Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

June, 2012

Responses to the Primary Dealer Policy Expectations Survey
Distributed: 6/7/2012 – Received by: 6/11/2012

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 (June)	99%	1%	0%	0%	0%	0%	0%
Two Meetings Ahead (August)	99%	1%	0%	0%	0%	0%	0%
Three Meetings Ahead (September)	99%	1%	0%	0%	0%	0%	0%

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

Many dealers expected the FOMC to introduce some form of easing at the June meeting. Several within this group expected the Maturity Extension Program (MEP) to be extended, while a couple expected the announcement of unsterilized asset purchases. A few dealers thought the Committee might update its forward guidance on the target federal funds rate. Aside from policy changes, many dealers expected a downgrade to the FOMC's assessment of economic conditions. In particular, several dealers expected the Committee to dampen or remove references to improving labor market conditions and firming inflation and commodity prices.

b) Do you expect any revisions to FOMC participants' forecasts provided in the advanced materials of the Summary of Economic Projections (SEP) and, if so, what changes?

All dealers expected downward revisions to GDP projections in the advance materials of the June SEP, and some dealers also expected upward revisions to unemployment projections. Some dealers anticipated modest downward revisions to near-term headline inflation projections. Some dealers expected one or more FOMC participants to push their appropriate timing of policy firming out into the future.

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

	H1 2012	**H2 2012**	**H1 2013**	**H2 2013**	**H1 2014**	**H2 2014**	**H1 2015**	**H2 2015**	**H1 2016**	**≥ H2 2016**
Average	0%	0%	4%	11%	17%	23%	18%	12%	8%	7%

[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	Q4 2014
75th Pctl	*Q1 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:**

(20 complete primary dealer responses)

	H1 2012	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016	Longer Run
25th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.50%*	*1.00%*	*1.50%*	*2.00%*	*3.94%*
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	1.00%	1.50%	2.00%	2.50%	4.00%
75th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*1.00%*	*1.75%*	*2.50%*	*3.00%*	*4.00%*	*4.00%*

5. **Of the possible outcomes below, please indicate the percent chance you attach to the fed 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%
June 2013 Average:	93%	5%	2%	0%	0%	0%	0%
Year-end 2014 Average:	40%	22%	15%	11%	6%	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 4/16/12? 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	5
4	14
5 - Very Effective	1

Some dealers held an overall positive view of FOMC communication since the last meeting, with a few noting that FOMC participants have clearly conveyed that the announcement of any further easing measures would be contingent on deterioration in the FOMC's outlook. A few dealers noted that speeches by Vice Chair Yellen had been particularly useful in outlining economic conditions that would spur further action. A couple noted comments from Chairman Bernanke on the Committee's outlook had been clear, while a couple others felt they were vague.

Some dealers commented that differing viewpoints in FOMC participants' public remarks since the last FOMC meeting had generated confusion. A couple of dealers viewed FOMC participants' interest rate forecasts in the SEP as inconsistent with the forward guidance language in the FOMC statement.

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
	25th Pctl	*0%*	*0%*	*15%*
Raise interest on excess reserves	Median	0%	2%	25%
	75th Pctl	*0%*	*10%*	*45%*
	25th Pctl	*0%*	*5%*	*18%*
Drain reserves through temporary tools	Median	0%	7%	25%
	75th Pctl	*0%*	*24%*	*55%*
	25th Pctl	*0%*	*5%*	*20%*
Halt reinvestments	Median	0%	10%	35%
	75th Pctl	*0%*	*20%*	*60%*
	25th Pctl	*0%*	*0%*	*2%*
Reduce size of SOMA portfolio through selling securities	Median	0%	0%	5%
	75th Pctl	*0%*	*2%*	*15%*
	25th Pctl	*0%*	*0%*	*2%*
Reduce duration of portfolio*	Median	0%	0%	5%
	75th Pctl	*0%*	*2%*	*10%*
	25th Pctl	*0%*	*10%*	*20%*
Change the forward guidance in the FOMC statement on the path of the federal funds rate	Median	0%	15%	40%
	75th Pctl	*0%*	*20%*	*60%*
	25th Pctl	*0%*	*1%*	*15%*
Provide additional guidance on the likely path for the size and composition of the balance sheet	Median	0%	10%	40%
	75th Pctl	*0%*	*40%*	*75%*

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

(20 primary dealer comments)

Some dealers thought any type of policy tightening was unlikely over the next two years. A few dealers thought asset sales in particular were unlikely over the next two years. A few dealers expected policy tightening would occur in roughly two years. Dealer commentary on the sequence and tools with which they expect the FOMC to tighten policy was broadly similar to written comments in prior surveys. Notably, some dealers thought a change to the forward rate guidance would be the first step taken to signal future policy tightening. These dealers noted that changes to the forward rate guidance would be followed by either the halting of reinvestments or the commencement of temporary reserve draining operations.

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.

(20 complete primary dealer responses)

		Probability at next FOMC meeting	Probability within 1 year	Probability within 2 years
	25th Pctl	*0%*	*5%*	*5%*
Lower interest on excess reserves	Median	2%	5%	10%
	75th Pctl	*5%*	*10%*	*15%*
	25th Pctl	*15%*	*35%*	*40%*
Expand SOMA portfolio through securities purchases	Median	25%	50%	60%
	75th Pctl	*35%*	*60%*	*65%*
	25th Pctl	*25%*	*30%*	*35%*
Increase duration of portfolio*	Median	35%	40%	45%
	75th Pctl	*55%*	*60%*	*60%*
	25th Pctl	*10%*	*30%*	*45%*
Change the forward guidance in the FOMC statement on the path of the federal funds rate	Median	15%	50%	55%
	75th Pctl	*25%*	*65%*	*70%*
	25th Pctl	*5%*	*25%*	*25%*
Provide additional guidance on the likely path for the size and composition of the balance sheet	Median	10%	35%	40%
	75th Pctl	*20%*	*50%*	*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.

(20 primary dealer comments)

Several dealers reiterated expectations for the FOMC to introduce additional easing measures at some point over the next two years, and some thought new easing measures would be announced shortly. Some dealers thought an extension of the MEP was the most likely next easing step. A few dealers thought unsterilized asset purchases were the most likely outcome. A few dealers thought changes to the forward guidance could complement balance sheet policy, but did not anticipate changes in the near-term. A few dealers expected the next FOMC policy action to be a tightening, not an easing.

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
	25th Pctl	*35%*	*50%*	*50%*
Ease with any method that utilizes the size or composition of the SOMA portfolio	Median	50%	70%	75%
	75th Pctl	*75%*	*80%*	*80%*

(17 primary dealer comments)

Some dealers reiterated their expectation for policy easing using that involves the SOMA portfolio. A couple of dealers noted that they did not expect both a duration extension and an asset purchase program simultaneously.

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	2015	2016
				$Billions		
Estimated amount of Treasuries	*25th Pctl*	1657	1657	1641	1500	1350
	Median	1660	1661	1717	1679	1565
	75th Pctl	1807	1913	1886	1824	1662
Estimated amount of agency debt and MBS	*25th Pctl*	945	945	895	694	525
	Median	1050	1138	1098	928	723
	75th Pctl	1145	1245	1245	1148	1003
Estimated amount of domestic assets in SOMA	*25th Pctl*	2602	2602	2508	2188	1775
	Median	2610	2899	2699	2428	2166
	75th Pctl	2920	3124	3102	3005	2644
Estimated level of reserves	*25th Pctl*	1524	1524	1333	850	483
	Median	1525	1540	1506	1226	800
	75th Pctl	1750	1861	1769	1563	1269

(20 primary dealer comments)

Several dealers commented that their outlook for the path of the SOMA portfolio includes between $475 billion and $800 billion of additional purchases of both Treasury and agency MBS within two years. Within this group, only a few dealers mentioned they expected the reserve increases caused by purchases to be sterilized. A few dealers noted that the SOMA portfolio was unlikely to grow any further over the next two years. Among medium-term influences on the balance sheet, some dealers mentioned active reserve-draining operations, some others noted the halting of reinvestment prior to asset sales, and a couple cited passive run-off of securities. A few dealers noted that sales of either Treasury securities or agency MBS were unlikely to occur before 2016.

9. a) According to the April FOMC meeting minutes, "it was noted that the forward guidance is conditional on economic developments and that the date given in the statement would be subject to revision should there be a significant change in the economic outlook." We are interested in your view on the minimum increment of time by which the guidance could be changed, if the Committee were to alter it. Please enter below what language you believe could be used to shorten or lengthen the forward guidance by this minimum time increment.

(20 primary dealer comments)

If the forward guidance were to be lengthened, all dealers noted that at a minimum, the forward guidance would be extended into 2015. Specifically, the range of responses varied between extending the guidance by one quarter and extending it by one year. As for shortening the guidance, several dealers noted that "late 2014" could be changed to either "early 2014" or "mid-2014", while a few proposed timing as early as "mid-2013". A few dealers suggested that guidance would be changed in either direction by as few as two or three months, while a couple dealers thought that such small changes would not carry any reasonable degree of precision, and a few dealers suggested a minimum change of 12 months.

b) If your wording in part a) was qualitative, please convert your minimum time increment into number of months.

(19 complete primary dealer responses)

	Shorten Forward Guidance
	Months
25th Pctl	*4*
Median	6
75th Pctl	*6*

	Lengthen Forward Guidance
	Months
25th Pctl	*5*
Median	6
75th Pctl	*6*

Economic Indicator Forecasts

10. 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.

(12 complete primary dealer responses)

		Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q4/Q4 2012*	Q4/Q4 2013*	Q4/Q4 2014*
	25th Pctl	*1.80%*	*2.00%*	*2.00%*	*1.30%*	*1.90%*	*2.00%*	*2.65%*
GDP	Median	2.00%	2.10%	2.20%	1.55%	2.10%	2.30%	2.95%
	75th Pctl	*2.20%*	*2.30%*	*2.50%*	*2.15%*	*2.20%*	*2.70%*	*3.00%*
	25th Pctl	*1.80%*	*1.70%*	*1.80%*	*1.70%*	*1.80%*	*1.60%*	*1.88%*
Core PCE	Median	1.90%	1.80%	1.90%	1.80%	1.90%	1.80%	2.00%
	75th Pctl	*1.90%*	*2.00%*	*2.00%*	*1.93%*	*2.00%*	*2.00%*	*2.13%*
	25th Pctl	*1.70%*	*1.50%*	*1.50%*	*1.48%*	*1.50%*	*1.60%*	*1.98%*
Headline PCE	Median	1.80%	1.54%	1.62%	1.60%	1.62%	1.90%	2.00%
	75th Pctl	*1.90%*	*1.80%*	*1.90%*	*1.90%*	*1.90%*	*2.00%*	*2.20%*
	25th Pctl					*8.00%*	*7.50%*	*6.80%*
Unemployment Rate	Median					8.10%	7.60%	7.00%
	75th Pctl					*8.10%*	*8.00%*	*7.40%*

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

(10 complete primary dealer responses)

2012 Forecasts

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	10	9	0
Core PCE	5	13	1
Headline PCE	9	9	1
Unemployment Rate	8	7	4

2013 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	12	7	0
Core PCE	5	10	4
Headline PCE	6	10	3
Unemployment Rate	9	5	5

2014 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	5	4	1
Core PCE	3	4	3
Headline PCE	3	4	3
Unemployment Rate	5	5	0

(16 primary dealer comments)

Many dealers cited the U.S. fiscal contraction in 2013 that they anticipate and the ongoing European sovereign debt and banking crisis as key sources of downside risk to their economic forecasts. As for potential upside risks to growth forecasts, a few dealers noted the possibility that much of the anticipated U.S. fiscal contraction could be averted, while a couple mentioned the possibility of a more rapid housing sector recovery.

c) Do you feel more, less or equally uncertain regarding your economic forecasts since the last survey on 4/16/12?

Number of Dealers:

	Less Uncertain	Equally Uncertain	More Uncertain
GDP Uncertainty	1	6	14
Core PCE Uncertainty	3	13	5

11. What percent chance do you attach to the 4-quarter change in the core PCE deflator falling below zero by the end of Q2 2013?

(20 complete primary dealer responses)

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

12. **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%	11%	24%	31%	21%	10%

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

13. **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	5%
75th Pctl	*10%*

	NBER Recession in 6 Months
25th Pctl	*15%*
Median	20%
75th Pctl	*30%*

14. **The 10-year Treasury yield has decreased by approximately 30 basis points since the release of the April FOMC statement. Please rate the importance of the factors below in explaining this decrease. Please explain.**

	Weaker growth prospects	Lower inflation outlook	Safe haven investor flows	Expectations for additional Fed balance sheet easing	Other
			Number of Respondents		
Very Important	5	1	15	0	3
Important	14	2	4	5	0
Somewhat Important	2	9	2	14	0
Not Important	0	9	0	2	3

(17 primary dealer comments)

In discussing safe haven investor flows, many dealers cited the recent deterioration in economic data as at least an important driver of these flows. A few of these dealers highlighted recent U.S. labor market data, while a few others noted the slowing in global economic growth.

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

(19 primary dealer comments)

Many dealers mentioned that they had downgraded their U.S. growth forecast over the intermeeting period. Risks posed by the European debt crisis, the recent slowing in the pace of global growth, tighter financial conditions, and a loss of momentum in employment gains were cited by a few dealers each as key factors driving their revision. A few dealers mentioned that they had lowered their estimates of inflation as well.