disagreement dissipated and that the overall view of the FOMC is becoming clearer. Additionally a few dealers noted that the discussion of the potential sequence for exiting accommodative policy was informative.

7. What is your expectation for the amount of domestic securities held outright in the SOMA portfolio at year-end for each of the next five years? For your reference, the current level of domestic assets in SOMA is $2,569 billion, according to the latest H.4.1 release.

(19 complete primary dealer responses)

Estimated amount of domestic securities
($ Billions)

	2011	2012	2013	2014	2015
25th Pctl	*2600*	*2238*	*1700*	*1275*	*1100*
Median	2629	2340	1981	1699	1400
75th Pctl	*2650*	*2500*	*2200*	*1900*	*1500*

Several dealers discussed the potential sequencing of tools that the FOMC could use to tighten monetary policy. Some of these dealers highlighted how natural runoff from the SOMA portfolio will figure into the tightening sequence, while a few dealers noted that reinvestment of U.S. agency and agency-backed MBS securities will likely cease in late 2011. Some dealers see asset sales beginning sometime in either 2012 or 2013, and a couple of dealers see gradual sales taking place over a period of five years. A few dealers suggested that the balance sheet will return to its pre-crisis trajectory around 2015 or later.

8. Please indicate whether the measures listed below will most likely be used for the first time before, concurrent with, or after the first increase in the fed funds target rate, if at all (excluding any operational readiness exercises). Secondly, if you select "before" or "after," please indicate the number of FOMC meetings relative to the first increase in the fed funds target rate you expect each measure to be first utilized.

		Number of meetings before (-) or after(+) first target rate increase
Increase IOER*	*25th Pctl*	*0*
	Median	0
	75th Pctl	*0*
Change in "Extended Period" Language in FOMC Statement	*25th Pctl*	*-4*
	Median	-3
	75th Pctl	*-2*
Reverse Repurchases Operations	*25th Pctl*	*-3*
	Median	-2
	75th Pctl	*-1*
Term Deposits	*25th Pctl*	*-2*
	Median	-2
	75th Pctl	*-1*
Halting Treasury Reinvestment	*25th Pctl*	*-4*
	Median	-3
	75th Pctl	*-1*
Halting Agency Debt Reinvestment	*25th Pctl*	*-6*
	Median	-4
	75th Pctl	*-3*
Halting Agency MBS Reinvestment	*25th Pctl*	*-6*
	Median	-4
	75th Pctl	*-3*
Treasury Sales	*25th Pctl*	*2*
	Median	5
	75th Pctl	*7*
Agency Debt Sales	*25th Pctl*	*3*
	Median	4
	75th Pctl	*5*
Agency MBS Sales	*25th Pctl*	*2*
	Median	3
	75th Pctl	*4*

** IOER refers to the rate paid on excess reserves.*

(15 primary dealer comments)

Several dealers expect that an increase in the Federal funds rate will be preceded by reserve-draining operations and the removal of the “extended period” language in the FOMC statement. Several dealers also expect that an increase in short-term interest rates will precede any asset sales. As for the overall tightening sequence, some dealers expect that the FOMC would employ the following tools in the following order: halt reinvestments of maturing SOMA security holdings, conduct reserve-draining operations, remove the “extended period” language, increase the Federal funds rate, begin asset sales. A couple of dealers noted their views of the tightening sequence were informed by the minutes of the April FOMC meeting, while a couple cited recent public remarks by FOMC members.

9. **What is the maximum dollar amount of assets that could be sold through permanent open market operations in a six month period without creating market dislocations (such as transitory large flow-driven movements in prices or a significant loss of liquidity)? Please assume market conditions similar to current market conditions.**

Maximum Amount of Asset Sales over 6 Month Period

($ Billions)

	Treasuries	Agency Debt and MBS	Treasuries, Agency Debt, and Agency MBS Combined
25th Pctl	*115*	*79*	*175*
Median	200	100	295
75th Pctl	*300*	*150*	*414*

Some dealers noted that selling at a high pace is likely to be disruptive than buying at a high pace, noting the potential for liquidity to diminish. Some dealers noted that the FOMC could likely sell assets at a moderate pace, and a couple noted that a clear schedule for sales would be beneficial. A few dealers discussed the impact that the level of U.S. Treasury yields and / or supply will have on the FOMC's ability to sell Treasury securities.

10. **In the previous survey, you were asked about your expectations for the effective fed funds rate at several different levels of interest on excess reserves (IOER) and excess reserves. Since then, the New York Fed announced an expansion in the base of its eligible counterparties for reverse repo operations to include Government Sponsored Enterprises (GSEs). What effect, if any, do you think this expansion will have on the spread between IOER and the effective fed funds rate relative to what you forecasted in the previous survey?**

Number of Respondents:

	Widen Significantly	Widen Somewhat	No Effect	Tighten Somewhat	Tighten Significantly
IOER-EFFR Spread	0	0	1	14	5

(18 primary dealer comments)

Many dealers reported that including Government Sponsored Enterprises (GSEs) in the Federal Reserve's base of eligible counterparties for reverse repo operations will cause the spread between interest on excess reserves (IOER) and the effective Federal funds rate to tighten. A few dealers pointed out that the GSEs' participation will depend on how well the reverse repo program meets their funding and liquidity needs. Some dealers noted that the GSEs would shift a meaningful amount of their activity from fed funds to reverse repos, while a couple emphasized that they would still remain active in the fed funds market.

11. **Please indicate the percent chance you attach to the Federal Reserve expanding its securities portfolio through additional purchases (not including those related to the current $600 billion Treasury purchase program) in each of the following asset classes within the next 2 years. Additionally, please indicate the percent chance you attach to the Federal Reserve conducting asset sales within the next 2 years and within the next 5 years.**

(19 complete primary dealer responses)

		Probability within 2 years		Probability within 5 years
		Purchases	**Sales**	**Sales**
	25th Pctl	*10%*	*19%*	*43%*
Treasuries	*Median*	20%	40%	63%
	75th Pctl	*25%*	*60%*	*91%*
	25th Pctl	*2%*	*44%*	*75%*
Agency Debt and MBS	*Median*	5%	65%	88%
	75th Pctl	*6%*	*76%*	*95%*

(15 primary dealer comments)

With regard to selling assets, a couple dealers noted that sales within five years are quite likely. Some dealers noted the FOMC would likely prefer MBS sales over Treasury sales, with a couple noting this is due to the FOMC's stated desire to return to a Treasury-only portfolio. A few dealers suggested that any sales would be very modest, given the amount of scheduled runoff from the SOMA portfolio.

With regard to purchasing assets, some dealers believe that the probability that the FOMC will announce a third LSAP has risen, but that such an announcement is not their base case. A couple of these dealers noted that further stimulus would likely be done through purchases of U.S. Treasury securities.

12. a and b) Provide your firm's estimate of the most likely outcome (i.e. the mode) for output and inflation. 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.

(11 complete primary dealer responses)

		Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q4/Q4 2011	Q4/Q4 2012	Q4/Q4 2013
	25th Pctl	*2.00%*	*3.00%*	*3.00%*	*2.50%*	*2.58%*	*2.98%*	*2.95%*
GDP	Median	2.50%	3.28%	3.45%	2.95%	2.65%	3.05%	3.20%
	75th Pctl	*2.70%*	*3.63%*	*3.80%*	*3.50%*	*3.03%*	*3.55%*	*3.50%*
	25th Pctl	*1.08%*	*1.20%*	*1.30%*	*1.38%*	*1.30%*	*1.50%*	*1.65%*
Core PCE	Median	1.10%	1.30%	1.50%	1.45%	1.50%	1.70%	2.00%
	75th Pctl	*1.10%*	*1.40%*	*1.63%*	*1.73%*	*1.63%*	*1.93%*	*2.30%*
	25th Pctl					*8.50%*	*7.78%*	*6.85%*
Unemployment Rate	Median					8.60%	8.00%	7.50%
	75th Pctl					*8.80%*	*8.26%*	*7.60%*

(11 complete primary dealer responses)

2011 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	10	9	1
Core PCE	1	12	7
Unemployment Rate	3	10	7

2012 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	9	8	3
Core PCE	0	14	6
Unemployment Rate	4	8	8

2013 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	2	9	0
Core PCE	1	7	3
Unemployment Rate	2	6	3

(17 primary dealer comments)

Several dealers highlighted developments related to fiscal policy as a key downside risk to their economic forecast. Specific fiscal factors discussed included the debt ceiling debate, possible ratings actions, and the expiry of payroll tax cuts. A few noted that the potential growth rate of the U.S. has declined. A few noted rising commodity prices could provide a downside risk to growth.

c) Do you feel more, less or equally uncertain regarding your economic forecasts since the last survey on 4/18/11?

	Number of Dealers:		
	Less Uncertain	**Equally Uncertain**	**More Uncertain**
GDP Uncertainty	1	7	12
Core PCE Uncertainty	5	12	3

13. What percent chance do you attach to the 4-quarter change in the core PCE deflator falling below zero by the end of Q2 2012?

	Probability
25th Pctl	*2%*
Median	5%
75th Pctl	*10%*

14. 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%	25%	32%	19%	9%

	Point Estimate
25th Pctl	*2.00%*
Median	2.28%
75th Pctl	*2.50%*

15. 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	*0%*
Median	4%
75th Pctl	*10%*

	NBER Recession in 6 Months
25th Pctl	*6%*
Median	15%
75th Pctl	*20%*

16. What effects do you believe the anticipated end of the current $600 billion Treasury purchase program in June has had or will have on the 10-year Treasury yield, U.S. dollar, and U.S. equities over the next few months?

Number of Respondents:

	Decrease Significantly	Decrease Somewhat	No Effect	Increase Somewhat	Increase Significantly
Ten-Year Treasury Yield	0	3	7	10	0
U.S. Dollar Index	0	1	9	10	0
U.S. Equities	1	8	10	1	0

(16 primary dealer comments)

Several dealers noted that they believe the end of the LSAP is already priced into financial markets and thus would not significantly affect asset prices. A few believe the end of the program will cause U.S. Treasury yields to rise somewhat. A few noted that price action due to the end of the LSAP would be difficult to distinguish from price action driven by other fundamental factors. Some dealers see the end of the program as positive for the U.S. dollar index, but a couple of these dealers think noted that debt ceiling-related uncertainty will limit the positive impact on the dollar. Some dealers noted that the end of the program will be negative for the equity market, and a couple of these dealers specified that they believe the flow effect is important for supporting the equity market at this time.

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

(19 primary dealer comments)

Many dealers downgraded their macroeconomic assessment, with several noting that their GDP forecast had been downgraded due to worsening U.S. economic data. Some of these dealers noted inclement weather or supply disruptions, while a few mentioned commodity prices and a few noted increasing fiscal drag. However, a few of the dealers that downgraded their assessment noted that they see the slowdown as transitory. A few dealers noted that they had made no meaningful changes to their macroeconomic assessment as recent economic data releases have been in line with their expectations.