Recommended Reading

MPC MEMBERS

From and (MFAD)

PRE-MPC FOLLOW UP: What are expectations for the stock of asset purchases once the US starts raising interest rates?

Ben Broadbent asked about expectations for when the FOMC would stop reinvestments of maturing assets on its stock of asset holdings once it starts to raise rates.

Main Message: **The FOMC has said that it will not stop reinvestments of maturing assets until after it starts raising short-term policy rates, but has not provided quantitative information on the likely gap between those events. In April, market participants' expectations were for a gap of 2-3 quarters between the first rate rise and ceasing reinvestments of US Treasury holdings, which corresponds with expected policy rates 75-100 basis points higher than current levels.**

The FOMC's 'policy normalization principles and plans'

1. In September 2014, the FOMC agreed on and published its approach to normalising the stance of monetary policy. This said that once economic conditions warrant a policy tightening, the FOMC will begin by increasing the target range for the federal funds rate and that during normalisation short-term interest rates will be the primary policy tool. The Committee expects to cease or commence phasing out reinvestments of maturing assets in a gradual and predictable manner after it begins increasing its short-term policy rates. Whilst the FOMC does not anticipate active sales of agency MBS as part of the normalisation process (although some sales may be warranted in the longer run to reduce or eliminate any residual holdings), it has not ruled out sales of Treasuries. The timing will depend on how economic and financial conditions and the economic outlook evolve. And the central bank balance sheet will normalise as these assets mature.

Remarks by FOMC Vice Chairman William Dudley

2. The head of the Federal Reserve Bank of New York, and Vice Chairman of the FOMC, William Dudley, has gone slightly further than the official FOMC line and said in a speech in December 2014 that the committee will only cease to reinvest proceeds from maturing Treasury securities and prepayments of agency MBS "after lift-off looks sustainable and the federal funds rate is somewhat above the zero lower bound".

Financial market participants' expectations

3. Responses to the New York Fed's two market surveys provide information on investors' expectations for when the FOMC will end reinvestments and the target range for the policy rate at the time. The most recent surveys that are publically available were taken ahead of the April FOMC meeting. **Table 1** below shows that the median respondent to the Primary Dealers survey expected a gap of 7-9 months between the first rate rise and the end of US Treasury reinvestments, which corresponded with expectations that policy rates would have been raised by 100bps. But Agency debt and MBS reinvestments were expected to cease a quarter earlier. The median respondent to the Market Participants survey suggested a gap of 4-6 months, which corresponded with expectations of policy rates having been raised by 75bps.

Table 1: Financial market participants' expectations around the end of reinvestment of US QE assets

		Median response of:	
		Primary Dealers	Market Participants
Expected timing of first rate rise:		September 2015	September 2015
End of reinvestment:	Agency debt and MBS	2016Q1	2016Q1/Q2
	Treasuries	2016Q2	2016Q1
Expected Fed Funds target range corresponding with expected end to reinvestment *:	Agency debt and MBS	0.75%-1%	0.75%-1%/1%-1.25%
	Treasuries	1%-1.25%	0.75%-1%

* Current target range is 0-0.25%

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and