Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

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

All of the dealers expected no significant changes to the policy statement, with several dealers expecting a somewhat shorter discussion of thresholds. Several dealers noted that the FOMC may acknowledge easing financial strains.

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

	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017	≥ H2 2017
Average	0%	1%	5%	10%	21%	29%	18%	8%	4%	4%

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

3. 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 half-year period and over the longer run.

(20 complete primary dealer responses)

	H1 2013	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-.25%	0.50%	0.94%	1.50%	2.00%	2.50%	4.00%
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.63%	1.25%	1.88%	2.75%	3.00%	4.00%
75th Pctl	0-.25%	0-.25%	0-.25%	0-.25%	0.25%	1.00%	2.00%	2.50%	3.06%	4.00%	4.00%

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

4. Of the possible outcomes below, please indicate the percent chance you attach to the fed funds target rate or range at the end of 2013, 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 - 2.5%	≥2.51%
Year-end 2013 :	97%	2%	1%	0%	0%	0%	0%
Year-end 2014 :	78%	12%	6%	2%	1%	0%	0%
Year-end 2015 :	33%	29%	20%	9%	5%	4%	1%

5. How would you grade the Federal Reserve System's communication with the markets and with the public since the last policy survey on 12/3/12? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness. Please explain.

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

Some dealers expressed that the December FOMC minutes increased uncertainty regarding the timing of the end of asset purchases. Several dealers noted that they would prefer more communication regarding the costs and goals of asset purchases.

Regarding economic thresholds for the target policy rate, several dealers saw the timing of the introduction of such thresholds as being earlier than expected. Separately, several dealers noted that further clarity was needed in order for market participants to better understand what the thresholds implied about the FOMC's reaction function. In contrast, there were several dealers who believed that the introduction of thresholds was helpful, or generated relatively little confusion.

6. In the December FOMC statement, the Committee announced it will purchase longer-term Treasury securities following the conclusion of the MEP, initially at a pace of $45 billion per month. The Committee also announced that it will continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month.

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

	Monthly Pace of Longer-Term Security Purchases ($Billions)		
		Treasuries	Agency MBS
January 29-30:	25th Pctl	45	40
	Median	45	40
	75th Pctl	45	40
March 19-20:	25th Pctl	45	40
	Median	45	40
	75th Pctl	45	40
April/May 30-1:	25th Pctl	45	40
	Median	45	40
	75th Pctl	45	40
1 Year ahead (January 28-29, 2014):	25th Pctl	0	0
	Median	20	0
	75th Pctl	25	20

Most dealers noted their expectations for asset purchases to continue into at least the second half of 2013, with several dealers noting expectations for further purchases into the first half of 2014. Several dealers reiterated their quantitative response (above) that the FOMC would maintain the current pace of asset purchases at the January meeting.

Some dealers noted an expectation for a slowing in the pace of purchases at various points during the program. Several dealers noted that an improvement in the labor market or economic growth would lead to the conclusion of asset purchases.

b) Please indicate the quarter and year during which you expect flow-based purchases in Treasury and agency MBS securities to be completed.

	Most likely quarter and year of program end:
25th Pctl	Q4 2013
Median	Q1 2014
75th Pctl	Q2 2014

c) The December FOMC statement included the phrase, "If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until such improvement is achieved in a context of price stability." Please describe what you believe the FOMC would consider a substantial improvement in the labor market outlook.

Many dealers cited stronger payroll growth, with the majority of those citing a level of around two hundred thousand jobs per month as an indicator of what they believed the FOMC would consider a substantial improvement in the labor market. Of those dealers, several stated that the two hundred thousand job threshold would have to be met for at least 6 months.

Some dealers also mentioned the unemployment rate as an indicator of substantial improvement, with several dealers highlighting a 7 percent level as significant. In addition, several dealers noted that the FOMC would look for a rise in the labor force participation rate along with a declining unemployment rate. Finally, several dealers referenced stronger GDP growth as an indicator of substantial improvement.

d) In the December FOMC statement and meeting minutes, the FOMC discussed the benefits of additional asset purchases. Please rate the potential benefits cited according to your current assessment of the efficacy of the ongoing asset purchase program in supporting the labor market and overall economic activity. (5 = very effective 1 = not effective). Please explain.

Asset Purchase Benefits
Number of Respondents:

	1 - Not Effective	2	3	4	5 - Very Effective
Putting downward pressure on longer-term interest rates:	1	4	8	5	3
Promoting more accommodative financial conditions:	0	3	9	6	3
Supporting mortgage markets:	1	3	12	3	2

(19 primary dealer comments)

Some dealers stressed the benefits that asset purchases have had on easing financial conditions, with a subset of those noting the program's role in lowering longer-term interest rates and MBS rates. In contrast, several dealers thought that MBS purchases would not be effective in improving MBS market conditions. Several dealers also noted that primary credit rates were less impacted by the program. Finally, many dealers stated that, going forward, the benefits of additional asset purchases would marginally diminish or be constrained by other factors, including the effectiveness of the transmission of low rates to consumers.

e) The minutes of the December FOMC meeting stated that while almost all members viewed the asset purchase program begun in September as having been effective and supportive of growth, they also generally saw that, "The potential costs could rise as the size of the balance sheet increased." Please rate the potential costs cited according to your current assessment of their importance in determining the size, pace, and composition of asset purchases going forward. (5 = very important, 1 = not important). Please explain.

Asset Purchase Costs
Number of Respondents:

	1 - Not Important	2	3	4	5 - Very Important
Increase in inflation expectations:	0	6	10	2	3
Impairment of future implementation of monetary policy:	1	5	5	8	2
Effect on Federal Reserve net income:	9	8	2	0	2
Effects on market functioning:	0	3	7	7	4
Effects on financial stability:	0	6	4	8	3

(18 primary dealer comments)

Some dealers noted that the FOMC's inexperience with tightening in the context of a significantly expanded balance sheet may impair the FOMC's ability to implement appropriate monetary policy in the future. Several dealers noted the potential for higher inflation expectations, and several noted impaired market functioning costs as potential costs. In contrast, several dealers stated that the costs of additional asset purchases were minimal.

f) **Given your responses above, do you expect that the end of asset purchases will primarily be the result of developments described in part c), part d), part e), or some other factors? Please explain below.**

Most dealers expected the end of asset purchases to be primarily the result of a substantial improvement in the labor market. Several dealers believed that costs would be a principal driver determining the end of asset purchases, while several others noted the potential for costs of the program to become a more significant factor influencing the FOMC's decision in the future.

7. **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. Please explain, including the reason for any changes to the pace of flow-based purchases.**[2]

		2013 H1	2013 H2	2014 H1	2014 H2	2015 H1	2015 H2	2016 H1	2016 H2	2017 H1
						$Billions				
Change in the estimated amount of Treasuries:	25th Pctl portfolio	270	195	75	0	0	-105	-65	-100	-120
	Median portfolio	270	270	15	0	0	-15	0	-60	-35
	75th Pctl portfolio	270	270	120	15	0	0	-35	-40	-50
Change in the estimated amount of agency debt and MBS:	25th Pctl portfolio	240	180	60	-60	-90	-129	-131	-200	-156
	Median portfolio	240	240	0	0	0	-120	-150	-150	-65
	75th Pctl portfolio	240	240	100	0	0	0	-50	-75	-75

Most dealers reiterated that they expected current asset purchases to continue in the near-term, with some dealers expecting a slowing in the pace of purchases at some point prior to the program's conclusion. Many dealers expected Treasury reinvestment to be halted by the end of 2016 or earlier, and MBS reinvestment to be halted by the end of 2015 or earlier. Several dealers stated that they expect no outright sales within the forecast horizon while several other dealers believed that sales would occur.

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 current level of the SOMA portfolio including inflation accretion and settled and unsettled agency MBS according to the January 10 H.4.1 is $2817 billion.**

Year End 2013

	<3000	3000-3250	3250-3500	3500-3750	3750-4000	4000-4250	>4250
Average	1%	5%	16%	28%	37%	10%	3%

Year End 2014

	<2500	2500-3000	3000-3500	3500-4000	4000-4500	4500-5000	>5000
Average	1%	5%	17%	39%	21%	13%	3%

[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.

9. 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.

(15 complete primary dealer responses)

		Q4/Q4 2013*	Q4/Q4 2014*	Long Run
	25th Pctl	1.80%	2.50%	2.25%
GDP:	Median	2.10%	2.70%	2.40%
	75th Pctl	2.30%	3.20%	2.50%
	25th Pctl	1.50%	1.70%	
Core PCE:	Median	1.70%	1.90%	
	75th Pctl	1.80%	2.10%	
	25th Pctl	1.40%	1.60%	2.00%
Headline PCE:	Median	1.70%	2.00%	2.00%
	75th Pctl	1.90%	2.10%	2.20%
	25th Pctl	7.40%	6.70%	5.80%
Unemployment Rate:	Median	7.50%	6.90%	6.00%
	75th Pctl	7.60%	7.00%	6.25%

*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:	5	14	2
Headline PCE:	2	16	3
Unemployment Rate:	4	13	4

2014 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP:	2	16	3
Core PCE:	2	13	6
Headline PCE:	1	14	6
Unemployment Rate:	2	15	4

(19 primary dealer comments)

Many dealers stated that fiscal restraint and uncertainty over future fiscal policy were the largest downside risks to their forecasts, while several believe that a potential resolution of fiscal uncertainty and a resulting pick-up in business investment would be an upside risk. Some dealers saw an improving housing market, and its effect on household balance sheets, as an upside risk. Further, several dealers noted the potential for stronger capital investment by businesses as an upside risk.

10. 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%	10%	24%	34%	20%	10%

	Point Estimate
25th Pctl	2.00%
Median	2.25%
75th Pctl	2.50%

11. 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	5%
Median	5%
75th Pctl	10%

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

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

		Joint Outcome for First Fed Funds Hike
	25th Pctl	6.25%
Unemployment Rate:	Median	6.50%
	75th Pctl	6.50%
	25th Pctl	2.00%
Headline 12-month PCE Inflation:	Median	2.00%
	75th Pctl	2.40%

At its December meeting, the FOMC introduced economic thresholds to provide forward guidance on the target rate, stating that it currently anticipates that the current range of the federal funds rate, "Will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee’s 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored."

b) **Provided that longer-term inflation expectations continue to be well anchored, and given a rate of inflation 1 to 2 years ahead below (as measured by the PCE deflator), what is the maximum level of the unemployment rate at which you would expect the Committee to increase its target for the federal funds rate or range?**

Maximum Unemployment Rate for a Given Inflation Rate Projection

	2.50%	**2.75%**	**3.00%**
25th Pctl	6.50%	6.50%	6.70%
Median	6.50%	7.00%	7.25%
75th Pctl	6.50%	7.00%	7.80%

c) **Provided longer-term inflation expectations continue to be well anchored, and given a rate of unemployment below, what is the minimum level of the inflation rate 1 to 2 years ahead (as measured by the PCE deflator) at which you would expect the Committee to increase its target for the federal funds rate or range? Please explain, listing any other factors you deem important in determining the timing of the first increase to the target federal funds rate.**

Minimum Headline 12-Month Inflation Projection for a Given Unemployment Rate

	6.50%	**6.25%**	**6.00%**
25th Pctl	2.00%	1.75%	1.50%
Median	2.50%	1.90%	1.75%
75th Pctl	2.50%	2.30%	2.20%

(17 primary dealer comments)

Several dealers noted that indicators of improvement in the labor market apart from the unemployment rate, such as labor force participation, would factor into the FOMC's decisions. Several dealers noted financial and credit market conditions would be important factors, with a subset of those making reference to stronger GDP growth.

Several dealers noted that they believed the FOMC is placing relatively more emphasis on the unemployment rate over the inflation rate in their reaction function. Several other dealers noted that an inflation rate of 2.5 percent or higher would be an important driver in a potential rate increase.

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

(19 primary dealer comments)

Many dealers noted the partial resolution of the fiscal cliff as having changed their macroeconomic forecasts, with some dealers describing current progress as better than expected, and several dealers noting continued downside risks. Several dealers noted as upside risks improving economic data, and an improvement in the housing market. Several dealers stated that they have reduced their GDP growth outlook. Some dealers cited no material changes to their macroeconomic assessments since the prior survey.