Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

August 2012

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 federal funds 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 (August)	100%	0%	0%	0%	0%	0%	0%
Two Meetings Ahead (September)	100%	0%	0%	0%	0%	0%	0%
Three Meetings Ahead (October)	100%	0%	0%	0%	0%	0%	0%

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

(20 primary dealer comments)

Several dealers expected further downgrades to the Committee's economic assessment in the August FOMC statement. A few dealers expected that revisions to the language would reflect the lack of improvement in labor market conditions, while a few dealers believed that weaker household spending would be noted. A few dealers noted that the statement could reflect an increase in the downside risks to the outlook. In contrast, a few dealers believed that the statement language would reflect an upgrade to the Committee's assessment of the housing sector.

Some dealers hypothesized that the FOMC might extend the forward rate guidance in the statement, while a few expected that such a change was likely. Of those, a couple specifically cited their expectation for the guidance to be extended to "mid 2015". A few dealers also noted that the Committee could strengthen the language suggesting the FOMC is prepared to provide additional policy accommodation. Some dealers expected no material changes to the August FOMC statement.

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

	H2 2012	**H1 2013**	**H2 2013**	**H1 2014**	**H2 2014**	**H1 2015**	**H2 2015**	**H1 2016**	**H2 2016**	**≥ H1 2017**
Average	0%	3%	8%	13%	16%	18%	20%	11%	6%	6%

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

	Most likely quarter and year of first target rate increase:
25th Pctl	*Q3 2014*
Median	Q1 2015
75th Pctl	*Q3 2015*

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 half-year period:

	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017	Longer Run
25th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.50%*	*1.00%*	*1.50%*	*2.00%*	*3.75%*
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	1.00%	2.00%	2.25%	3.00%	4.00%
75th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*1.00%*	*1.50%*	*2.00%*	*2.50%*	*3.50%*	*4.00%*	*4.00%*

5. Of the possible outcomes below, please indicate the percent chance you attach to the federal funds target rate or range 1 year from now and at the end of 2014:

	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%
July 2013 Average:	93%	5%	2%	0%	0%	0%	0%
Year-end 2014 Average:	51%	15%	13%	10%	5%	4%	2%

6. How would you grade the Federal Reserve System's communication with the markets and with the public since the last policy survey on 6/11/12? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness. Please explain.

	Number of Respondents
1 - Very Ineffective	0
2	1
3	10
4	9
5 - Very Effective	1

(20 primary dealer comments)

Some dealers stated that Federal Reserve communication in general had been clear, and a few specifically mentioned that Chairman Bernanke's semiannual Monetary Policy Report to Congress was clear. A few dealers noted that the perceived high level of uncertainty and complexity surrounding monetary policy decisions makes clear communications difficult. A couple of dealers each commented that more clarity on both easing options and thresholds for easing would be needed.

A few dealers cited what they perceived to be contrasting interpretations of appropriate policy responses within the Committee as contributing to a lack of clarity. A few dealers also highlighted what they believed to be discrepancies between information contained in various forms of official communications and public commentary. A couple of dealers cited what they perceived to be a discrepancy between the magnitude of the downgrades to the economic projections in the June Summary of Economic Projections (SEP) and the Committee's ultimate decision to extend the Maturity Extension Program (MEP), a move they judged as less aggressive than warranted given the outlook change.

7. **FOMC communications have 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 at the next FOMC meeting and within the next 1 and 2 years. Please explain.

		Probability at next FOMC meeting	Probability within 1 year	Probability within 2 years
Raise interest on excess reserves	*25th Pctl*	*0%*	*0%*	*13%*
	Median	0%	1%	15%
	75th Pctl	*0%*	*5%*	*30%*
Drain reserves through temporary tools	*25th Pctl*	*0%*	*3%*	*15%*
	Median	0%	5%	20%
	75th Pctl	*0%*	*10%*	*45%*
Halt reinvestments	*25th Pctl*	*0%*	*5%*	*20%*
	Median	0%	5%	30%
	75th Pctl	*0%*	*18%*	*70%*
Reduce size of SOMA portfolio through selling securities	*25th Pctl*	*0%*	*0%*	*2%*
	Median	0%	0%	5%
	75th Pctl	*0%*	*2%*	*10%*
Reduce duration of portfolio*	*25th Pctl*	*0%*	*0%*	*0%*
	Median	0%	0%	5%
	75th Pctl	*0%*	*2%*	*10%*
Change the forward guidance in the FOMC statement on the path of the federal funds rate	*25th Pctl*	*0%*	*5%*	*20%*
	Median	0%	10%	30%
	75th Pctl	*0%*	*15%*	*55%*
Provide additional guidance on the likely path for the size and composition of the balance sheet	*25th Pctl*	*0%*	*0%*	*10%*
	Median	0%	5%	30%
	75th Pctl	*0%*	*18%*	*60%*

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

(17 primary dealer comments)

Some dealers commented that the FOMC would alter the forward guidance and halt portfolio reinvestments prior to raising the federal funds rate. A few of those dealers also expected that draining of reserves would also take place before the first target rate increase. A few dealers noted that any asset sales would be unlikely over the forecast period, and a few others noted that they regarded policy tightening over the next two years as unlikely.

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

		Probability at next FOMC meeting	Probability within 1 year	Probability within 2 years
Lower interest on excess reserves	*25th Pctl*	*2%*	*10%*	*15%*
	Median	10%	25%	25%
	75th Pctl	*10%*	*30%*	*35%*
Expand SOMA portfolio through securities purchases	*25th Pctl*	*10%*	*55%*	*55%*
	Median	25%	65%	70%
	75th Pctl	*35%*	*75%*	*80%*
Increase duration of portfolio*	*25th Pctl*	*0%*	*2%*	*5%*
	Median	0%	5%	10%
	75th Pctl	*5%*	*20%*	*25%*
Change the forward guidance in the FOMC statement on the path of the federal funds rate	*25th Pctl*	*20%*	*50%*	*55%*
	Median	40%	65%	70%
	75th Pctl	*50%*	*80%*	*85%*
Provide additional guidance on the likely path for the size and composition of the balance sheet	*25th Pctl*	*5%*	*25%*	*30%*
	Median	10%	35%	40%
	75th Pctl	*20%*	*50%*	*50%*
Introduce new tools to promote more accommodative financial conditions	*25th Pctl*	*5%*	*20%*	*25%*
	Median	*5%*	30%	35%
	75th Pctl	*25%*	*45%*	*50%*

*i.e. a deliberate action to increase the duration of the SOMA portfolio beyond the currently announced maturity extension program, independent of other policy changes.

(18 primary dealer comments)

Several dealers noted that they regard near-term easing as likely. Of those expecting additional balance sheet easing, a few noted that any new large-scale asset purchase program (LSAP) would likely include agency MBS. Some dealers regarded a cut to the rate of interest on excess reserves (IOER) as possible, while a couple mentioned this outcome was now more likely given the European Central Bank's recent action to cut its deposit rate to zero percent. A few other dealers perceived the costs of cutting IOER as high. A couple of dealers expected the forward rate guidance to be extended further because of the period of time that had elapsed since the guidance was last altered in January. A couple of dealers expected communication changes to precede any further balance sheet easing.

A few dealers did not expect further easing, and a few noted their belief that the recent announcement of the MEP extension makes other easing measures less likely in the near term. A couple of dealers noted their belief that a further extension of the MEP was not likely or possible.

Please describe what new tools might be introduced:

(20 primary dealer comments)

Several dealers noted their expectations that new tools could include a scheme similar to the Bank of England's Funding for Lending program, and a few others suggested a similar program involving the discount window to promote targeted credit creation. A couple of dealers cited further guidance on the balance sheet, open-ended asset purchases, or targets for macroeconomic variables.

c) Because respondents could see some of the choices from part b as overlapping, the answers to that part do not necessarily reveal the combined probability of various choices. We are interested in the probability you assign to any easing policy action that uses the SOMA portfolio -- that is, those actions described in either row 2 or row 3 from part b above. Please indicate the proabability these tools will be used at the next FOMC meeting and within the next 1 and 2 years. Please explain.

		Probability at next FOMC meeting	Probability within 1 year	Probability within 2 years
Ease with any method that utilizes the size or composition of the SOMA portfolio	*25th Pctl*	*10%*	*60%*	*60%*
	Median	25%	65%	70%
	75th Pctl	*35%*	*75%*	*80%*

(20 primary dealer comments)

Some dealers commented that more easing measures that utilize the Federal Reserve's balance sheet are likely over the near term. A few dealers noted that agency MBS would be a likely component of any further asset purchases. A few others noted that they assigned lower probabilities to additional near-term easing as a result of the recent decision to extend the MEP. A couple of dealers noted that a suspension of MEP sales would be likely to occur if additional LSAPs were announced.

8. Please provide your most likely expectation (i.e., the mode) for the amount of domestic securities held outright in the SOMA portfolio and for the expected level of reserves at year-end for each of the next five years. Please explain.

(20 complete primary dealer responses)

		2012	2013	2014 *$Billions*	2015	2016
Estimated amount of Treasuries	*25th Pctl*	1663	1663	1663	1604	1423
	Median	1663	1793	1778	1714	1625
	75th Pctl	1760	1922	1953	1913	1766
Estimated amount of agency debt and MBS	*25th Pctl*	946	1058	934	850	572
	Median	950	1243	1193	1056	910
	75th Pctl	1095	1345	1286	1204	1002
Estimated amount of domestic assets in SOMA	*25th Pctl*	2609	2879	2757	2342	1888
	Median	2724	3105	3014	2827	2500
	75th Pctl	2860	3163	3111	3031	2696
Estimated level of reserves	*25th Pctl*	1526	1548	1388	906	499
	Median	1610	1802	1668	1225	969
	75th Pctl	1713	1955	1860	1586	1363

Several dealers commented on their expected sequence for the eventual removal of policy accommodation. Several dealers commented on their assumptions regarding further SOMA expansion, expecting that an LSAP would include both agency MBS and Treasury securities. A couple of dealers noted expectations for an agency MBS-only LSAP.

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.

(10 complete primary dealer responses)

		Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q4/Q4 2012*	Q4/Q4 2013*	Q4/Q4 2014*	Long Run
	25th Pctl	*1.20%*	*1.60%*	*1.80%*	*1.30%*	*1.70%*	*2.10%*	*2.50%*	*2.25%*
GDP	Median	1.40%	2.00%	2.00%	1.50%	1.80%	2.20%	2.70%	2.50%
	75th Pctl	*1.50%*	*2.20%*	*2.20%*	*2.10%*	*2.00%*	*2.30%*	*3.00%*	*2.50%*
	25th Pctl	*1.80%*	*1.70%*	*1.80%*	*1.60%*	*1.80%*	*1.60%*	*1.90%*	
Core PCE	Median	1.90%	1.80%	1.90%	1.80%	1.90%	1.80%	2.00%	
	75th Pctl	*1.90%*	*1.90%*	*2.00%*	*1.90%*	*2.00%*	*2.00%*	*2.10%*	
	25th Pctl	*1.60%*	*1.40%*	*1.50%*	*1.40%*	*1.50%*	*1.60%*	*2.00%*	*2.00%*
Headline PCE	Median	1.70%	1.50%	1.60%	1.60%	1.60%	1.80%	2.00%	2.00%
	75th Pctl	*1.70%*	*1.60%*	*1.70%*	*1.70%*	*1.70%*	*2.10%*	*2.10%*	*2.30%*
	25th Pctl					*8.00%*	*7.50%*	*7.00%*	*5.95%*
Unemployment Rate	Median					8.10%	7.80%	7.40%	6.00%
	75th Pctl					*8.20%*	*8.00%*	*7.60%*	*6.23%*

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

(12 complete primary dealer responses)

2012 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	12	8	0
Core PCE	4	14	2
Headline PCE	4	12	4
Unemployment Rate	11	9	1

2013 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	12	9	0
Core PCE	6	10	4
Headline PCE	5	11	4
Unemployment Rate	13	6	2

2014 Forecasts

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	5	7	1
Core PCE	3	5	4
Headline PCE	3	5	4
Unemployment Rate	6	6	1

(18 primary dealer comments)

Several dealers described downside risks to growth, while only a few mentioned sources of upside risk. Many dealers cited uncertainty around the upcoming fiscal cliff as a source of downside risk, with a few of these dealers focusing specifically on the potential effects of fiscal drag on 2013 GDP. Several dealers cited the ongoing European sovereign debt and banking crisis as another downside risk to growth. Specifically, a couple of dealers pointed to a potential exit of one or more countries from the euro area as a tail risk. Slowing global growth was cited as a risk to domestic activity by a few dealers, and Middle East turmoil was cited by a couple of dealers.

A resolution to the fiscal cliff and continued improvement in the housing market were both cited as potential catalysts for stronger growth by a few dealers.

Regarding inflation forecasts, a few dealers mentioned the effect of drought conditions on agricultural goods prices as a source of upside risk to inflation.

c) Do you feel more, less or equally uncertain regarding your economic forecasts since the last survey on 6/11/12?

Number of Dealers:

	Less Uncertain	Equally Uncertain	More Uncertain
GDP Uncertainty	1	6	14
Core PCE Uncertainty	2	14	5

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 2013?

	Probability
25th Pctl	*4%*
Median	5%
75th Pctl	*10%*

11. For the outcomes below, please indicate the percent chance you attach to the annual average CPI inflation rate from 2017 - 2022. 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	4%	12%	26%	30%	19%	9%

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

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

	Currently in NBER Recession
25th Pctl	*5%*
Median	7%
75th Pctl	*10%*

	NBER Recession in 6 Months
25th Pctl	*20%*
Median	25%
75th Pctl	*35%*

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

(19 primary dealer comments)

Several dealers downgraded their growth forecasts based on generally weaker economic data over the intermeeting period. Some dealers cited U.S. fiscal headwinds as contributing to the downgrades, while some others cited euro-area headwinds. Some dealers cited slowing growth globally as a factor behind their forecast downgrades, while a couple cited tighter financial conditions. A few dealers perceived the risk of another recession as higher, and a few also noted that their forecasts may need to be downgraded further. A couple of dealers cited no significant changes to their forecasts.