# Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

October 2013

# Responses to the Primary Dealer Policy Expectations Survey
# Distributed: 10/17/2013 – Received by: 10/22/2013

*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. The September FOMC statement contained information outlining the Committee's view on the economy as well as discussion of policy actions with regard to asset purchases and forward rate guidance. Provide below your expectations for changes, if any, to the language referencing each of these topics in the October FOMC statement. Limit your responses to changes you consider most likely.**

**Current economic conditions and the economic outlook:**

*Some dealers expected the October FOMC statement to contain a downgrade to the outlook for the labor market or to note a recent weaker trend in labor market indicators. Several others noted their expectation for the FOMC statement to acknowledge slower economic momentum in general. Some dealers mentioned that the statement might include language regarding the negative impact on the economy resulting from the government shutdown, including fiscal drag and increased uncertainty.*

**Communication on the overall size, pace, and composition of asset purchases, and factors influencing them:**

*Most dealers noted that they did not expect changes to the language on the overall size, pace, and composition of asset purchases in the October FOMC statement.*

**Communication on the expected path of policy rates and forward guidance on the target federal funds rate:**

*Most dealers noted that they did not expect changes to the language on the expected path of policy rates and forward guidance on the target federal funds rate in the October FOMC statement.*

**Other:** ***(8 primary dealer responses)***

*Dealers did not provide substantial commentary in this section.*

---

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

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

| | H2 2013 | H1 2014 | H2 2014 | H1 2015 | H2 2015 | H1 2016 | H2 2016 | H1 2017 | ≥ H2 2017 |
|---|---|---|---|---|---|---|---|---|---|
| Average | 0% | 1% | 8% | 22% | 32% | 20% | 10% | 5% | 3% |

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

b) **If you made any changes to your expectations for the most likely timing of the first target rate increase since the last survey update on September 23, explain the factors that motivated you to make the change(s).**

***(19 primary dealer responses)***

*Several dealers noted that they pushed out their expectation for the most likely timing of the first target rate increase based on their revised expectations for a longer period of Federal Reserve asset purchases. Several dealers also mentioned that they decreased the probabilities they placed on an earlier target rate increase, citing fiscal uncertainty, weaker labor market data, and their revised views on the path of the balance sheet. Some other dealers noted that they did not make any changes to their expectations for the most likely timing of the first target rate increase.*

3) a) **Provide your estimate of the most likely outcome (i.e., the mode) for the target federal funds rate or range at the end of each half-year period. In addition, provide your estimate of the longer run target federal funds rate and your expectation for the average federal funds rate over the next 10 years**

| | H2 2013 | H1 2014 | H2 2014 | H1 2015 | H2 2015 | H1 2016 | H2 2016 | H1 2017 | H2 2017 | Longer Run | 10-yr Average FF Rate |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 25th Pctl | 0-.25% | 0-.25% | 0-.25% | 0-.25% | 0.50% | 1.00% | 1.50% | 2.00% | 2.50% | 3.75% | 2.50% |
| Median | 0-.25% | 0-.25% | 0-.25% | 0-.25% | 0.75% | 1.25% | 2.00% | 2.50% | 3.25% | 4.00% | 2.75% |
| 75th Pctl | 0-.25% | 0-.25% | 0-.25% | 0-.25% | 1.00% | 1.50% | 2.25% | 3.25% | 4.00% | 4.00% | 3.00% |

b) **As noted in the minutes to the September FOMC meeting, a number of participants expected that, "if economic headwinds died away only slowly…the achievement of the Committee's employment and price stability objectives would likely require keeping the federal funds rate below its longer-run equilibrium value for some time even as economic conditions improved." We are interested in the degree to which economic headwinds are impacting your estimate of the neutral nominal federal funds rate over the next several years—that is, the rate that would be consistent with no unemployment gap and inflation at the FOMC's objective. Please provide your estimate of the neutral nominal federal funds rate at end-2016, given the financial and economic conditions you expect to prevail at that time.**

| | End-2016 Neutral Rate |
|---|---|
| 25th Pctl | 2.00% |
| Median | 3.25% |
| 75th Pctl | 3.75% |

**Please comment on any difference between this estimate and your longer run estimate provided in Part a) above:**

***(19 primary dealer responses)***

*Some dealers noted that their estimate for the neutral nominal federal funds rate at end-2016 was different from their estimate of the longer run target, while several others stated that they saw little to no difference between the rates. Of the dealers that saw a difference between the two estimates, some cited a variety of economic and regulatory headwinds resulting from the financial crisis that would imply a lower neutral nominal rate over a shorter time horizon. Several dealers noted their view that various economic headwinds had put downward pressure on the economy's potential growth rate.*

**4) Provide the probability you assign to the unemployment rate falling within the following ranges at the time of the first increase in the target federal funds rate. Please assume that the rate of inflation between one and two years ahead remains below 2.5 percent and longer-term inflation expectations remain well anchored prior to the first increase. Consider all possible conditions that may be associated with these scenarios in formulating your responses.**

| | < 6.0% | 6.0 - 6.5% | > 6.5% |
|---|---|---|---|
| Average | 30% | 60% | 9% |

**5) The minutes of the September 2013 meeting noted that the Committee discussed "the potential for clarifying or strengthening the Committee's forward guidance for the federal funds rate." Provide the probability you assign to the Committee clarifying or strengthening its current forward guidance for the target federal funds rate at some point in the future?**

| | Clarification or Strengthening of Forward Guidance |
|---|---|
| 25th Pctl | 60% |
| Median | 70% |
| 75th Pctl | 90% |

**Please comment on any changes to your expectations for the likelihood, timing, or type of guidance since the prior survey on September 9:**

*Several dealers noted the possibility that the FOMC could introduce a lower bound on inflation, below which the Committee would not consider raising the target federal funds rate, while several others discussed the likelihood of a lower unemployment rate threshold. Several dealers noted that the probability of a change to the forward rate guidance had increased since the last FOMC meeting, and that they believed the Committee would introduce changes to it at the meeting where they announce the first reduction in the pace of asset purchases. Several dealers noted that the perceived likelihood of clarifying or strengthening the forward rate guidance had increased following the nomination of Vice Chair*

*Yellen to succeed Chairman Bernanke. Several other dealers noted that their expectations had not materially changed since the last survey.*

**6) Of the possible outcomes below, please indicate the percent chance you attach to the target federal funds rate or range falling in each of the following ranges at the end of 2014, 2015, and 2016.**

**Year End 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% |
|---|---|---|---|---|---|---|---|
| Average | 88% | 9% | 3% | 1% | 0% | 0% | 0% |

**Year End 2015**

| | 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 | 26% | 23% | 31% | 14% | 5% | 1% | 1% |

**Year End 2016**

| | ≤1.00% | 1.01 - 1.50% | 1.51 - 2.00% | 2.01 - 2.50% | 2.51 - 3.00% | 3.01 - 3.50% | ≥ 3.51% |
|---|---|---|---|---|---|---|---|
| Average | 17% | 18% | 26% | 19% | 10% | 5% | 5% |

**7) How would you grade the Federal Reserve System's communication with the markets and with the public since the policy survey on September 9? Please provide a rating between 1 and 5, with 1 indicating ineffectiveness and 5 indicating effectiveness.**

| | Fed Communication Grade<br>Number of Respondents: |
|---|---|
| 1 - Very Ineffective | 5 |
| 2 | 11 |
| 3 | 2 |
| 4 | 3 |
| 5 - Very Effective | 0 |

*Some dealers described the FOMC's decision not to reduce the pace of asset purchases at the September FOMC meeting as unexpected. Some dealers suggested that FOMC communication had been unclear, with several noting what they perceived to be contradictory messages from the Chairman's recent press conferences. Several also specifically noted that more frequent appearances from key members of the FOMC could have improved communication.*

**8) In the September FOMC statement, the Committee announced it will continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month, and also stated that decisions about the pace, "will remain contingent on the Committee's economic outlook as well as its assessment of the likely efficacy and costs of such purchases."**

**a) Provide your most likely expectation for the monthly pace of purchases that will be in effect after each of the below FOMC meetings.**

| | | | Monthly Pace of Longer-Term Security Purchases ($Billions) | |
|---|---|---|---|---|
| | | | Treasuries | Agency MBS |
| 2013 | October 29-30: | 25th Pctl | 45 | 40 |
| | | Median | 45 | 40 |
| | | 75th Pctl | 45 | 40 |
| | December 17-18: | 25th Pctl | 45 | 40 |
| | | Median | 45 | 40 |
| | | 75th Pctl | 45 | 40 |
| 2014 | January 28-29: | 25th Pctl | 40 | 40 |
| | | Median | 45 | 40 |
| | | 75th Pctl | 45 | 40 |
| | March 18-19: | 25th Pctl | 33 | 30 |
| | | Median | 35 | 35 |
| | | 75th Pctl | 40 | 35 |
| | April 29-30: | 25th Pctl | 28 | 30 |
| | | Median | 30 | 30 |
| | | 75th Pctl | 35 | 35 |
| | June 17-18: | 25th Pctl | 20 | 20 |
| | | Median | 23 | 21 |
| | | 75th Pctl | 25 | 25 |
| | July 29-30: | 25th Pctl | 14 | 15 |
| | | Median | 15 | 15 |
| | | 75th Pctl | 24 | 20 |
| | September 16-17: | 25th Pctl | 0 | 0 |
| | | Median | 7 | 5 |
| | | 75th Pctl | 13 | 12 |
| | October 28-29: (1 year ahead) | 25th Pctl | 0 | 0 |
| | | Median | 0 | 0 |
| | | 75th Pctl | 8 | 7 |

**Please explain any changes to your assumptions behind the increments of pace reduction and any changes in the composition of Treasury and agency MBS purchases since the last survey update on September 23.**

***(20 primary dealer responses)***

*Many dealers pushed back their expectations for the most likely timing of the first reduction in the pace of asset purchases, with several stating that they viewed March 2014 as most likely. Several dealers cited recent fiscal developments, including the impact of the government shutdown on economic data releases as well as increased uncertainty around the next round of fiscal negotiations, as informing their expectations for the likely timing of the first pace reduction, while several also cited recent softer employment data as a contributing factor. Several other dealers noted that they made no changes to their forecasts.*

**b) Provide your distribution of probabilities for the timing of the announcement of the first reduction in pace, given the FOMC meetings below.**

| | Oct 2013 | Dec 2013 | Jan 2013 | Mar 2013 | > Q1 2014 |
|---|---|---|---|---|---|
| Treasuries, average : | 1% | 12% | 23% | 36% | 29% |
| Agency MBS, average : | 1% | 9% | 20% | 35% | 35% |

**c) In his September press conference, Chairman Bernanke noted that in judging when to moderate the pace of asset purchases, "the Committee will, at its coming meetings, assess whether incoming information continues to support the Committee's expectations of ongoing improvement in labor market conditions**

**and inflation moving back toward its longer-run objective." What announced purchase pace, effective following the upcoming FOMC meeting, do you believe would result in roughly no change in the price of the 10-year Treasury note, assuming no other policy action?**

**Monthly Pace Resulting in No Change in 10-year Treasury Yield**

| | Treasuries | Agency MBS |
|---|---|---|
| 25th Pctl | 45 | 40 |
| Median | 45 | 40 |
| 75th Pctl | 45 | 40 |

***(20 primary dealer responses)***

*Most dealers noted that the market did not expect the FOMC to announce a reduction in the pace of purchases at the October meeting. Several dealers stated the effects of the government shutdown and weaker economic data have shifted the market's view towards a later initial reduction in the pace of asset purchases. Several dealers noted that a decision at the October meeting to adjust the pace of asset purchases would be a surprise, and would precipitate a market reaction.*

**d) Provide your most likely expectation for the change in the amount of domestic securities held in the SOMA portfolio during each of the periods below. In the case of purchases, please include settled and unsettled amounts.[2]**

***(18 complete primary dealer responses)***

| | | 2014 H2 | 2015 H1 | 2015 H2 | 2016 CY* | 2017 CY* | 2018 CY* |
|---|---|---|---|---|---|---|---|
| | | $Billions | | | | | |
| Change in the estimated amount of Treasuries: | 25th Pctl portfolio | 45 | 0 | 0 | -215 | -244 | -356 |
| | Median portfolio | 65 | -10 | 0 | -209 | -201 | -311 |
| | 75th Pctl portfolio | 100 | 0 | -35 | -162 | -188 | -311 |
| Change in the estimated amount of agency debt and MBS: | 25th Pctl portfolio | 50 | -20 | -70 | -233 | -210 | -151 |
| | Median portfolio | 65 | -13 | -75 | -118 | -180 | -135 |
| | 75th Pctl portfolio | 75 | -5 | -27 | -148 | -123 | -116 |

**Calendar Year*

**Please explain your assumptions behind your projections for the timing, size, and pace of redemptions and sales of securities, if applicable. Please note if your assumptions have changed since the last survey:**

***(20 primary dealer responses)***

*Several dealers mentioned that their expectations for the size of the SOMA portfolio in the second half of 2014 had increased due to their evolving outlook for the asset purchase program. Several dealers saw purchases ending in the fourth quarter of 2014, while several others saw purchases ending in the third quarter of 2014. Some dealers expected the level of the SOMA portfolio to start declining in 2015, while several others expected declines to begin in 2016. Some dealers also provided details regarding their assumptions behind the pace and magnitude of portfolio declines. Some dealers stated that they believed asset sales were unlikely during the process of balance sheet normalization.*

---

[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.

**9) 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 2014. For your reference, the level of the SOMA portfolio including inflation accretion and settled and unsettled agency MBS according to the January 3, 2013 H.4.1 was $2,785 billion (the H.4.1 closest to the start of 2013).**

| | Year End 2014 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **<3500** | **3500-3750** | **3750-4000** | **4000-4250** | **4250-4500** | **4500-4750** | **4750-5000** | **>5000** |
| Average | 1% | 1% | 7% | 26% | 41% | 18% | 5% | 2% |

**10) Provide your estimate of the most likely outcome 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?**

***(17 complete primary dealer responses)***

| | | Q4/Q4 2013 | Q4/Q4 2014 | Q4/Q4 2015 | Longer Run |
|---|---|---|---|---|---|
| | 25th Pctl | 1.85% | 2.50% | 2.60% | 2.25% |
| GDP: | Median | 1.90% | 2.80% | 3.00% | 2.30% |
| | 75th Pctl | 2.00% | 3.00% | 3.10% | 2.50% |
| | 25th Pctl | 1.30% | 1.60% | 1.80% | |
| Core PCE: | Median | 1.30% | 1.70% | 1.90% | |
| | 75th Pctl | 1.40% | 1.80% | 2.00% | |
| | 25th Pctl | 1.10% | 1.60% | 1.70% | 2.00% |
| Headline PCE: | Median | 1.20% | 1.80% | 1.90% | 2.00% |
| | 75th Pctl | 1.40% | 1.90% | 2.10% | 2.00% |
| | 25th Pctl | 7.10% | 6.50% | 6.00% | 5.50% |
| Unemployment Rate*: | Median | 7.20% | 6.60% | 6.10% | 5.80% |
| | 75th Pctl | 7.20% | 6.70% | 6.20% | 6.00% |

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

**2013 Forecasts***

**Number of Respondents Citing:**

| | Downside Risk | Balanced Risk | Upside Risk |
|---|---|---|---|
| GDP: | 9 | 12 | 0 |
| Core PCE: | 2 | 18 | 1 |
| Headline PCE: | 1 | 18 | 2 |
| Unemployment Rate: | 0 | 13 | 8 |

**2014 Forecasts***

**Number of Respondents Citing:**

| | Downside Risk | Balanced Risk | Upside Risk |
|---|---|---|---|
| GDP: | 8 | 13 | 0 |
| Core PCE: | 4 | 13 | 4 |
| Headline PCE: | 3 | 14 | 4 |
| Unemployment Rate: | 3 | 11 | 7 |

**2015 Forecasts***

**Number of Respondents Citing:**

| | Downside Risk | Balanced Risk | Upside Risk |
|---|---|---|---|
| GDP: | 0 | 17 | 0 |
| Core PCE: | 1 | 13 | 3 |
| Headline PCE: | 2 | 12 | 3 |
| Unemployment Rate: | 3 | 12 | 2 |

**Upside risk is a risk towards higher GDP growth, a higher inflation rate, and a lower unemployment rate. Downside risk is a risk towards lower GDP growth, a lower inflation rate, and a higher unemployment rate.*

11) **For the outcomes below, please indicate the percent chance you attach to the annual average CPI inflation rate from 2018-2023. Please also indicate your point estimate for the most likely outcome.**

| | **≤1.0%** | **1.01-1.5%** | **1.51-2.0%** | **2.01-2.5%** | **2.51-3.0%** | **≥3.01%** |
|---|---|---|---|---|---|---|
| Average | 3% | 10% | 25% | 35% | 18% | 9% |

| | **Point Estimate** |
|---|---|
| 25th Pctl | 2.00% |
| Median | 2.20% |
| 75th Pctl | 2.40% |

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 | 2% |
| Median | 5% |
| 75th Pctl | 5% |

| | **NBER Recession in 6 Months** |
|---|---|
| 25th Pctl | 10% |
| Median | 15% |
| 75th Pctl | 20% |