Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

January, 2012

Responses to the Primary Dealer Policy Expectations Survey
Distributed: 1/12/2012 – Received by: 1/17/2012

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 (January)	99%	1%	0%	0%	0%	0%	0%
Two Meetings Ahead (March)	99%	1%	0%	0%	0%	0%	0%
Three Meetings Ahead (April)	99%	1%	0%	0%	0%	0%	0%

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

Nearly all dealers expected the FOMC's forward rate guidance language in the FOMC statement to be revised at the January meeting. Several dealers expected that the statement would reference or be consistent with FOMC participants' federal funds target rate projections to be provided in the advance projection materials from the Summary of Economic Projections (SEP). Several dealers believed that the Committee would drop the phrase "at least through mid-2013" from the statement entirely, while some predicted that the calendar-based guidance would remain, but be pushed out further into the future. A couple of dealers expected the statement to include guidance on the Federal Reserve's balance sheet.

A few dealers expected an upgrade to the Committee's assessment of economic conditions in the statement, with a couple specifically citing expectations for language pointing to improved labor market conditions. However, a few dealers expected the statement to continue to focus on strains in the labor market, while a couple expected the statement to contain a reference to the state of the housing market. A few dealers did not expect the assessment of economic conditions to change materially from the December statement.

b) What additional information do you expect Chairman Bernanke to provide in his post-FOMC meeting press conference on January 25th?

Many dealers expected that Chairman Bernanke would discuss the recently announced changes to the SEP in his press conference, with a couple of dealers specifically anticipating that the Chairman would discuss participants' projections for the longer-run target federal funds rate. Some dealers expected the Chairman to discuss expectations for the Federal Reserve's balance sheet, and a few expected him to discuss possible further easing steps, including the possibility for an additional round of asset purchases. A couple of dealers noted uncertainty in the market around what information would be released on January 25th in the advance projection materials of the SEP. A few dealers expected the Chairman to discuss the FOMC's policy strategy and longer-run goals, including the possible introduction of a long-run inflation goal. A couple of dealers expected the Chairman to discuss ongoing strains related to the European sovereign debt and banking crisis.

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

3. **Of the possible outcomes below, please indicate the percent chance you attach to the timing of the first federal funds target rate increase. Note: The probability buckets were increased to half-year increments, as much of the distribution of aggregate dealer responses to the December survey fell in Q2 2014 or later.**

	H1 2012	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	≥H2 2016
Average	0%	1%	5%	16%	22%	21%	13%	9%	8%	6%

(20 complete primary dealer responses)

	Most likely quarter and year of first target rate increase:
25th Pctl	*Q1 2014*
Median	Q2 2014
75th Pctl	*Q3 2014*

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:**

	H1 2012	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016
25th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.50%*	*0.75%*	*1.00%*	*1.50%*	*1.50%*
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.75%	1.25%	1.75%	2.50%	3.00%
75th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.50%*	*1.50%*	*2.00%*	*2.50%*	*3.00%*	*3.50%*

5. **Of the possible outcomes below, please indicate the percent chance you attach to the federal funds target rate or range 12 months from now:**

	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%
Average	95%	4%	1%	0%	0%	0%	0%

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

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

While some dealers commented that the announcement of upcoming changes to the SEP was clear, a few indicated that many questions remained about the format of the various new communication releases and the timing with which specific releases would be made public. In addition, a few dealers highlighted that the announced changes to the SEP were a positive development with regard to FOMC communications. However, an equal number expressed the concern that enhanced Federal Reserve communications could be misinterpreted by the market.

A few dealers commented that the range of views expressed by various FOMC participants since the last FOMC meeting contributed to a lack of clarity on the outlook for policy, and a couple mentioned that they would like to hear from Chairman Bernanke more frequently. A couple of dealers commented that Federal Reserve communication over the intermeeting period led them to believe that additional asset purchases focused on agency MBS securities were likely.

7. a) Recent FOMC communication has discussed several different ways monetary policy could be altered to provide either less or more accommodation. 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 comment.

		Probability at next FOMC meeting	Probability within 1 year	Probability within 2 years
Raise interest on excess reserves	*25th Pctl*	*0%*	*0%*	*10%*
	Median	0%	1%	20%
	75th Pctl	*0%*	*5%*	*40%*
Drain reserves through temporary tools	*25th Pctl*	*0%*	*3%*	*15%*
	Median	0%	6%	24%
	75th Pctl	*0%*	*10%*	*50%*
Halt reinvestments	*25th Pctl*	*0%*	*5%*	*10%*
	Median	0%	8%	30%
	75th Pctl	*0%*	*20%*	*75%*
Reduce size of SOMA portfolio through selling securities	*25th Pctl*	*0%*	*0%*	*2%*
	Median	0%	0%	5%
	75th Pctl	*0%*	*4%*	*20%*
Reduce duration of portfolio	*25th Pctl*	*0%*	*0%*	*3%*
	Median	0%	0%	5%
	75th Pctl	*0%*	*5%*	*20%*
Change guidance on the period over which the target rate will remain in effect	*25th Pctl*	*0%*	*2%*	*10%*
	Median	0%	15%	50%
	75th Pctl	*0%*	*30%*	*80%*

(18 primary dealer comments)

Several dealers commented on the sequence and tools with which they expect the FOMC to tighten policy, with some viewing a change to the forward rate guidance as the first action to be taken to signal future policy tightening or to tighten policy. Some dealers commented that they do not expect any tightening over the next two years.

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
	25th Pctl	*0%*	*5%*	*5%*
Lower interest on excess reserves	Median	1%	10%	10%
	75th Pctl	*5%*	*15%*	*15%*
	25th Pctl	*1%*	*40%*	*45%*
Expand SOMA portfolio through security purchases	Median	5%	55%	55%
	75th Pctl	*10%*	*65%*	*75%*
	25th Pctl	*0%*	*10%*	*10%*
Increase duration of portfolio	Median	0%	15%	15%
	75th Pctl	*5%*	*25%*	*35%*
	25th Pctl	*50%*	*65%*	*60%*
Change the forward guidance on the path of the federal funds rate	Median	70%	80%	90%
	75th Pctl	*90%*	*99%*	*99%*
	25th Pctl	*15%*	*35%*	*40%*
Provide guidance on the period over which the SOMA portfolio will remain at the current level	Median	40%	50%	60%
	75th Pctl	*60%*	*75%*	*75%*

(20 primary dealer comments)

Many dealers viewed changes to the forward rate guidance to signal future policy easing or to ease policy as likely, citing the upcoming communication changes announced in the December FOMC minutes. Several dealers also commented on the possibility of additional asset purchases over the next two years, with some dealers specifically expecting purchases to be concentrated in agency MBS securities. Some dealers also expected the FOMC to provide forward guidance on the path of the SOMA portfolio, with many of these dealers referring to the Committee's decision to provide an accompanying narrative, including participants' expectations for the Federal Reserve's balance sheet.

8. What are your expectations 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)

				($Billions)		
		2012	**2013**	**2014**	**2015**	**2016**
	25th Pctl	1663	1663	1568	1331	1141
Estimated amount of Treasuries	Median	1665	1663	1664	1663	1429
	75th Pctl	*1775*	*1900*	*1866*	*1719*	*1663*
	25th Pctl	*942*	*942*	*886*	*748*	*527*
Estimated amount of agency debt and MBS	Median	1142	1250	1155	960	795
	75th Pctl	*1292*	*1442*	*1411*	*1250*	*1011*
	25th Pctl	*2607*	*2605*	*2516*	*2139*	*1816*
Estimated amount of domestic assets in SOMA	Median	2892	3005	2978	2685	2325
	75th Pctl	*3102*	*3352*	*3205*	*2934*	*2630*
	25th Pctl	*1579*	*1575*	*982*	*538*	*488*
Estimated level of reserves	Median	1675	1820	1705	1350	1040
	75th Pctl	*1979*	*2100*	*1920*	*1745*	*1520*

(20 primary dealer comments)

In describing their expectations for the path of the SOMA portfolio and the expected level of reserves, many dealers commented on their expectations for the sequence with which they envision an eventual tightening of policy. Specifically, several dealers envisioned that a halting of portfolio reinvestments would be the first action taken to reduce the size of the SOMA portfolio. Many dealers commented on expectations for further asset purchases, with most of those that did so expressing an expectation for agency-MBS purchases. Some also expressed expectations for Treasury purchases.

Economic Indicator Forecasts

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.

(20 complete primary dealer responses)

		Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4/Q4 2011	Q4/Q4 2012	Q4/Q4 2013
	25th Pctl	*2.80%*	*1.50%*	*1.50%*	*1.70%*	*1.60%*	*1.80%*	*2.08%*
GDP	Median	3.00%	2.00%	2.00%	2.30%	1.60%	2.20%	2.50%
	75th Pctl	*3.10%*	*2.20%*	*2.40%*	*2.50%*	*1.60%*	*2.40%*	*2.73%*
	25th Pctl	*1.70%*	*1.70%*	*1.50%*	*1.40%*	*1.70%*	*1.50%*	*1.50%*
Core PCE	Median	1.70%	1.70%	1.60%	1.50%	1.70%	1.60%	1.70%
	75th Pctl	*1.80%*	*1.90%*	*1.80%*	*1.80%*	*1.80%*	*1.90%*	*2.03%*
	25th Pctl	*2.50%*	*1.85%*	*1.30%*	*1.10%*	*2.50%*	*1.50%*	*1.60%*
Headline PCE	Median	2.50%	2.00%	1.60%	1.40%	2.50%	1.70%	1.90%
	75th Pctl	*2.60%*	*2.30%*	*1.90%*	*2.10%*	*2.60%*	*2.10%*	*2.13%*
	25th Pctl					*8.70%*	*8.20%*	*7.80%*
Unemployment Rate*	Median					8.70%	8.50%	8.10%
	75th Pctl					*8.70%*	*8.70%*	*8.50%*

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

2011 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	2	18	0
Core PCE	2	17	1
Headline PCE	2	18	0
Unemployment Rate	2	16	1

2012 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	7	11	2
Core PCE	5	13	2
Headline PCE	6	12	2
Unemployment Rate	5	9	6

2013 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	7	10	2
Core PCE	4	11	4
Headline PCE	4	11	4
Unemployment Rate	4	11	5

(19 primary dealer comments)

Many dealers see the ongoing European sovereign debt and banking crisis as a major downside risk to their economic forecasts. U.S. fiscal policy developments were also an often-cited risk, with several dealers citing uncertainty over near-term fiscal policy and anticipated future fiscal tightening as a major downside risk. A few dealers cited slowing growth in Asia, particularly China, as a downside risk to growth. A few dealers also noted escalating global tensions with Iran or turmoil in the Middle East as a risk to oil prices and thus the domestic economy.

A couple of dealers cited accommodative monetary policy as the primary contributor to the upside risk to inflation and inflation expectations.

c) Do you feel more, less or equally uncertain regarding your economic forecasts since the last survey on 12/5/11?

Number of Respondents:

	Less Uncertain	Equally Uncertain	More Uncertain
GDP Uncertainty	1	19	1
Core PCE Uncertainty	3	17	1

10. What percent chance do you attach to the 4-quarter change in the core PCE deflator falling below zero by the end of Q1 2013?

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

11. For the outcomes below, please indicate the percent chance you attach for 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%	23%	31%	21%	10%

	Point Estimate
25th Pctl	*2.00%*
Median	2.30%
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	*1%*
Median	5%
75th Pctl	*10%*

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

13. Please provide the total contribution to your Q4/Q4 forecasts for real GDP growth in 2012 and 2013 from U.S. federal fiscal policy, combining your assessment of the direct and indirect effects. Please explain, including describing your expectations for U.S. fiscal policy actions over this period. Please ensure that your signs are correct.

(20 primary dealer responses)

U.S. Fiscal Policy Impact on GDP

(Percentage points)

	2012	**2013**
25th Pctl	*-0.50%*	*-1.00%*
Median	-0.40%	-0.75%
75th Pctl	*-0.15%*	*-0.35%*

(20 primary dealer comments)

Several dealers believed that the payroll tax cut and unemployment benefits will be extended to the end of 2012, while a few think they will expire before then. Some dealers commented that reductions in fiscal spending and continued roll-off of stimulus measures will drag on growth. Several dealers believed that the Bush tax cuts will be extended, while some believed they will be allowed to expire. Several dealers believed that the automatic sequester included in the Budget Control Act will take place, while a few believed that it will be legislated away in whole or in part.

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

(15 primary dealer comments)

Some dealers commented that their macroeconomic forecasts were essentially unchanged since the December survey. Some dealers upgraded their forecasts for GDP growth, with a few citing more positive recent data; however, most of these dealers' upgrades were to Q4 2011 or H1 2012 only. A few dealers also upgraded their forecasts for the unemployment rate.