OpenFed

POLICY STATEMENT | December 12, 2000

PREDICTED FED DECISION **HOLD**

6.50%

OPENFED OPTIMAL RATE **−25 bps**

6.25%

KEY TAKEAWAY

The Committee expects the Federal Reserve to hold at 6.5% (4-1), while its own framework judges the optimal move to be a 25 bps cut, a divergence the majority itself acknowledged reflects a stance now tighter than conditions warrant.

STATEMENT

Information reviewed for this meeting described an economy slowing gradually against a backdrop of contained inflation. Core PCE stood at 1.6%, below the 2.0% target, with finished-goods and manufacturers' selling prices reported flat even as the Beige Book flagged lingering cost pressures in health benefits and energy inputs. The labor market remained tight, with unemployment at 4.0%, well below the 5.1% natural rate, though members noted scattered signs of easing labor shortages and initial claims running at an elevated 321,000. Set against this were accumulating signals of a cooling economy: the Chicago Fed activity index at -0.27, an inverted 10y-2y spread at -0.18, a 3-month T-bill sitting 0.61 below the funds rate, and credit stress evident in a Baa spread of 2.72 and a VIX of 24.88. Banks reported tighter commercial lending standards and mixed-to-declining loan demand, suggesting some tightening was already occurring endogenously.

In assessing the most likely action of the Federal Reserve, participants generally judged that policy would be left unchanged, holding the funds rate at 6.5%. Those favoring a hold emphasized that, while the slowdown signals were real, the contraction the market was pricing had not yet arrived: growth was softening gradually rather than breaking, the labor market had not clearly deteriorated, and cost pressures, though not passing through to consumer prices, had not fully abated. Several members regarded an abrupt cut as a communication risk as much as an economic one, observing that easing had not been signaled in advance and that a move not yet fully priced by markets could provoke a disorderly repricing. One member dissented from this reading and favored a 25 bps cut, arguing that restrictive policy at 6.5% against 1.6% core inflation risked employment damage and that preemptive easing was the prudent insurance against mounting downside risk. On balance, the Committee's predictive judgment was for no change at this meeting, with the acknowledgment, shared even among those holding, that the balance of risks had shifted toward easing.

The Committee's own deterministic framework arrived at a different conclusion, recommending a 25 bps cut as the loss-minimizing policy. With r* estimated at 3.857 and inflation momentum essentially flat at 0.015, the framework read the current stance as meaningfully restrictive: a nominal neutral rate near 5.5% leaves 6.5% well above where conditions warrant, and unemployment momentum at -0.05 offered no reason to add restraint. The reference rules spanned a wide range. The Taylor rule returned 25 bps and the first-difference rule 0 bps, the latter aligning with the predictive hold by responding to inflation gaps and momentum rather than levels. The balanced-approach and ELB-adjusted rules both read 75 bps, driven by the still-wide unemployment gap below the natural rate. Members who weighted forward-looking curve, spread, and credit signals discounted those higher readings as ignoring the market's warning, while those inclined to hold found the first-difference rule the better fit for realized, rather than anticipated, deterioration.

Reconciling the two conclusions, the Committee noted that the gap between the predictive hold and the optimal 25 bps cut is itself informative: it reflects a stance the framework judges tighter than the data support, with below-target inflation and flat momentum leaving room to begin unwinding restriction safely. Members who endorsed the cut argued it would preempt credit-market deterioration and cushion slowing job growth without unanchoring prices, leaving policy still restrictive against any inflation resurgence. The Committee thus offers both conclusions with equal weight: it expects the Federal Reserve to hold at 6.5%, and it independently judges that the optimal policy at this meeting would be a 25 bps cut.

COMMITTEE VOTE

The predictive vote was 4-1 for no change, with one member favoring a 25 bps cut; on the framework's -25 bps recommendation, the Committee split 3 endorse, 1 decline, and 1 partial.

NOTES

On the optimal side, the inflation-focused member declined the framework's recommendation, holding that easing while upstream cost pressures persist and unemployment remains at 4.0% would risk re-igniting inflation prematurely and that restrictiveness near a 4.9% real rate is acceptable insurance against latent cost-push risk; the centrist agreed with the easing direction but not the full magnitude, judging that early slowing and still-tight labor did not yet force a 25 bps move.