Appendix 1: Materials used by Mr. Kos
2- and 10-Year Treasury Yields and Target Fed Funds Rate
January 2, 2006 – October 20, 2006

U.S. Breakeven Inflation Rates
January 2, 2006 – October 20, 2006
Review of Domestic Portfolio Guidelines:

**Investment Principles**
- Safety
- Liquidity
- Neutrality
- Return

**Portfolio Liquidity**
- Prompt contraction of portfolio

**Liquidity Need Assessment**

**Scenarios:**
- Large-scale discount window borrowing
- FX intervention

**Results:**
- Refine liquidity guideline
- $80 billion over 3 months
- $208 billion over 1 year

**Available Liquidity Tools**
- Maturity liquidity: repo
- Maturity liquidity: securities
- Reverse repos
- Outright sales

---

**Maturity Profile of SOMA as of 9/29/2006 ($blns)**

<table>
<thead>
<tr>
<th>Repo</th>
<th>0-1 weeks</th>
<th>1-2 weeks</th>
<th>$22</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bills</td>
<td>0-3 months</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3-6 months</td>
<td>80</td>
<td>$277</td>
</tr>
<tr>
<td>Coupons</td>
<td>0-1 year</td>
<td>135</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1-2 year</td>
<td>110</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2-5 year</td>
<td>112</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5-10 year</td>
<td>51</td>
<td></td>
</tr>
<tr>
<td></td>
<td>10-30 year</td>
<td>80</td>
<td>$488</td>
</tr>
<tr>
<td>Total Domestic Portfolio</td>
<td>$786</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

**Maturity Liquidity Profile**
As of September 29, 2006

- Bills
- Repo
- Coupons

---

$m_3$ $m_5$ $m_7$ $m_9$ $m_{11}$ $m_{13}$ $m_{15}$ $m_{17}$ $m_{19}$ $m_{21}$ $m_{23}$ $m_{25}$ $m_{27}$ $m_{29}$ $m_{31}$ $m_{33}$ $m_{35}$ $m_{37}$ $m_{39}$ $m_{41}$ $m_{43}$ $m_{45}$ $m_{47}$ $m_{49}$ $m_{51}$ $m_{53}$ $m_{55}$ $m_{57}$ $m_{59}$ $m_{61}$ $m_{63}$ $m_{65}$ $m_{67}$ $m_{69}$ $m_{71}$ $m_{73}$ $m_{75}$ $m_{77}$ $m_{79}$ $m_{81}$ $m_{83}$ $m_{85}$ $m_{87}$ $m_{89}$ $m_{91}$ $m_{93}$ $m_{95}$ $m_{97}$ $m_{99}$ $m_{101}$ $m_{103}$ $m_{105}$ $m_{107}$ $m_{109}$ $m_{111}$ $m_{113}$ $m_{115}$ $m_{117}$ $m_{119}$ $m_{121}$ $m_{123}$ $m_{125}$ $m_{127}$ $m_{129}$ $m_{131}$ $m_{133}$ $m_{135}$ $m_{137}$ $m_{139}$ $m_{141}$ $m_{143}$ $m_{145}$ $m_{147}$ $m_{149}$ $m_{151}$ $m_{153}$ $m_{155}$ $m_{157}$ $m_{159}$ $m_{161}$ $m_{163}$ $m_{165}$ $m_{167}$ $m_{169}$ $m_{171}$ $m_{173}$ $m_{175}$ $m_{177}$ $m_{179}$ $m_{181}$ $m_{183}$ $m_{185}$ $m_{187}$ $m_{189}$ $m_{191}$ $m_{193}$ $m_{195}$ $m_{197}$ $m_{199}$ $m_{201}$ $m_{203}$
Market Neutrality

- Avoid distortion of market pricing or liquidity

Limit Structure

Conclusion:
- Revert to flat limit structure

Rationale:
- Treasury securities in ample supply
- Avoid market impact at short-end of curve
- Avoid redemptions

Impact:
- No immediate change in portfolio composition
- Alleviate operational burden

Auction Participation

Observation:
- Auction participation can be highly variable
- Dependent on Treasury auction calendar
- Fed add-on purchases add to floating supply and can impact “specialness” of an issue

Conclusion:
- Prefer regular, consistent participation

Constraints:
- Restrictions on investment of maturing proceeds

SOMA Participation in 5-year Auction Varies Based on Settlement Date

Abbreviated Forecast SOMA Rollover Schedule

<table>
<thead>
<tr>
<th>Settle Date</th>
<th>Maturing Holdings</th>
<th>3-year</th>
<th>10-year</th>
<th>30-year</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/15/06</td>
<td>8.4</td>
<td>6.1</td>
<td>2.3</td>
<td>-</td>
</tr>
<tr>
<td>2/15/07</td>
<td>3.5</td>
<td>1.5</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>5/15/07</td>
<td>11.3</td>
<td>6.0</td>
<td>2.3</td>
<td>3.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Settle Date</th>
<th>Maturing Holdings</th>
<th>2-year</th>
<th>5-year</th>
<th>20-yr TIPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/31/07</td>
<td>6.1</td>
<td>2.5</td>
<td>2.0</td>
<td>1.5</td>
</tr>
<tr>
<td>2/28/07</td>
<td>8.7</td>
<td>5.2</td>
<td>3.5</td>
<td></td>
</tr>
</tbody>
</table>
Appendix 2: Materials used by Mr. Reinhart
Class I FOMC – Restricted Controlled (FR)

Material for
FOMC Briefing on Monetary Policy Alternatives

Vincent R. Reinhart
October 24-25, 2006
Financial Developments

Federal funds and Eurodollar futures contract rates

Note, 5-minute intervals. Data through 3:00 pm on October 24, 2006.

Expected federal funds rate*

*Estimates from futures quotes. Seventy- and 90-percent confidence intervals estimated from options prices shown in green and blue, respectively. Estimated from quotes on October 23, 2006.

Alternative federal funds rate projections

Unemployment rate

Core CPI inflation

Real GDP growth

Page 1 of 5
Exhibit 2
A Rorschach Test for Your Assessment of the Economy

Home sales

Thousands of units

Monthly

Existing home sales (left scale)

New home sales (right scale)

Thousands of units

1999 2000 2001 2002 2003 2004 2005 2006

Home sales have declined sharply and the resulting weakness is a risk to the outlook.

Home sales appear to be bottoming out amid generally strong fundamentals.

Real federal funds rate*

Quarterly

Percent


Policy has tightened considerably and may now be restrictive.

The real federal funds rate remains below its average level in the late 1990s.

Inflation compensation*

Daily

Next five years

Five-year forward, five years ahead

Percent


Inflation compensation remains contained and has declined of late at shorter horizons.

Inflation compensation is above the range consistent with price stability.

*Nominal federal funds rate less the four-quarter percent change in the core PCE price index.

*Estimates based on smoothed nominal and inflation-indexed Treasury yield curves and adjusted for the indexation-lag (carry) effect. Data for October 24, 2006 are preliminary.
Exhibit 3
Where Do You Want to Be?

Optimal Policy with
1½ Percent Inflation Objective

Federal funds rate

Exhibit 3
Alternative Inflation Objectives
(Equal weights)

Civilian unemployment rate

Core PCE inflation
Four-quarter average
Rationale

- In every alternative:
  
  Economic growth appears to have slowed further in the third quarter, partly reflecting a cooling of the housing market.

- In Alternative A:
  
  Readings on core inflation have been elevated, and the high levels of resource utilization and of the prices of energy and other commodities have has the potential to sustain inflation pressures.

Assessment of risk

<table>
<thead>
<tr>
<th>Alternative</th>
<th>Possible Effect</th>
<th>Target Rate</th>
<th>Assessment of Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Ratify expectations of easing</td>
<td>Unchanged</td>
<td>In these circumstances, future policy adjustments will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.</td>
</tr>
<tr>
<td>B</td>
<td>Leave expectations about unchanged</td>
<td>Unchanged</td>
<td>Nonetheless, the Committee judges that some inflation risks remain. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.</td>
</tr>
<tr>
<td>B+</td>
<td>Emphasize tightening is more likely than easing</td>
<td>Unchanged</td>
<td>Although the Committee both seeks and expects a gradual reduction in inflation, it continues to view the risks to that outcome as remaining to the upside. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.</td>
</tr>
<tr>
<td>C</td>
<td>Impose additional restraint</td>
<td>+25 basis points</td>
<td>Although the Committee both seeks and expects a gradual reduction in inflation, it continues to view the risks to that outcome as remaining to the upside. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.</td>
</tr>
<tr>
<td>Table 1: Alternative Language for the October FOMC Announcement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------</td>
<td>------------------------</td>
<td>------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td><strong>September FOMC</strong></td>
<td><strong>Alternative A</strong></td>
<td><strong>Alternative B</strong></td>
<td><strong>Alternative C</strong></td>
</tr>
<tr>
<td><strong>Policy Decision</strong></td>
<td>1. The Federal Open Market Committee decided today to keep its target for the federal funds rate at 5¼ percent.</td>
<td>The Federal Open Market Committee decided today to keep its target for the federal funds rate at 5¼ percent.</td>
<td>The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 5½ percent.</td>
</tr>
<tr>
<td><strong>Rationale</strong></td>
<td>2. Economic growth appears to have slowed further in the third quarter, partly reflecting a cooling of the housing market. Although there is a risk that the slowdown in economic growth may become more pronounced, the economy seems likely to expand at a moderate pace.</td>
<td>Economic growth appears to have slowed further in the third quarter, partly reflecting a cooling of the housing market. Going forward, the economy seems likely to expand at a moderate pace.</td>
<td>Economic growth appears to have slowed further in the third quarter, partly reflecting a cooling of the housing market. Going forward, the economy seems likely to expand at a moderate pace.</td>
</tr>
<tr>
<td><strong>Assessment of Risk</strong></td>
<td>3. Readings on core inflation have been elevated, and the high levels of resource utilization and of the prices of energy and other commodities have the potential to sustain inflation pressures. However, inflation pressures seem likely to moderate over time, reflecting reduced impetus from energy prices, contained inflation expectations, and the cumulative effects of monetary policy actions and other factors restraining aggregate demand.</td>
<td>[Unchanged]</td>
<td>Readings on core inflation have been elevated and the high levels of resource utilization and of the prices of energy and other commodities have the potential to sustain inflation pressures. Inflation pressures seem likely to moderate over time, but the extent and speed of that moderation is uncertain. In these circumstances, the Committee believed that an additional firming of policy was appropriate to bolster progress towards achieving price stability.</td>
</tr>
<tr>
<td></td>
<td>4. Nonetheless, the Committee judges that some inflation risks remain. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.</td>
<td>In these circumstances, future policy adjustments will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.</td>
<td>[Unchanged]</td>
</tr>
</tbody>
</table>