The Shadow Survey of Market Participants

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MACROPOLICY PERSPECTIVES

Shadow Survey of Market Participants

- What is it?
  - Quarterly survey launched in June 2017 by independent research firm MacroPolicy Perspectives LLC.
- Goals
  - To collect information about consensus expectations that the FOMC uses as an input into its policy decisions.
  - To capture and probe a more diverse set of market views on monetary policy than other surveys.

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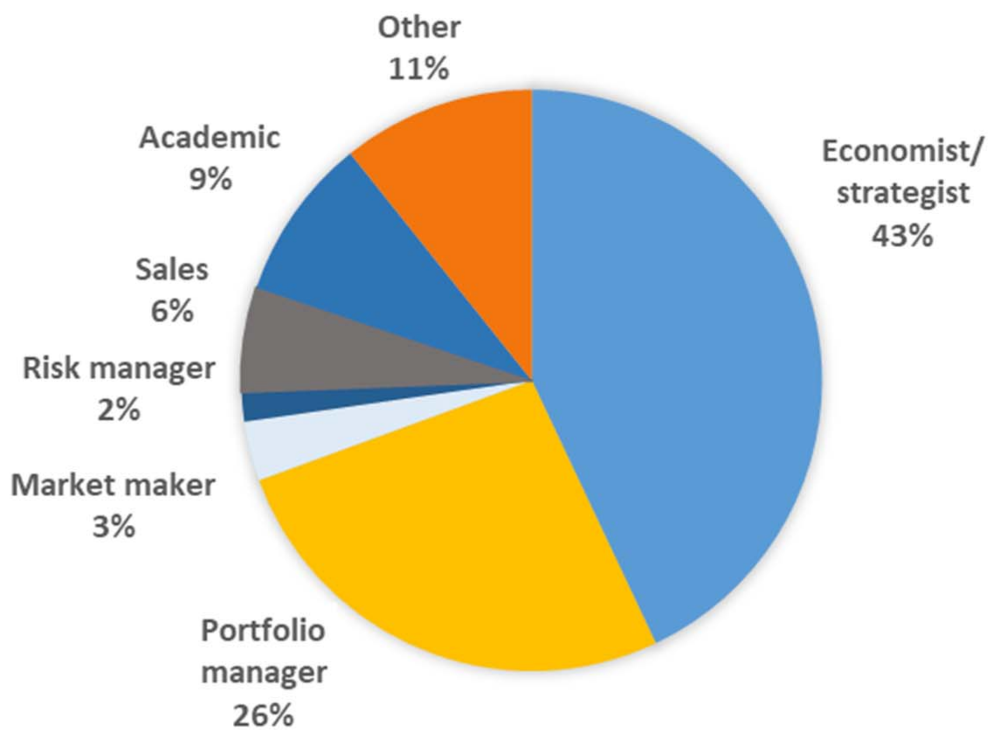
September 2017 Shadow Survey of Market Participants

Composition of SSMP Sample

One goal of our shadow survey is to capture a diverse set of market views

MPP shadow survey respondents: December 2018



Source: MacroPolicy Perspectives LLC.

SSMP Advantages

- Results released ahead of FOMC Meetings
- Larger, more diverse pool of respondents
- Greater flexibility in questions asked

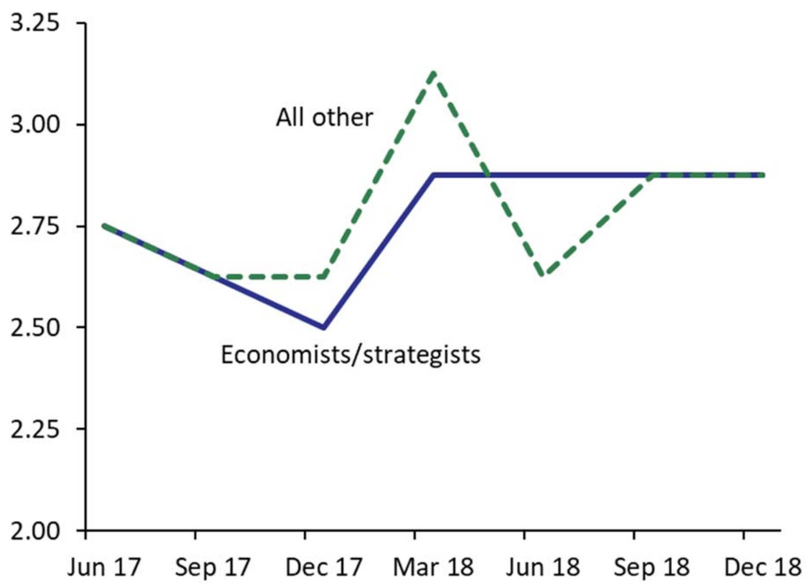
	FOMC Summary of Economic Projections (SEP)	Survey of Primary Dealers (SPD)	Survey of Market Participants (SMP)	Shadow Survey of Market Participants (SSMP)
Topics covered	Forecasts of GDP, headline and core PCE inflation, unemployment and the Fed funds rate	Forecasts of monetary policy, the economy and financial conditions in addition to special questions.		
Source	Federal Reserve Board	Federal Reserve Bank of NY	Federal Reserve Bank of NY	MacroPolicy Perspectives LLC
Number of respondents	17	23	26	100-130
Composition of sample	FOMC participants	Mostly economists/strategists employed by primary dealers	Mostly economists/strategists employed by buyside firms	Economists/strategists (40%); traders/investors (30-35%); other financial market participants (25-30%)
Frequency	Quarterly	Before all FOMC meetings (8 times a year)	Before all FOMC meetings (8 times a year)	Quarterly
Timing of release	2pm on the second day of FOMC meetings	Day following release of FOMC minutes (about 3 weeks after FOMC meetings)	Day following release of FOMC minutes (about 3 weeks after FOMC meetings)	In advance of FOMC meetings
Start date of published results	October 2007 for economic projections; January 2012 for Fed funds rate projections	January 2011	January 2014	June 2017

Source: MacroPolicy Perspectives LLC.

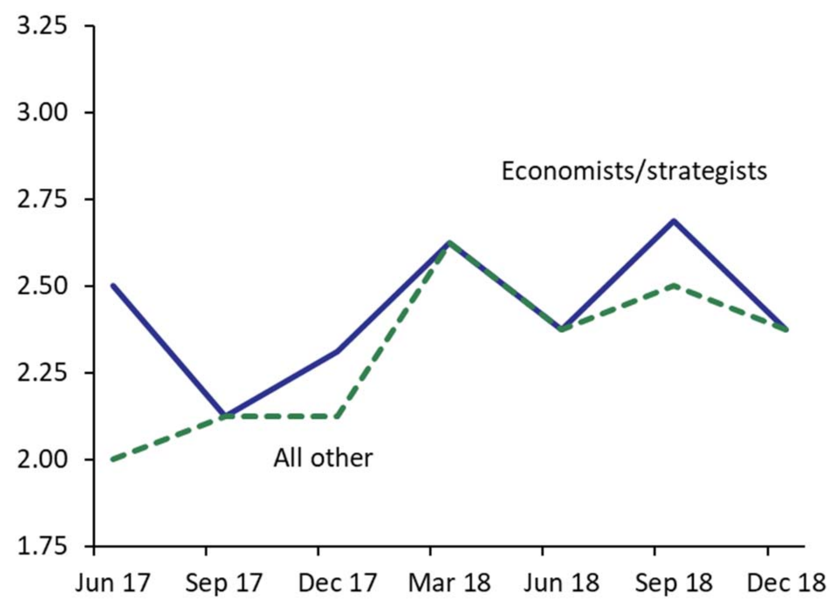
Economist and Non-Economist Views on Monetary Policy Can Differ

- Following the legislation of fiscal stimulus, non-economists raised their estimates of the long-run Fed funds rate more than economists and then subsequently revised them back down.
- The 25th percentile of non-economist views is generally lower than that of economists. In June 2017 it was 50bp lower.

Shadow Survey of Market Participants:
Median long-run Fed funds rate expecations (%)



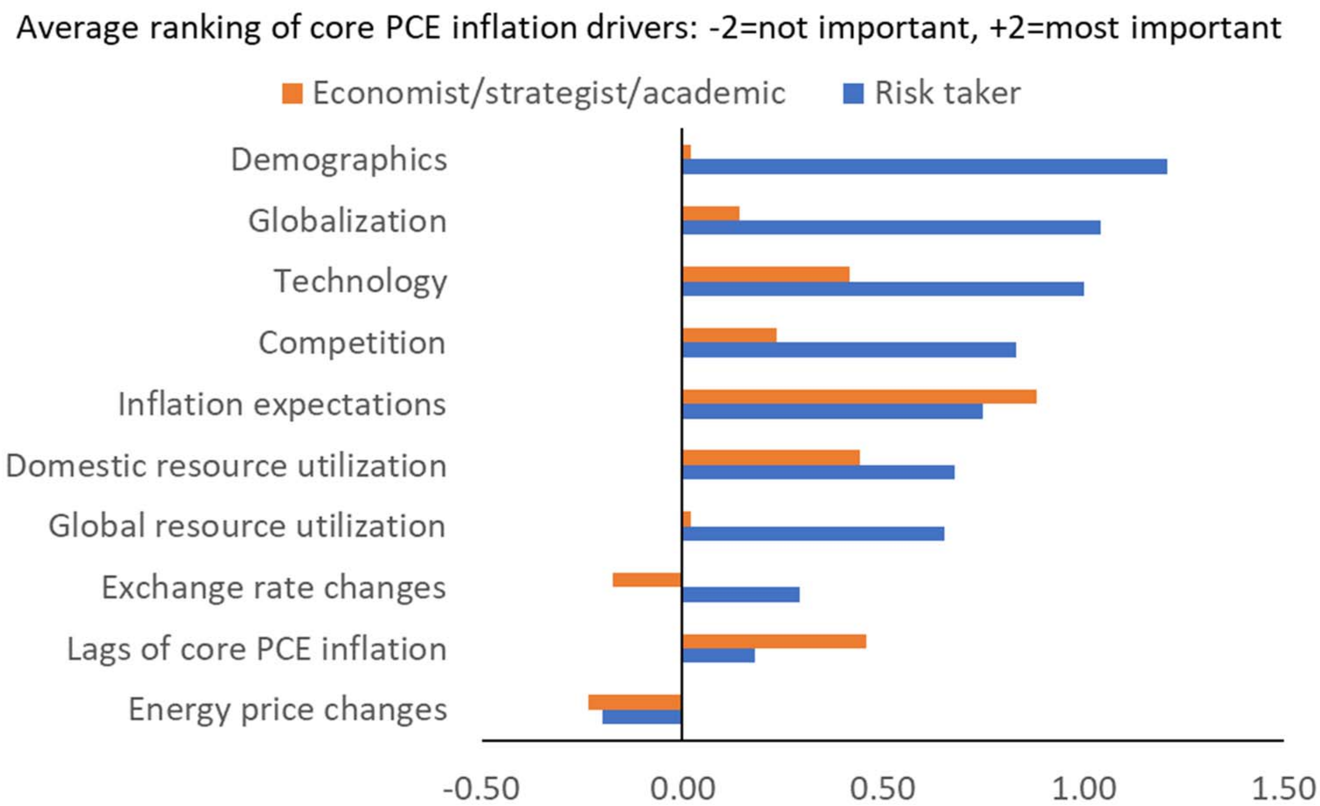
Shadow Survey of Market Participants:
25th percentile long-run Fed funds rate expecations (%)



Source: MacroPolicy Perspectives LLC.

Risk Takers Have a Different Understanding of Inflation than Economists

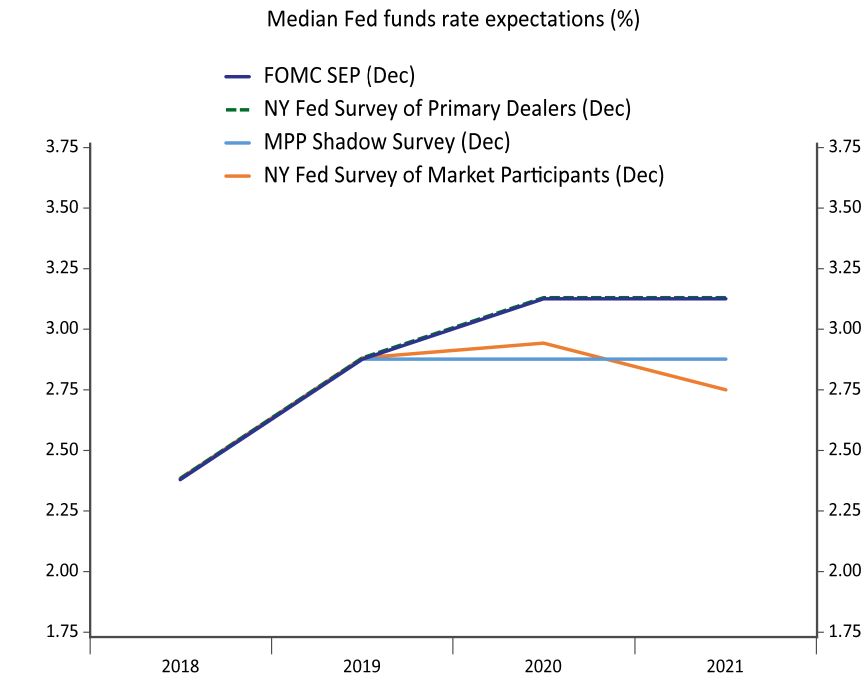
- The factors that risk takers see as most important in driving core PCE inflation generally do not enter economists' models of inflation.



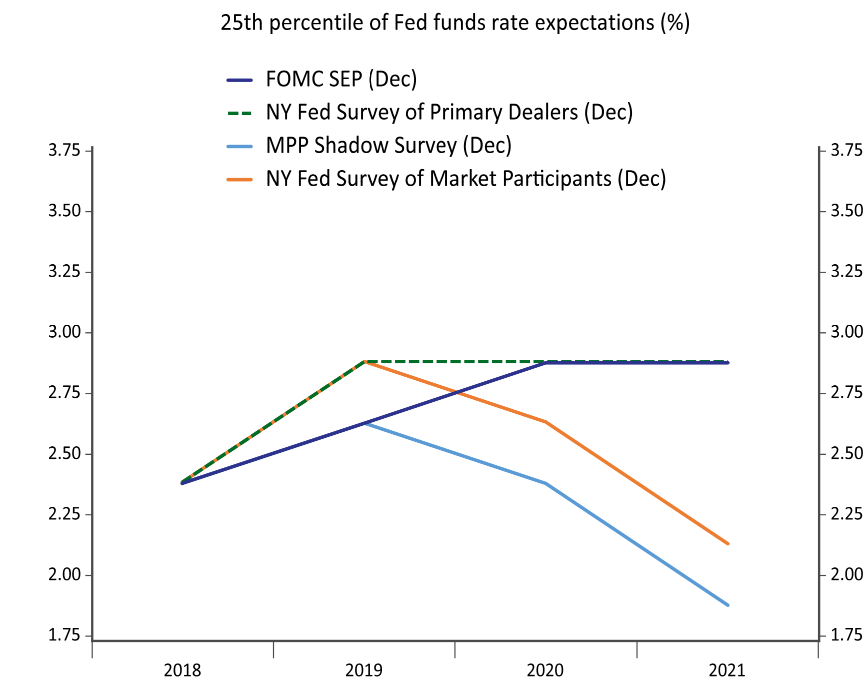
Source: MacroPolicy Perspectives LLC.

Our Survey Picked up the Market Angst in December

- At the end of 2018 our survey's median path was roughly in line with the Survey of Market Participants.
- The dovish tail of our survey was more pessimistic.



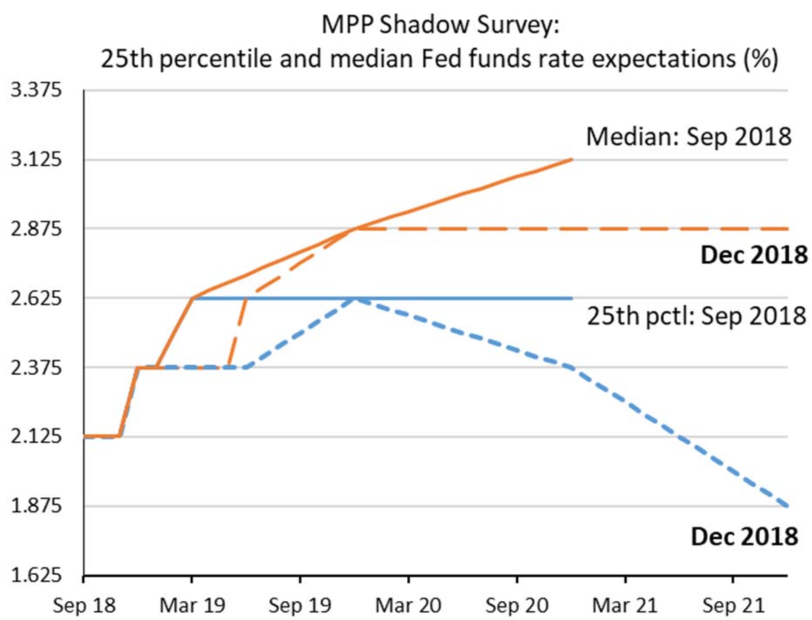
Sources: FRB/H, FRBNY, MPP/Haver

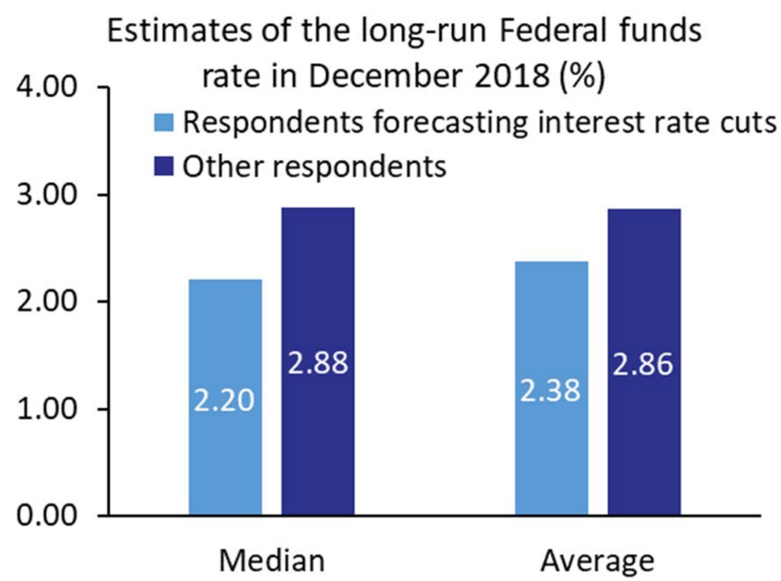


Sources: FRB/H, FRBNY, MPP/Haver

The December SSMP Showed Expectations of a Pause in Fed Hikes

- Both the median and 25th percentile SSMP respondent expected a pause in rate hikes which other surveys did not capture.
- Market pessimism at the end of 2018 was <u>not</u> concentrated among non-economists.
- Respondents forecasting interest rate cuts have lower estimates of the long-run neutral rate than those not forecasting cuts.





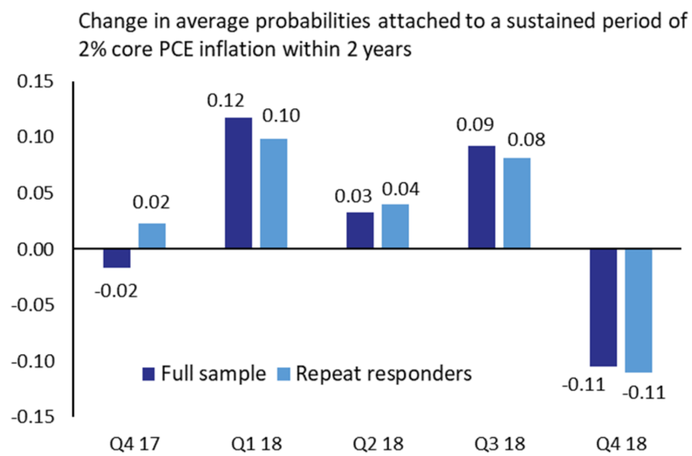
Source: MacroPolicy Perspectives LLC.

Our Survey Probes Inflation Expectations

- Inflation views have moved a lot in the last year.
- Movements were not an artifact of a shifting sample composition; changes for the full sample were very similar to those for repeat responders.

What probability do you attach to seeing a sustained* period of 2% annual core PCE inflation within the next two years? ***By sustained we mean core PCE inflation at or above 2% on a y/y basis for a period longer than 6 months.***

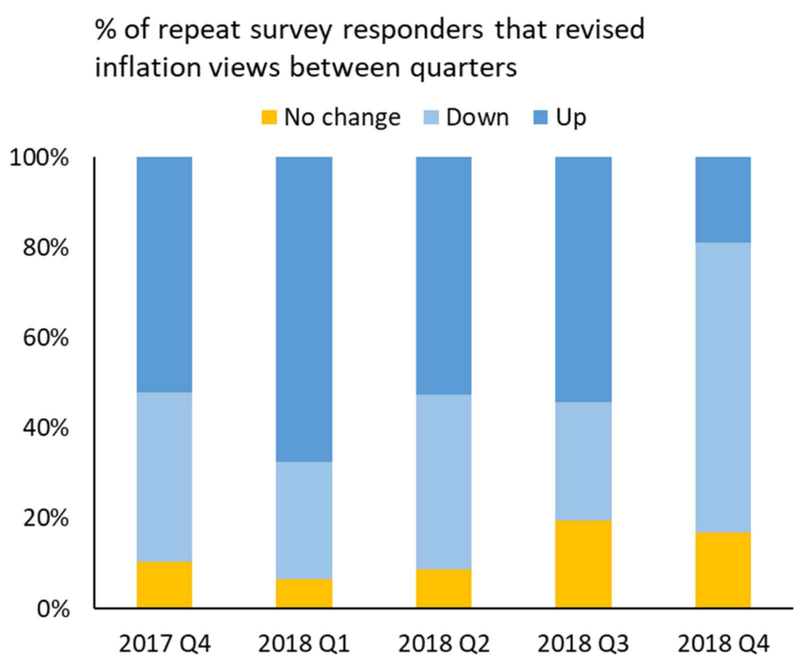
	Total respondents					
	25th pctl	Median	Average	75th pctl	Std dev	# of responses
Sep 17	20%	25%	32%	44%	20%	91
Dec 17	15%	25%	31%	50%	22%	90
Mar 18	25%	40%	43%	63%	24%	104
Jun 18	25%	50%	46%	65%	23%	92
Sep 18	35%	60%	55%	75%	22%	85
Dec 18	30%	40%	44%	60%	22%	98

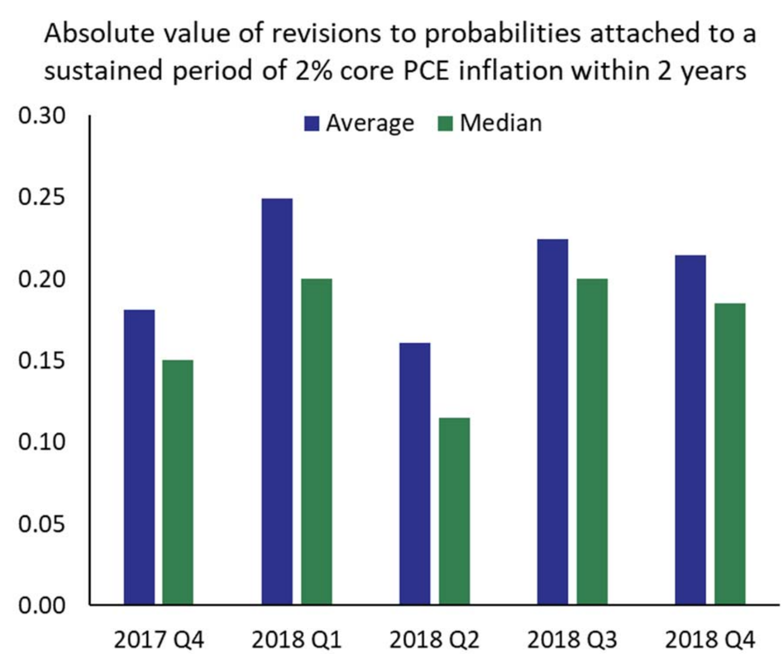


Source: MacroPolicy Perspectives LLC.

SSMP Respondents' Inflation Views are Flexible

- The vast majority of respondents revise their inflation views between surveys.
- The revisions are not small: the median absolute revision has ranged from 10 to 20 percentage points.



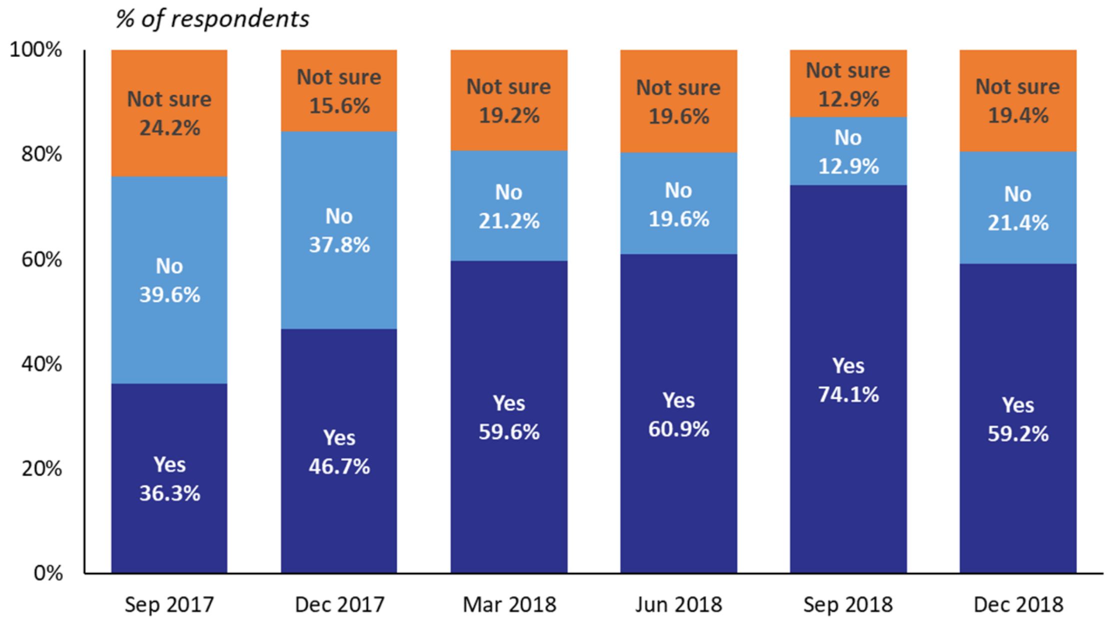


Source: MacroPolicy Perspectives LLC.

Confidence in the Fed's Ability to Deliver Price Stability Also Ebbs and Flows

- In September 2017, about 40% of our respondents thought the Fed couldn't deliver price stability within two years with current monetary policy tools.
- As 2018 unfolded and actual inflation increased, participants became more confident in monetary policy tools' ability to generate inflation.

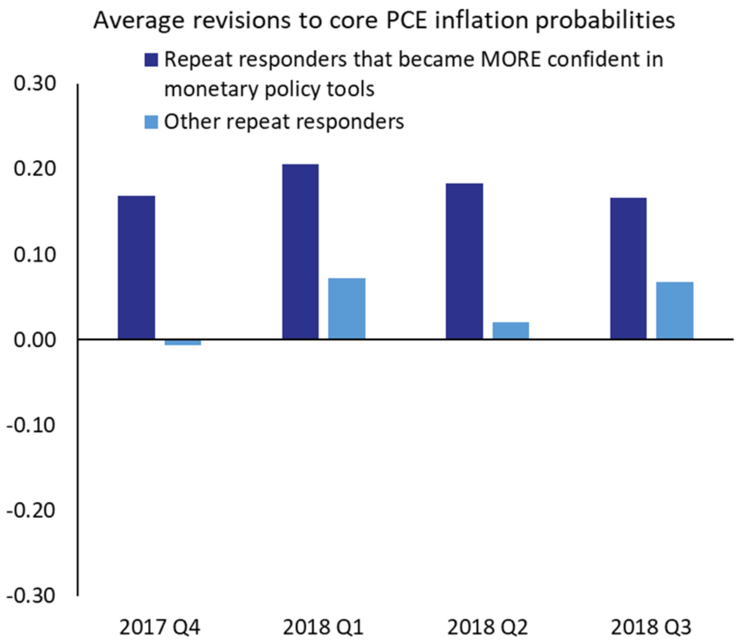
Do you believe that current monetary policy tools are capable of generating a sustained* period of 2% core PCE inflation within the next 2 years? **By sustained we mean core PCE inflation at or above 2% on a y/y basis for a period longer than 6 months.*

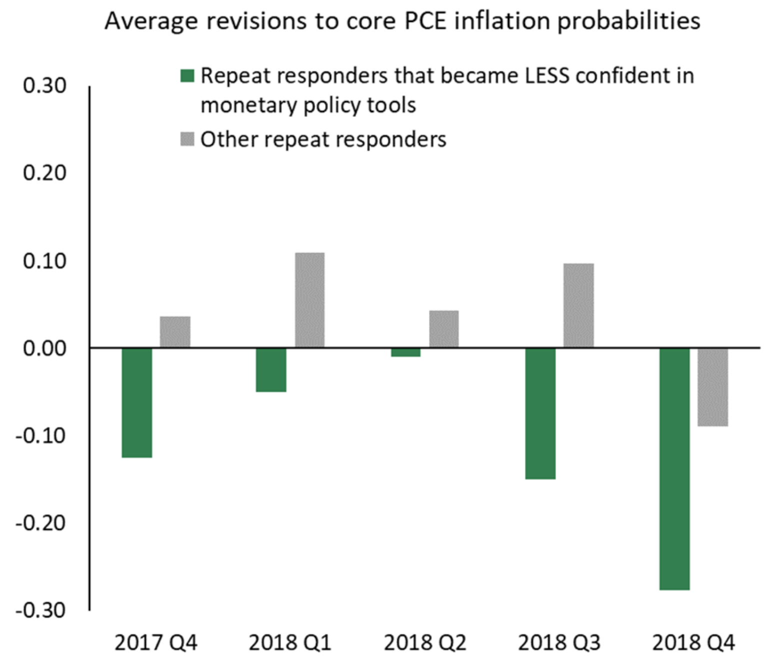


Source: MacroPolicy Perspectives LLC.

Inflation Expectations are Tied to Confidence in Monetary Policy Tools

- Higher probabilities of 2% inflation go hand in hand with increased confidence in the Fed's ability to generate 2% inflation.
- Lower probabilities come with greater skepticism about the monetary toolkit.
- Interaction between the two suggests asymmetry in inflation risks.





"Core PCE inflation probabilities" refer to the probabilities attached to a sustained period of 2% annual core PCE inflation within two years, where sustained means core PCE inflation at or above 2% on a y/y basis for a period longer than 6 months.

Source: MacroPolicy Perspectives LLC.

Reference Slides

Survey Content

- Identifying characteristics: current employer, job role, location, market focus, whether they transact/invest in inflation-linked securities or other financial products based on their views about US inflation.
- Expectations for the upcoming FOMC meeting:
  - Policy changes
  - Summary of Economic Projections
  - Distribution of “dots”
- Federal funds rate path expectations
  - Point estimate forecasts at specific dates and over the longer-run
- Inflation expectations
- Economic outlook
  - Point estimate forecasts of GDP, inflation, and unemployment
  - Expectations for financial conditions over the next year
  - Influence of trade and fiscal policies on respondents’ outlooks
- Probabilities assigned to risk events
  - ZLB, impeachment, major geopolitical conflict

SSMP Gauges Expectations for the Summary of Economic Projections

- A majority of SSMP respondents expected lower median Fed funds rate projections for 2019-2021 in the December SEP.

	2018		2019		2020		2021		Longer-run	
	Sep SEP median	*Expectations for Dec SEP median*	Sep SEP median	*Expectations for Dec SEP median*	Sep SEP median	*Expectations for Dec SEP median*	Sep SEP median	*Expectations for Dec SEP median*	Sep SEP median	*Expectations for Dec SEP median*
Change in real GDP (% Q4/Q4)	3.1	Higher 4% **Unchanged 65%** Lower 31% Not sure 0%	2.5	Higher 1% Unchanged 31% **Lower 67%** Not sure 1%	2.0	Higher 2% **Unchanged 68%** Lower 28% Not sure 2%	1.8	Higher 5% **Unchanged 88%** Lower 6% Not sure 2%	1.8	Higher 5% **Unchanged 87%** Lower 7% Not sure 1%
Unemployment rate (%, Q4 average)	3.7	Higher 3% **Unchanged 87%** Lower 10% Not sure 0%	3.5	Higher 26% **Unchanged 64%** Lower 8% Not sure 2%	3.5	Higher 34% **Unchanged 61%** Lower 3% Not sure 2%	3.7	Higher 26% **Unchanged 71%** Lower 3% Not sure 0%	4.5	Higher 8% **Unchanged 63%** Lower 28% Not sure 1%
Core PCE inflation (% Q4/Q4)	2.0	Higher 4% **Unchanged 57%** Lower 40% Not sure 0%	2.1	Higher 6% **Unchanged 57%** Lower 36% Not sure 2%	2.1	Higher 6% **Unchanged 67%** Lower 25% Not sure 2%	2.1	Higher 6% **Unchanged 70%** Lower 22% Not sure 3%		
Federal funds rate (%, EOP)	2.375	Higher 3% **Unchanged 89%** Lower 8% Not sure 0%	3.125	Higher 3% Unchanged 24% **Lower 72%** Not sure 1%	3.375	Higher 3% Unchanged 26% **Lower 70%** Not sure 1%	3.375	Higher 1% Unchanged 38% **Lower 58%** Not sure 3%	3.000	Higher 2% **Unchanged 73%** Lower 21% Not sure 4%

= majority of respondents expect a change = close call =some risk of a change

Percentages reflect the shares of SSMP respondents expecting different outcomes for the Summary of Economic Projection medians.

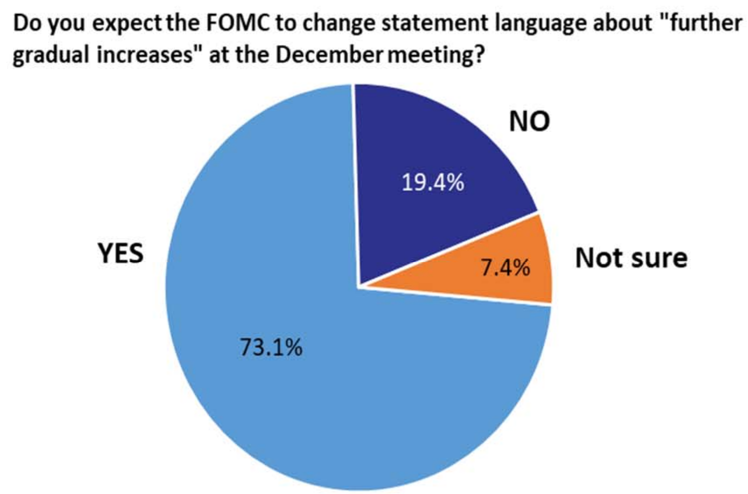
Source: MacroPolicy Perspectives LLC.

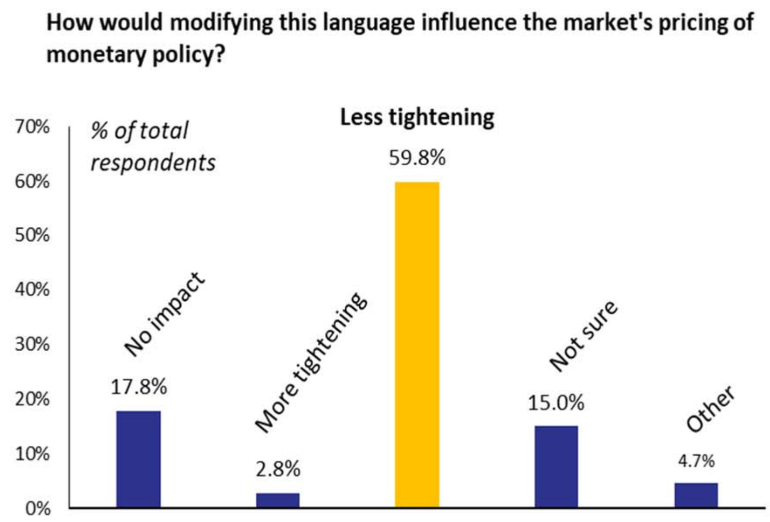
Special Questions

- Do you think expectations of balance sheet reduction are embedded in asset prices in the following markets?
- Do you think that the Treasury debt issuance required to finance a widening federal deficit is embedded in asset prices in the following markets?
- Why have financial conditions eased despite rate hikes and the Fed's announcement of plans to shrink its balance sheet? Rank the following possible explanations in terms of their importance.
- Is the 2y10y Treasury yield spread a good leading indicator of recession in the current environment?
- If the 2y10y Treasury yield spread were to invert, would that prompt you to reallocate your portfolio?
- If the FOMC announced that press conferences would be held after all FOMC meetings, how would that impact your expectations for monetary policy over the next year?

SSMP Links Questions about FOMC Communication & Market Reaction

In December, nearly 3/4 of SSMP respondents expected the Fed to modify statement language about “further gradual increases” in the Fed funds rate and expected these changes to lead the market to price in less policy tightening.





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