Responses to Survey of Primary Dealers

Markets Group, Federal Reserve Bank of New York

January 2011

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 policy 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)	98%	2%	0%	0%	0%	0%	0%

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

Nearly all of the primary dealers commented on expectations for only slight changes to the FOMC statement language at the January meeting. Many dealers noted that the FOMC might upgrade its economic assessment to some extent. A few dealers expected the Committee to note that improvements in the labor market have been insufficient so far, while a couple of dealers expected the statement to include a cautious interpretation of the recent improvements in economic data.

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

	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	≥ Q1 2013
Average	0%	1%	2%	11%	14%	13%	16%	17%	25%

	Most likely quarter and year of first target rate increase:
25th Pctl	*Q1 2012*
Median	Q3 2012
75th Pctl	*Q4 2012*

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

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 quarter:

	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012
25th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.25%*
Median	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0-.25%	0.50%	0.63%
75th Pctl	*0-.25%*	*0-.25%*	*0-.25%*	*0-.25%*	*0.41%*	*0.59%*	*1.13%*	*1.63%*

4. 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	75%	16%	6%	2%	1%	0%	0%

5. If you have changed your federal funds forecasts from the prior survey, what were the main drivers of that change? Please note in particular how these changes relate to your economic forecasts, FOMC communications, or other factors.

A few dealers noted that their expectation for the timing of the first rate increase had indeed shifted to an earlier date since the last policy survey. In addition, a few dealers indicated that they attached a somewhat greater chance to the first rate increase occurring earlier than their published forecasts. However, a few dealers noted they had made no changes to their forecast for the path of the target federal funds rate.

6. How would you grade the Federal Reserve System's communication with the markets and with the public since the last policy survey on 12/16/10? 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	11
4	5
5 - Very Effective	1

(17 primary dealer comments)

Primary dealers had an overall positive view of the Federal Reserve's communication with the markets and the public over the intermeeting period. Several dealers noted that views expressed publicly by FOMC members had become more consistent. However, of the dealers that took a less positive view of the Federal Reserve's communication, a few noted that the explicit goals of the large-scale asset purchase (LSAP) program remain unclear. Additionally, a couple of dealers indicated that various Committee members' public comments create confusion among market participants.

7. In the November 2010 FOMC statement, the Committee announced the following: "The Committee intends to purchase a further $600 billion of longer-term Treasury securities by the end of the second quarter of 2011, a pace of about $75 billion per month. The Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster maximum employment and price stability." What is your current expectation for the total cumulative size of the asset purchase program, and when do you expect the program to be completed? In your estimate of total cumulative size, please include securities already purchased under this program since November 3, but exclude purchases associated with agency and agency MBS reinvestment.

	Cumulative Size of Program *($ Billions)*	**Total Length of Program** *(Months)*
25th Pctl	*600*	*6.7*
Median	600	6.7
75th Pctl	*750*	*12.0*

Several dealers commented on their expectation for the Federal Reserve to complete its LSAP program as initially outlined in the November FOMC statement, with no changes to the program's size or schedule. A few of these dealers noted they had decreased expectations for the cumulative size of asset purchases somewhat in response to recent improvements in economic data and/or upgraded forecasts. However, a few dealers expected that the FOMC may decide to taper the program's purchases over a longer timeframe than announced, with no change to the overall size of the program, and a couple of these dealers specifically cited that the reason would be to minimize the impact of the program's end on market functioning.

8. What is your expectation for the amount of domestic securities held outright in the SOMA portfolio at year-end for each of the next five years?

Estimated amount of domestic securities
($ Billions)

	2011	**2012**	**2013**	**2014**	**2015**
25th Pctl	*2600*	*2200*	*1700*	*1213*	*1100*
Median	2650	2450	2050	1600	1325
75th Pctl	*2827*	*2600*	*2250*	*2075*	*1788*

Dealers have varied expectations for changes to SOMA over the next several years, covering passive runoff, the commencement and pace of securities sales, and the pace at which the size of the portfolio will normalize. Across all of these dimensions, several dealers expect the FOMC to allow passive runoff of the portfolio to begin at some point in 2012. Meanwhile, a few dealers expect that agency debt and MBS reinvestment will continue after securities purchases conclude, but none specify the timeframe over which that will proceed.

9. The size of the SOMA portfolio can be influenced by several factors, including asset purchases, changes to the reinvestment strategy, and asset sales. Please indicate the likelihood of these outcomes over the next two and five years. Specifically, please indicate the percent chance you assign to: 1) the Federal Reserve expanding its securities portfolio through additional purchases in the given asset class, 2) the Federal Reserve halting the reinvestment of principal payments from its holdings of the given asset class, and 3) the Federal Reserve conducting sales of the given asset class. For each, please indicate the cumulative probabilities over horizons of within two years and within five years.

		Additional Purchases		***Halting Reinvestment***		***Sales***	
		Probability within 2 years	***Probability within 5 years***	***Probability within 2 years***	***Probability within 5 years***	***Probability within 2 years***	***Probability within 5 years***
	25th Pctl	*N/A*	*N/A*	*20%*	*60%*	*10%*	*51%*
Treasuries	*Median*	N/A	N/A	73%	90%	23%	70%
	75th Pctl	*N/A*	*N/A*	*79%*	*95%*	*55%*	*89%*
	25th Pctl	*0%*	*0%*	*43%*	*83%*	*5%*	*25%*
Agencies	*Median*	5%	8%	75%	95%	13%	38%
	75th Pctl	*10%*	*15%*	*94%*	*100%*	*29%*	*73%*
	25th Pctl	*5%*	*5%*	*50%*	*83%*	*6%*	*31%*
MBS	*Median*	10%	10%	75%	95%	20%	50%
	75th Pctl	*25%*	*29%*	*94%*	*100%*	*38%*	*80%*

Dealers' opinions varied widely on the factors that would influence the size of the SOMA portfolio over the coming two to five years. A few dealers noted that the FOMC could decide to engage in MBS purchases if economic conditions were to worsen materially, but viewed this as an unlikely outcome. All dealers mentioned asset sales in their comments, but views on the topic varied greatly across participants.

Economic Indicator Forecasts

10. a and b) Provide your firm's estimate of the most likely outcome (i.e. the mode) for output and inflation. 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)

		Q4 2010	**Q1 2011**	**Q2 2011**	**Q3 2011**	**Q4/Q4 2011***	**Q4/Q4 2012***	**Q4/Q4 2013***
	25th Pctl	*3.00%*	*3.03%*	*3.03%*	*2.83%*	*3.20%*	*3.00%*	*3.00%*
GDP	Median	3.35%	3.30%	3.40%	3.50%	3.35%	3.20%	3.15%
	75th Pctl	*3.50%*	*3.50%*	*3.78%*	*3.88%*	*3.68%*	*3.50%*	*3.38%*
	25th Pctl	*0.80%*	*0.73%*	*0.80%*	*0.80%*	*0.83%*	*1.00%*	*1.43%*
Core PCE	Median	0.80%	0.80%	0.90%	1.00%	1.05%	1.20%	1.60%
	75th Pctl	*0.90%*	*0.90%*	*1.00%*	*1.20%*	*1.30%*	*1.70%*	*2.30%*
	25th Pctl					*8.80%*	*7.70%*	*6.63%*
Unemployment Rate	Median					9.00%	8.40%	7.40%
	75th Pctl					*9.08%*	*8.60%*	*7.98%*

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

2011 Forecasts

Number of Respondents Citing:

	Downside Risk	**Balanced Risk**	**Upside Risk**
GDP	0	13	5
Core PCE	1	11	6
Unemployment Rate	4	10	4

2012 Forecasts

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	1	12	4
Core PCE	2	8	7
Unemployment Rate	1	11	5

2013 Forecasts

Number of Respondents Citing:

	Downside Risk	Balanced Risk	Upside Risk
GDP	1	9	0
Core PCE	0	7	3
Unemployment Rate	0	8	2

(10 primary dealer comments)

Several dealers noted the following factors as sources of downside risk: a notable decline in housing prices, a sharp rise in energy prices, and a negative resolution to the euro-area fiscal and banking crisis. Meanwhile, several dealers also commented on potential upside risks to their forecasts. A couple of dealers mentioned the outlook for business fixed investment spending as one source of upside risk to growth forecasts.

c) Do you feel more, less or equally uncertain regarding your economic forecasts since the last survey on 12/6/10?

Number of Respondents:

	Less Uncertain	Equally Uncertain	More Uncertain
GDP Uncertainty	4	12	2
Core PCE Uncertainty	4	12	2

11. What percent chance do you attach to the 4-quarter change in the core PCE deflator falling below zero by the end of Q1 2012?

	Probability
25th Pctl	*6%*
Median	15%
75th Pctl	*19%*

12. For the outcomes below, please indicate the percent chance you attach for the annual average CPI inflation rate from 2016 - 2021. 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	5%	10%	24%	34%	19%	9%

	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 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		NBER Recession in 6 Months
25th Pctl	*0%*	*25th Pctl*	*6%*
Median	1%	Median	10%
75th Pctl	*5%*	*75th Pctl*	*15%*

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

Many primary dealers commented on upgrades to macroeconomic assessments since the last FOMC meeting. Many dealers noted that fiscal policy decisions have had a positive impact on their outlook, and some of these dealers indicated that this had driven an actual upgrade to their GDP forecast. Some dealers noted that they upgraded their assessment based on recent improvements in economic data, while a couple noted instead that their upgraded assessment is based on expectations that economic conditions will continue to improve.

15. The 10-year Treasury yield has increased by approximately 75 basis points since the release of the November FOMC statement. Please rate the importance of the factors below in explaining this increase.

	Number of Respondents:			
	Not Important	Somewhat Important	Important	Very Important
Shift in short rate expectations amid prospects for stronger growth	1	1	7	9
Increase in long-run inflation expectations	3	8	7	0
Increase in expected Treasury supply due to federal tax compromise	2	9	4	3
Reduced expectations for cumulative size of Fed Treasury purchases	1	10	4	3
Temporary technical factors including liquidity	4	7	4	3
Other	0	1	1	0

Several dealers summarized their numerical answers.