Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

July 2013

Responses to the Primary Dealer Policy Expectations Survey
Distributed: 7/17/2013 – Received by: 7/22/2013

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

Some dealers expected no material changes to the July FOMC statement. Of those that did expect changes, several dealers each noted their expectation that the Committee would more explicitly focus on recent low inflation as well as highlight weaker growth data over the intermeeting period. Several dealers discussed the possibility that the FOMC would provide either additional details regarding the expected pace of asset purchases, similar to those provided in Chairman Bernanke's June 19th press conference, or language that would highlight the data dependency of asset purchases. Several dealers also thought that it was possible that the Committee may decide to strengthen or reinforce the current forward rate guidance.

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

	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017	≥ H2 2017
Average	0%	4%	10%	26%	28%	17%	7%	4%	3%

	Most likely quarter and year of first target rate increase:
25th Pctl	Q2 2015
Median	Q3 2015
75th Pctl	Q3 2015

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

b) **If you made any changes to your expectations for the most likely timing of the first target rate increase since the last survey update on June 24, please explain the factors that motivated you to make the change(s).**

(16 primary dealer responses)

Many dealers had no change to their expectations for the most likely timing of the first target rate increase. Several dealers noted a shift in the distribution of risks around the expected timing of the first interest rate increase.

c) **Assuming inflation between one and two years ahead is projected to be no more than 2.5 percent and longer-term inflation expectations continue to be well anchored, please provide the percent chance you attach to the timing of the 6.5 percent unemployment rate threshold being reached.**

	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015	≥ Q3 2015
Average	0%	1%	3%	8%	15%	24%	20%	15%	15%

d) **Please provide your estimate of the most likely joint outcome for the unemployment rate and headline 12-month PCE inflation at the time of the first federal funds target rate increase.**

	Joint Outcome for First Fed Funds Hike	
	25th Pctl	6.20%
Unemployment Rate:	Median	6.30%
	75th Pctl	6.40%
	25th Pctl	1.80%
Headline 12-month PCE Inflation:	Median	2.00%
	75th Pctl	2.00%

3) **Provide your estimate of the most likely outcome (i.e., the mode) for the federal funds target rate or range at the end of each half-year period and over the longer run:**

	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017	H2 2017	Longer Run
25th Pctl	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	1.00%	1.50%	2.00%	2.50%	3.50%
Median	0-.25%	0-.25%	0-.25%	0-.25%	1.00%	1.50%	2.50%	3.00%	3.50%	4.00%
75th Pctl	0-.25%	0-.25%	0-.25%	0.50%	1.00%	2.00%	2.75%	3.50%	4.00%	4.00%

4) **Of the possible outcomes below, please indicate the percent chance you attach to the fed funds target rate or range falling in each of the following ranges at the end of 2014 and 2015.**

	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%
Year-end 2014 :	84%	12%	4%	0%	0%	0%	0%
Year-end 2015 :	25%	21%	26%	15%	8%	3%	1%

5) The path of expected policy rates, as measured by the overnight index swap and federal funds futures curves, has shifted appreciably higher since the release of the June FOMC statement. Please rate the importance of the following factors below in explaining this increase. (5 = very important, 1 = not important)

Factors Influencing the Increase in Policy Rate Path
Number of Respondents:

	1 - not important	2	3	4	5 - very important
Improved economic outlook	4	7	10	0	0
Change in perception of FOMC's view of appropriate policy rate path	2	4	5	3	7
Higher uncertainty around path of policy rates	0	2	3	6	10
Change in perception of FOMC's view of appropriate asset purchase path	0	3	4	5	9
Other / technical factors	9	5	1	5	1

(20 primary dealer responses)

Some dealers stated that an earlier expected start to reducing the pace of asset purchases has led to increased expectations for a higher path of policy rates, as market participants perceived a link between the Federal Reserve's asset purchase and federal funds rate policies. Several dealers also noted changes in the perception of the FOMC's view of the appropriate policy rate path and the Committee's more optimistic economic projections as shifting short rates higher. In explaining their response to 'Other / technical factors', some dealers cited the unwind of leveraged positions and carry-related trades as contributing to the increase in short rates.

6) How would you grade the Federal Reserve System's communication with the markets and with the public since the policy survey on 6/10/2013? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness.

Fed Communication Grade

	Number of Respondents:
1 - Very Ineffective	1
2	9
3	6
4	5
5 - Very Effective	0

Some dealers highlighted that more recent FOMC communications have been clearer compared to earlier in the intermeeting period. Several dealers found Chairman Bernanke's recent appearances helped in these efforts. By contrast, several dealers described the multiple viewpoints expressed by FOMC participants as contributing to a lack of clarity. Several noted that clearly communicating the nuances of the current policy stance is difficult and that market participants find it challenging to consistently follow the Committee's message.

7) **In the June FOMC statement, the Committee announced it will continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month, and also stated that it would take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives in determining the size, pace, and composition of its asset purchases.**

a) **Please provide your expectation for the monthly pace of purchases that will be in effect after each of the below FOMC meetings.**

			Monthly Pace of Longer-Term Security Purchases ($Billions)	
			Treasuries	Agency MBS
2013	July 30-31:	25th Pctl	45	40
		Median	45	40
		75th Pctl	45	40
	September 17-18:	25th Pctl	35	30
		Median	35	35
		75th Pctl	45	40
	October 29-30:	25th Pctl	35	30
		Median	35	35
		75th Pctl	35	35
	December 17-18:	25th Pctl	25	20
		Median	30	25
		75th Pctl	35	30
2014	January 28-29:	25th Pctl	20	16
		Median	25	20
		75th Pctl	25	30
	March 18-19:	25th Pctl	10	10
		Median	15	15
		75th Pctl	20	20
	April 29-30:	25th Pctl	0	0
		Median	15	10
		75th Pctl	15	20
	June 17-18:	25th Pctl	0	0
		Median	0	0
		75th Pctl	0	0
	July 29-30: (1 year ahead)	25th Pctl	0	0
		Median	0	0
		75th Pctl	0	0

Please explain the drivers of your assumptions behind the increments of pace reduction and any changes in the composition of Treasury and agency MBS purchases, if applicable.

While several dealers noted that recent FOMC communications have influenced their expected path of asset purchases, several others highlighted that economic data will continue to determine the timing of reductions in purchase pace. Several dealers noted their expectation that pace reductions would occur at meetings followed by press conferences and the release of quarterly projections. Several dealers noted future reductions in the pace of each Treasury and MBS purchases are likely to be evenly split between both asset classes. Several dealers noted the possibility of reducing Treasury purchases at a faster pace than MBS purchases to provide support for the housing market, while several others suggested MBS purchases would see relatively larger declines due to possible market functioning issues in the MBS market.

b) At the Chairman's press conference on June 19, he indicated that, "If the incoming data are broadly consistent with [the Committee's] forecast, the Committee currently anticipates that it would be appropriate to moderate the monthly pace of purchases later this year." Please provide your distribution of probabilities for the timing of the first reduction in pace, given the FOMC meetings below.

	Jul 2013	Sep 2013	Oct 2013	Dec 2013	> 2013
Treasuries :	2%	44%	15%	26%	14%
Agency MBS :	2%	43%	15%	26%	14%

c) Please provide your expectation for the change in the amount of domestic securities held in the SOMA portfolio during each of the periods below. In the case of purchases, please include settled and unsettled amounts.[2]

		2014 H2	2015 H1	2015 H2	2016 CY*	2017 CY*	2018 CY*
		$Billions					
Change in the estimated amount of Treasuries:	25th Pctl portfolio	0	0	0	-233	-232	-299
	Median portfolio	0	0	0	-215	-215	-306
	75th Pctl portfolio	0	0	0	-198	-198	-274
Change in the estimated amount of agency debt and MBS:	25th Pctl portfolio	0	-75	-97	-185	-225	-167
	Median portfolio	0	-54	-84	-148	-137	-148
	75th Pctl portfolio	-10	-15	-40	-216	-106	-83

**Calendar Year*

Please describe your assumptions for the monthly pace of asset purchases for Treasury and agency MBS, if not clear from the above:

(13 primary dealer responses)

Some dealers clarified their assumptions for the monthly pace of purchases, with several noting that they expect the first reduction in the pace of purchases to be announced at the September FOMC meeting. Some noted their expectations for purchases to end in 2014, with several specifying the June FOMC meeting as the likely end of the program. Several dealers noted their assumptions regarding the timing of policy normalization steps.

Please explain your assumptions behind your projections for the size and pace of passive redemption and sales of securities, if applicable:

(20 primary dealer responses)

Many dealers highlighted that they either did not expect asset sales in the given timeframe, or viewed asset sales as unlikely in the context of balance sheet normalization. Many also noted that passive redemptions would be an important component of balance sheet normalization at some point after the end of the asset purchase program. Some dealers provided details on Treasury and MBS redemptions, including MBS prepayment assumptions. Several dealers noted changes to their expectations for runoff, in the form of either a later start date or smaller runoff amount relative to their prior survey.

[2] Respondents provided their expected change in the SOMA portfolio of Treasuries and agency debt and MBS at each time horizon. The above data is constructed by creating a portfolio level for each respondent at each time horizon based upon their responses. The 25th percentile, median, and 75th percentile portfolio level are then sampled at each time horizon. The above data represent the changes in these portfolios at each time horizon.

d) Please indicate the month and year during which you expect asset purchases in Treasuries and agency MBS to be completed.

	Most likely quarter and year Treasury purchases end:
25th Pctl	Apr 2014
Median	Jun 2014
75th Pctl	Jun 2014

	Most likely quarter and year agency MBS purchases end:
25th Pctl	Mar 2014
Median	Jun 2014
75th Pctl	Jun 2014

Please explain the factors that motivated you to make changes to your expectations for the overall size, pace, and/or composition of asset purchases relative to your responses since the last survey update on June 24, if applicable.

(19 primary dealer responses)

Some dealers noted changes to their expectations. Of those dealers, several cited FOMC communications as influencing their projections, while several stated that the recent evolution of economic data had changed their expectations for the Federal Reserve's balance sheet. Several dealers noted no changes to the overall size, pace, and/or composition of asset purchases since the last survey.

8) Of the possible outcomes below, please indicate the percent chance you attach to the SOMA portfolio level falling in each of the following ranges at year-end 2013 and year-end 2014. For your reference, the level of the SOMA portfolio including inflation accretion and settled and unsettled agency MBS according to the January 3 H.4.1 was $2,785 billion (the H.4.1 closest to the start of 2013).

	Year End 2013						
	<3000	3000-3250	3250-3500	3500-3750	3750-4000	4000-4250	>4250
Average	0%	0%	6%	41%	46%	4%	1%

	Year End 2014						
	<2500	2500-3000	3000-3500	3500-4000	4000-4500	4500-5000	>5000
Average	0%	1%	9%	49%	34%	5%	1%

9) a) How would you rate the current state of market functioning in longer-term Treasury and production coupon MBS today? (1 = worst conditions since 2009, 5 = best conditions since 2009)

	Relative to Conditions Since 2009 Number of Respondents:				
	1 - worst conditions	2	3	4	5 - best conditions
Longer-Term Treasury Market	0	4	8	7	2
Production Coupon Agency MBS Market	0	8	6	6	1

b) How would you rate the change in market functioning since prior to the announcement of outcome-based purchases at the September 2012 FOMC meeting? (1 = significantly worse, 3 = same, 5 = significantly better)

Change in Market Functioning Since September 2012
Number of Respondents:

	1 - Significantly Worse	2	3 - Same	4	5 - Significantly Better
Longer-Term Treasury Market	1	9	9	2	0
Production Coupon Agency MBS Market	4	8	8	1	0

Please explain, including discussions of any specific indicators that inform your views.

(17 primary dealer responses)

Several dealers described signs of weaker liquidity conditions in current coupon MBS since September. Several dealers described conditions in longer-dated Treasury markets as decent or good, though several dealers specifically highlighted poorer liquidity in off-the-run Treasuries. Several dealers commented on higher volatility in both current coupon MBS and longer-dated Treasury markets recently, with some noting a relative lack of buying interest in current-coupon MBS.

10) Provide your 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?

(16 complete primary dealer responses)

		Q4/Q4 2013	Q4/Q4 2014	Q4/Q4 2015	Longer Run
	25th Pctl	1.80%	2.70%	2.73%	2.25%
GDP:	Median	1.90%	2.80%	3.00%	2.30%
	75th Pctl	2.00%	3.00%	3.23%	2.50%
	25th Pctl	1.30%	1.60%	1.84%	
Core PCE:	Median	1.30%	1.70%	1.95%	
	75th Pctl	1.50%	1.90%	2.00%	
	25th Pctl	1.20%	1.50%	1.88%	2.00%
Headline PCE:	Median	1.30%	1.80%	2.00%	2.00%
	75th Pctl	1.50%	2.00%	2.08%	2.05%
	25th Pctl	7.20%	6.50%	6.00%	5.78%
Unemployment Rate*:	Median	7.30%	6.60%	6.20%	6.00%
	75th Pctl	7.40%	6.80%	6.40%	6.05%

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

2013 Forecasts*

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP:	7	13	1
Core PCE:	7	13	1
Headline PCE:	6	15	0
Unemployment Rate:	1	18	2

2014 Forecasts*

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP:	4	13	4
Core PCE:	5	12	4
Headline PCE:	5	12	4
Unemployment Rate:	3	14	4

2015 Forecasts*

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP:	4	11	1
Core PCE:	1	11	4
Headline PCE:	1	11	4
Unemployment Rate:	3	11	2

**Upside risk is a risk towards higher GDP growth, a higher inflation rate, and a lower unemployment rate. Downside risk is a risk towards lower GDP growth, a lower inflation rate, and a higher unemployment rate.*

11) For the outcomes below, please indicate the percent chance you attach to the annual average CPI inflation rate from 2018-2023. 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	3%	11%	25%	33%	18%	10%

	Point Estimate
25th Pctl	2.00%
Median	2.25%
75th Pctl	2.40%

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	4%
Median	5%
75th Pctl	5%

	NBER Recession in 6 Months
25th Pctl	10%
Median	15%
75th Pctl	20%

13) Please comment on any changes to your macroeconomic assessments and risks to your forecast since the last FOMC meeting.

Many dealers revised their 2013 GDP projections lower, though several noted expectations for growth to improve later this year. Several dealers commented on increased downside risk to their forecasts, with a subset of those noting the risks posed by higher interest rates. However, several other dealers noted tightening financial conditions did not materially impact their forecasts. Some dealers commented that they made no significant changes to their forecasts.