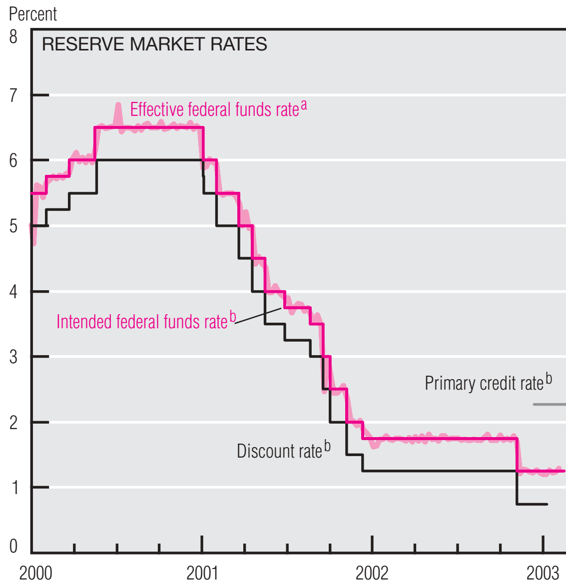
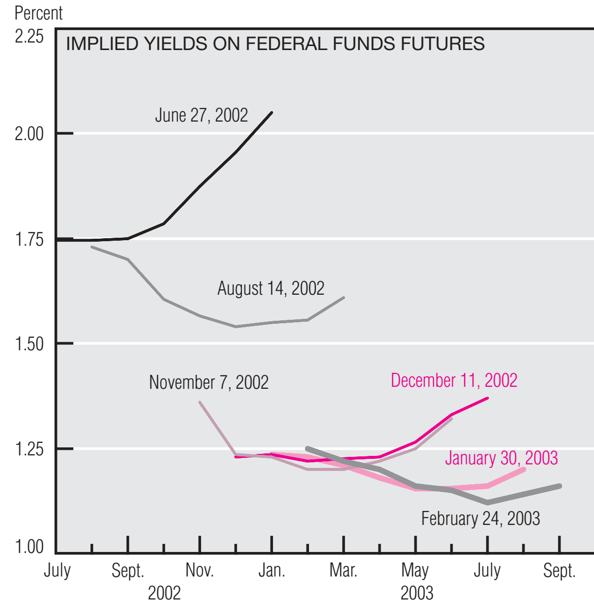
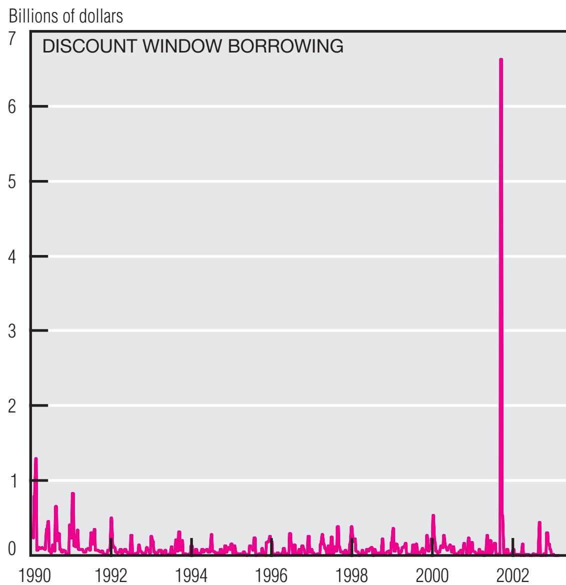
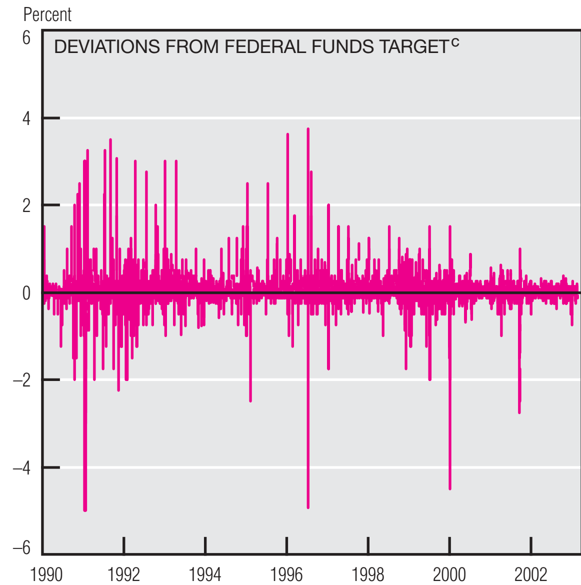
Monetary Policy









a. Weekly average of daily figures.
b. Daily observations.
c. The high–low chart is plotted daily. The high point is the daily high minus the federal funds target; the low point is the daily low minus the federal funds target.
SOURCES: Board of Governors of the Federal Reserve System; and Bloomberg Financial Information Services.

On February 11, the Board of Governors released its semiannual *Monetary Policy Report to the Congress*, which noted that although "the economy remained sluggish at the end of 2002 and early this year," the household sector "continued to be a solid source of demand." Improved outlooks for business, the current leanness of inventories, rapid productivity growth, and fiscal stimulus at the federal level "are expected to lead to a faster pace of economic expansion, while inflation pressures are anticipated to remain well contained."

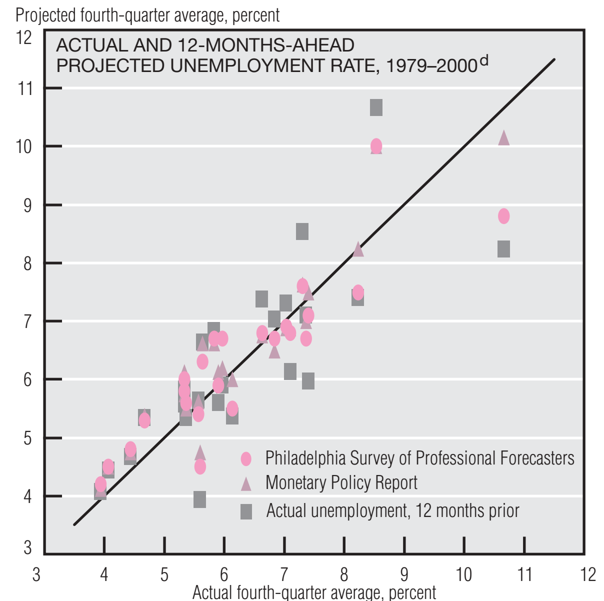
Since the last meeting of the Federal Open Market Committee on January 28–29, implied yields on federal funds futures have not moved strongly. Over the last few months, market participants have pushed back the date at which they expect the next round of tightening to begin.

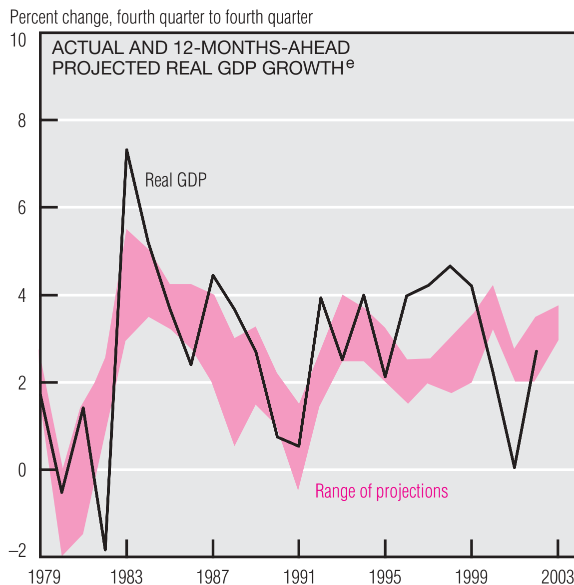
On January 9, the Federal Reserve implemented significant changes in its discount window lending policy. Under the new policy, Reserve Banks extend short-term primary credit to qualified institutions at an interest rate that is currently 100 basis points above the intended federal funds rate. Before this change, the rate on similar loans typically was below the fed funds rate. The new regime replaces the old system of rationing credit at the discount window with one that extends primary credit with "no questions asked." The changes are designed to reduce the stigma of discount window use and to lower variability in the fed funds rate by capping it at the primary credit rate. However, we have yet to see a reserve shortage large enough to drive the fed funds rate up to the primary credit rate. When such an

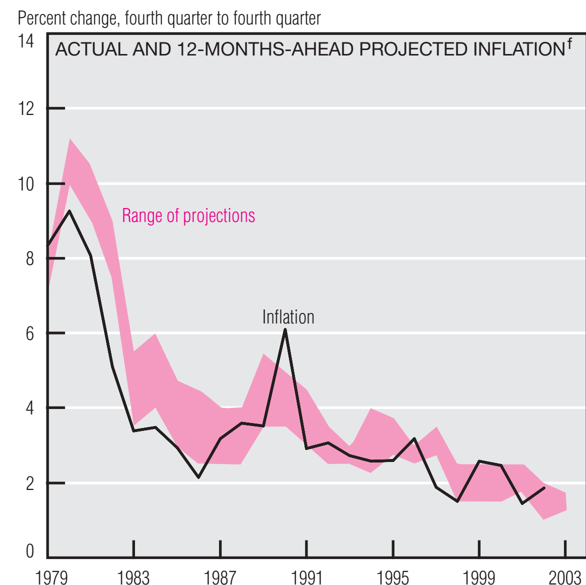
(continued on next page)

Economic Projections for 2003

	Actual 2002	Federal Reserve Governors and Reserve Bank Presidents: Range	Federal Reserve Governors and Reserve Bank Presidents: Central tendency
Nominal GDP[a]	4.1	4.5–5.5	4.75–5.0
Real GDP[b]	2.8	3.0–3.75	3.25–3.50
PCE Chain-type Price Index[a]	1.9	1.25–1.75	1.25–1.50
Civilian unemployment rate[c]	5.9	5.75–6.0	5.75–6.0







a. Change, fourth quarter to fourth quarter.
b. Change, fourth quarter to fourth quarter. Chain weighted.
c. Average level, fourth quarter.
d. The *Monetary Policy Report* projection is the midpoint of the range. The *Survey of Professional Forecasters* projection is the median response.
e. Projected and real GDP are both GNP prior to 1992.
f. From 1979 to 1989, inflation and projected inflation are plotted as the implicit GDP deflator; from 1990 to 1999 they are plotted in terms of the CPI; and from 1999 to 2002 as the PCE Chain-type Price Index.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress*; and Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters*.

event occurs, qualified institutions are expected to turn to the discount window to borrow at the more attractive primary credit rate rather than push the funds rate even higher to avoid borrowing from the Fed.

The *Monetary Policy Report* presents a set of semiannual economic projections by the Board of Governors and Reserve Bank presidents. How do these projections compare to those of private forecasters? If the summary statistics of projections were exact, a scatter plot of actual versus summary statistics would show points lying along a 45-degree line. The same is true of the unemployment rate, except that there are some significant misses.

The *Report's* accuracy can be compared to private forecasters' and to a naive forecast predicting that a variable's future value will equal its current value. At a 12-month horizon, the average absolute error of professional forecasters' unemployment projection is 0.55% versus the Fed's 0.41%. Both of them fare better than the naive forecast, whose average absolute error is 0.73%.

Although the Fed's projections for real GDP growth and inflation track the actual values fairly closely, there are periods when the actual values lie well outside the range of projections. Predicting GDP growth in the last five to ten years has proven particularly difficult.