Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

December 2012

Responses to the Primary Dealer Policy Expectations Survey

Distributed: 11/29/2012 – Received by: 12/3/2012

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

Nearly all dealers noted that they expected the FOMC to announce the continued purchase of Treasury securities following the conclusion of the Maturity Extension Program (MEP) at the December meeting. A couple of dealers noted the possibility that the FOMC could announce a change to its communication policy at the December meeting. Some dealers expected the Committee's macro outlook to remain relatively unchanged, while a few dealers noted that the FOMC may mention disruptions in economic activity due to Hurricane Sandy.

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

Several dealers expected downward revisions to the FOMC's GDP and unemployment forecasts in the December SEP, while a couple of dealers expected inflation forecasts to be revised downward. A few dealers cited U.S. fiscal policy as a driver for the reduction in the FOMC's outlook for GDP. A few dealers also noted that they expect the FOMC member who at the time of the September SEP forecasted a target rate increase in 2012 to shift their forecast to 2013. Some dealers expected any changes would be minor or not material.

2. 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%	1%	2%	5%	10%	22%	28%	18%	8%	7%

	Most likely quarter and year of first target rate increase:
25th Pctl	Q2 2015
Median	Q3 2015
75th Pctl	Q4 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.

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

(19 complete primary dealer responses)

	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%	0.88%	1.50%	2.00%	4.00%
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.75%	1.25%	2.00%	3.00%	4.00%
75th Pctl	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	1.13%	2.00%	2.63%	3.50%	4.00%

4. **How would you grade the Federal Reserve System's communication with the markets and with the public since the last policy survey on 10/15/12? 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	4
4	14
5 - Very Effective	2

(20 primary dealer comments)

Several dealers cited the communication from policy makers around economic thresholds to provide guidance on the timing of the initial increase in the federal funds rate as providing additional clarity. In this regard, some dealers specifically noted the November 13 speech by Governor Yellen, and a few dealers mentioned the minutes from the October FOMC meeting. A couple of dealers noted that more information about the possible use of economic thresholds would enhance public understanding. A few dealers noted that the discussions surrounding LSAPs were clear and adequate. A couple of dealers believed further clarity on the LSAPs' effect on market functioning is needed.

5. **In the September FOMC statement, the Committee announced a new asset purchase program. In the statement, the Committee said "These actions...together will increase the Committee's holdings of longer-term securities by about $85 billion each month through the end of the year."**

   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
December 11-12	25th Pctl	45	40
	Median	45	40
	75th Pctl	45	40
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
1 Year Ahead	25th Pctl	15	20
	Median	35	40
	75th Pctl	45	40

Several dealers noted that they expected the FOMC to continue purchasing Treasury securities after the expiration of the MEP. Several dealers expected the current pace of purchases to be maintained following the December FOMC meeting. Many dealers discussed their expectations for the timing of the end of purchases. A few dealers stated their expectations for the tapering of purchases.

b) Please indicate the quarter and year you expect purchases associated with the flow-based asset purchase program to end. Please explain, including a description of why you expect the purchase program to end at the quarter and year indicated.

	Most likely quarter and year of program end:
25th Pctl	Q4 2013
Median	Q1 2014
75th Pctl	Q3 2014

Several dealers expected the end of the purchase program to coincide with improvements in the labor market, with some dealers assigning specific unemployment rates to their forecasts for the end of asset purchases. A few dealers cited that improving GDP growth expectations would influence their projections for the end of purchases.

6. Please provide your expectation for the change in the amount of domestic securities held outright in the SOMA portfolio by year-end, and then the half-year changes for the following 4 years. For your reference, as of the November 23 H.4.1 release the current level of Treasury holdings including inflation accretion is $1650 billion and the current level of agency debt and settled and unsettled agency MBS holdings is $1074 billion. Please explain, including the reason for any changes to the pace of flow-based purchases.[2]

		Through Year End 2012	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1	2015 H2	2016 H1	2016 H2
		$Billions								
Change in the estimated amount of Treasuries	25th Pctl portfolio	0	270	150	0	30	0	-45	-50	-115
	Median portfolio	0	270	270	0	0	0	0	0	-50
	75th Pctl portfolio	0	270	270	180	90	0	0	-130	-5
Change in the estimated amount of agency debt and MBS	25th Pctl portfolio	40	240	240	0	-50	-90	-139	-121	-153
	Median portfolio	40	240	240	0	0	0	-44	-66	-130
	75th Pctl portfolio	40	240	240	150	90	-40	-100	-100	0

Many dealers noted their forecasts included an expectation for tapering off of the pace of purchases. Several dealers commented that they expected MBS reinvestment to be halted by the end of 2016, and some dealers stated expectations for the FOMC to allow Treasuries to mature. While some dealers mentioned that they do not expect outright sales within the forecast horizon, a few dealers believed that sales would occur. A couple of dealers noted the possibility of an increased monthly pace of asset purchases in 2013.

7. 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 November 23 H.4.1 is $2725 billion.

[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.

	Year End 2013						
	<3000	**3000-3250**	**3250-3500**	**3500-3750**	**3750-4000**	**4000-4250**	**>4250**
Average	1%	7%	16%	27%	35%	9%	4%

	Year End 2014						
	<2500	**2500-3000**	**3000-3500**	**3500-4000**	**4000-4500**	**4500-5000**	**>5000**
Average	1%	6%	17%	34%	20%	13%	8%

8. The October FOMC minutes included the phrase "Participants generally favored the use of economic variables, in place of or in conjunction with a calendar date, in the Committee's forward guidance, but they offered different views on whether quantitative or qualitative thresholds would be most effective."

a) Please provide the likelihood you place on the FOMC adopting quantitative or qualitative thresholds to provide forward guidance on the target rate at each of the next FOMC meetings. Additionally, please provide the likelihood you place on the FOMC not adopting these thresholds within the next 2 years.

		Probability of Thresholds	
		Quantitative	Qualitative
December 11-12	25th Pctl	10%	3%
	Median	10%	10%
	75th Pctl	15%	15%
January 29-30	25th Pctl	10%	10%
	Median	20%	15%
	75th Pctl	20%	20%
March 19-20	25th Pctl	20%	10%
	Median	30%	25%
	75th Pctl	40%	40%
Not Within 2 Years	25th Pctl	5%	5%
	Median	25%	20%
	75th Pctl	40%	40%

b) If the FOMC were to adopt either qualitative or quantitative thresholds, what thresholds would you expect it to adopt?

Most dealers believed that the FOMC would adopt quantitative thresholds using inflation and unemployment rates. Several dealers believed that the FOMC would tie the target federal funds rate to a projected rate of inflation, with some dealers specifically citing PCE price data. A few dealers expected that FOMC could adopt quantitative thresholds similar to those proposed by Chicago Fed President Evans.

c) If the FOMC were to adopt the thresholds you described above, would this adoption change financial conditions? If yes, how so?

(20 primary dealer comments)

Several dealers stated that thresholds would ease financial conditions,with a few mentioning that the threshold levels they expected to be adopted could potentially signal a later lift-off date than that expected by the market. Several other dealers did not see thresholds as significantly altering financial conditions. A few dealers suggested that thresholds could result in increased market volatility.

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.

(13 complete primary dealer responses)

		Q4/Q4 2012*	Q4/Q4 2013*	Q4/Q4 2014*	Q4/Q4 2015*	Long Run
	25th Pctl	1.70%	1.90%	2.50%	2.50%	2.23%
GDP	Median	1.70%	2.00%	2.80%	3.00%	2.50%
	75th Pctl	1.80%	2.30%	3.00%	3.20%	2.50%
	25th Pctl	1.60%	1.70%	1.70%	1.80%	
Core PCE	Median	1.70%	1.80%	1.90%	1.90%	
	75th Pctl	1.80%	2.00%	2.05%	2.00%	
	25th Pctl	1.60%	1.60%	1.65%	1.80%	2.00%
Headline PCE	Median	1.70%	2.00%	2.00%	2.00%	2.00%
	75th Pctl	1.90%	2.00%	2.15%	2.10%	2.20%
	25th Pctl	7.90%	7.50%	6.80%	6.50%	5.80%
Unemployment Rate	Median	7.90%	7.60%	7.10%	6.50%	6.00%
	75th Pctl	7.90%	7.70%	7.20%	6.70%	6.25%

*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	3	17	0
Core PCE	2	18	0
Headline PCE	1	19	0
Unemployment Rate	4	14	1

2013 Forecasts
Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	10	10	0
Core PCE	6	12	2
Headline PCE	6	10	4
Unemployment Rate	9	9	1

	2014 Forecasts Number of Respondents Citing:		
	Downside Risk	Balanced Risk	Upside Risk
GDP	5	11	3
Core PCE	2	10	7
Headline PCE	2	10	7
Unemployment Rate	5	10	3

	2015 Forecasts Number of Respondents Citing:		
	Downside Risk	Balanced Risk	Upside Risk
GDP	2	10	1
Core PCE	0	7	6
Headline PCE	0	7	6
Unemployment Rate	4	8	0

Nearly all dealers cited the U.S. fiscal policy as a potential downside risk to their economic growth forecasts. A few dealers also cited the ongoing European fiscal and banking crisis, while a couple of dealers mentioned geopolitical tensions in the Middle East and a couple mentioned global growth concerns. Ongoing improvements in the housing market were cited by a few dealers as an upside risk to their growth forecasts.

10. What percent chance do you attach to the 4-quarter change in the core PCE deflator falling below zero by the end of Q4 2013?

(20 complete primary dealer responses)

	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%	9%	24%	34%	20%	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 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	20%
Median	25%
75th Pctl	30%

13. The Congressional Budget Office (CBO) has estimated the growth of inflation-adjusted GDP in 2013 under 3 fiscal policy scenarios. Please indicate the probabilities you place on each fiscal policy scenario occurring and the basis point impact you believe each fiscal policy scenario would have on the 10-year Treasury yield. For more information on these estimates, see Economic Effects of Policies Contributing to Fiscal Tightening in 2013, CBO November 2012. Please explain.

(20 complete primary dealer responses)

		Probability of Policy Scenario Occuring
Current-Law Fiscal Policy	25th Pctl	10%
	Median	20%
	75th Pctl	25%
No Fiscal Restraint	25th Pctl	10%
	Median	15%
	75th Pctl	20%
Alternative Fiscal Scenario	25th Pctl	50%
	Median	60%
	75th Pctl	67%

		Effect on 10-Year Treasury Yield (bps)
Current-Law Fiscal Policy	25th Pctl	(53)
	Median	(40)
	75th Pctl	(33)
No Fiscal Restraint	25th Pctl	19
	Median	40
	75th Pctl	50
Alternative Fiscal Scenario	25th Pctl	0
	Median	5
	75th Pctl	16

* Numbers in parentheses are negative.

(20 primary dealer comments)

Some dealers mentioned that they believed the outcome of the fiscal cliff would be similar to that of the CBO's alternative fiscal scenario. A few dealers expected that an ultimate deal might involve slightly more fiscal restraint than the CBO alternative scenario, with a couple of those dealers suggesting tax increases for upper income brackets. Some dealers noted that the probability of no fiscal restraint was very low while a few dealers noted the same for the probability of full fiscal restraint. A few dealers expected that if current-law fiscal policy were to remain in place, the 10-year Treasury yield would likely decline to or below its prior all-time low yield.

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

(19 primary dealer comments)

Several dealers mentioned the fiscal cliff as a downside risk to their macroeconomic outlook. Some dealers also noted the temporary negative economic impact of Hurricane Sandy. Regarding upside risks, some dealers cited improvement in the housing market, while a couple of dealers mentioned an improved outlook for corporate capital expenditures. Some dealers reported that there have been no material changes to the economic outlook.

Appendix: Updates to the Survey

Updated as of December 10, 2012

Following the November Employment Report (December 7) and associated market reaction, primary dealers were asked to update their responses to questions 5 - 7.

5. In the September FOMC statement, the Committee announced a new asset purchase program. In the statement, the Committee said "These actions...together will increase the Committee's holdings of longer-term securities by about $85 billion each month through the end of the year."

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
December 11-12	25th Pctl	45	40
	Median	45	40
	75th Pctl	45	40
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
1 Year Ahead	25th Pctl	15	20
	Median	35	40
	75th Pctl	45	40

b) Please indicate the quarter and year you expect purchases associated with the flow-based asset purchase program to end. Please explain, including a description of why you expect the purchase program to end at the quarter and year indicated. Please explain.

	Most likely quarter and year of program end:
25th Pctl	Q4 2013
Median	Q1 2014
75th Pctl	Q3 2014

6. Please provide your expectation for the change in the amount of domestic securities held outright in the SOMA portfolio by year-end, and then the half-year changes for the following 4 years. For your reference, as of the November 23 H.4.1 release the current level of Treasury holdings including inflation accretion is $1650 billion and the current level of agency debt and settled and unsettled agency MBS holdings is $1074 billion. Please explain, including the reason for any changes to the pace of flow-based purchases.[3]

[3] 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 data below represent the changes in these portfolios at each time horizon.

		Through Year End 2012	2013 H1	2013 H2	2014 H1	2014 H2	2015 H1	2015 H2	2016 H1	2016 H2
						$Billions				
Change in the estimated amount of Treasuries	25th Pctl portfolio	0	270	150	0	30	0	-45	-50	-115
	Median portfolio	0	270	270	0	0	0	0	0	-50
	75th Pctl portfolio	0	270	270	180	60	0	-50	-50	-5
Change in the estimated amount of agency debt and MBS	25th Pctl portfolio	40	240	240	0	-50	-90	-139	-121	-153
	Median portfolio	40	240	240	0	0	0	-50	-60	-130
	75th Pctl portfolio	40	240	240	150	50	0	-100	-100	0

7. 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 November 23 H.4.1 is $2725 billion.

Year End 2013

	<3000	3000-3250	3250-3500	3500-3750	3750-4000	4000-4250	>4250
Average	1%	6%	17%	28%	35%	9%	4%

Year End 2014

	<2500	2500-3000	3000-3500	3500-4000	4000-4500	4500-5000	>5000
Average	1%	6%	17%	35%	20%	13%	8%

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Updated as of December 17, 2012

Following the December FOMC Meeting (December 11-12), primary dealers were asked to update their responses to questions 2 - 7.

2. 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	N/A	1%	2%	5%	10%	21%	28%	18%	8%	7%

	Most likely quarter and year of first target rate increase:
25th Pctl	Q2 2015
Median	Q3 2015
75th Pctl	Q4 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.

(19 complete primary dealer responses)

	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017	Longer Run
25th Pctl	N/A	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	0.75%	1.50%	2.00%	4.00%
Median	N/A	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.75%	1.25%	2.00%	3.00%	4.00%
75th Pctl	N/A	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	1.00%	2.00%	2.63%	3.50%	4.00%

4. How would you grade the Federal Reserve System's communication with the markets and with the public since the last policy survey on 10/15/12? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness. Please explain.

	Number of Respondents
1 - Very Ineffective	1
2	4
3	6
4	9
5 - Very Effective	1

Some dealers thought that the thresholds and the conditions around them were not well understood by the market, and some others noted that they were surprised by the timing of the announcement. A few mentioned that the change in the distribution of Treasury purchases across maturities relative to that under the expiring maturity extension program was a surprise. Finally, several dealers reported no changes to their December 3 survey answers.

5. In the September FOMC statement, the Committee announced a new asset purchase program. In the statement, the Committee said "These actions...together will increase the Committee's holdings of longer-term securities by about $85 billion each month through the end of the year."

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
December 11-12	25th Pctl	N/A	N/A
	Median	N/A	N/A
	75th Pctl	N/A	N/A
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
1 Year Ahead	25th Pctl	15	20
	Median	45	40
	75th Pctl	45	40

b) **Please indicate the quarter and year you expect purchases associated with the flow-based asset purchase program to end. Please explain, including a description of why you expect the purchase program to end at the quarter and year indicated. Please explain.**

	Most likely quarter and year of program end:
25th Pctl	Q4 2013
Median	Q1 2014
75th Pctl	Q3 2014

6. **Please provide your expectation for the change in the amount of domestic securities held outright in the SOMA portfolio by year-end, and then the half-year changes for the following 4 years. For your reference, as of the November 23 H.4.1 release the current level of Treasury holdings including inflation accretion is $1650 billion and the current level of agency debt and settled and unsettled agency MBS holdings is $1074 billion. Please explain, including the reason for any changes to the pace of flow-based purchases.**[4]

		Through Year End 2012	**2013 H1**	**2013 H2**	**2014 H1**	**2014 H2**	**2015 H1**	**2015 H2**	**2016 H1**	**2016 H2**
					$Billions					
Change in the estimated amount of Treasuries	25th Pctl portfolio	N/A	270	195	75	0	0	0	-90	-150
	Median portfolio	N/A	270	270	90	0	0	-30	-60	-10
	75th Pctl portfolio	N/A	270	270	180	60	0	-50	-50	-5
Change in the estimated amount of agency debt and MBS	25th Pctl portfolio	N/A	240	210	30	-60	-80	-139	-121	-163
	Median portfolio	N/A	240	240	0	0	0	-44	-60	-136
	75th Pctl portfolio	N/A	240	240	150	50	0	-100	-100	0

7. **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 November 23 H.4.1 is $2725 billion.**

Year End 2013

	<3000	**3000-3250**	**3250-3500**	**3500-3750**	**3750-4000**	**4000-4250**	**>4250**
Average	1%	5%	15%	32%	34%	9%	4%

Year End 2014

	<2500	**2500-3000**	**3000-3500**	**3500-4000**	**4000-4500**	**4500-5000**	**>5000**
Average	1%	5%	16%	36%	20%	14%	8%

[4] 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.