OpenFed

POLICY STATEMENT | May 8, 2001

PREDICTED FED DECISION −50 bps

4.00%

OPENFED OPTIMAL RATE −25 bps

4.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to cut 50 bps, while its own deterministic framework judges 25 bps optimal — a 25 bp divergence between anticipated policy and loss-minimizing policy.

STATEMENT

The clearest feature of this meeting is a gap between what the Committee expects and what it judges best. On the predictive question, four of five members concluded that the real Federal Reserve will cut 50 basis points from the current 4.5% funds rate, while the Committee's own deterministic framework points to a smaller move of 25 basis points as the loss-minimizing choice. Both conclusions run in the same direction; they part company only on magnitude.

The case for the 50 bp prediction rests on a broad reading of softening activity against contained inflation. Members pointed to the Chicago Fed National Activity Index at -0.43, initial jobless claims elevated at 381,000, and a Beige Book that describes a slow pace of activity across nearly all districts, with industrial orders and production falling and labor market tightness having eased almost everywhere. Core PCE at 1.52% sits below the 2.0% objective, and members generally agreed the sharp rise in energy costs is a supply-side relative-price shock rather than demand-driven inflation, so it need not restrain easing. Weighing heavily for the majority was market pricing: the 3-month T-bill at 0.88 below the funds rate was read as consistent with roughly two 25 bp cuts already anticipated, such that under-delivering could itself tighten conditions against an elevated VIX of 24.44 and a Baa spread of 2.76. On this reading, a decisive move gets ahead of the slowdown and validates what markets have already priced.

The framework's 25 bp recommendation grows out of the same data but weights the reference rules against each other differently. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each pointed the opposite way, to +75 basis points, reflecting unemployment at 4.5% still below the estimated natural rate of 5.09% and an r* of 3.927. The framework, judging the reference rules reliable, nonetheless discounted those level readings as anchored to a labor tightness the Beige Book shows already unwinding, and leaned instead on the first-difference rule at -25 basis points, which keys off change rather than gaps. That momentum framing fits the recorded terms: inflation momentum of -0.155 shows prices decelerating, and unemployment momentum of +0.10 shows slack beginning to build. Members who engaged with this framing agreed the direction is unambiguous — easing is warranted — and that a measured 25 bp step eases into weakness without overshooting, preserving room if credit stress intensifies. Those who preferred 50 bps located their disagreement in magnitude, not direction: the labor-focused view wanted more insurance against deteriorating hiring momentum, and the market-weighted view held that a single 25 bp step undershoots what the -0.88 bill spread implies markets expect.

Taken together, the Committee's considered judgment is that the real Federal Reserve is most likely to cut 50 basis points, while its own framework identifies 25 basis points as the optimal, loss-minimizing move. The divergence is itself informative: it suggests the Committee reads the anticipated policy path as front-loading easing somewhat beyond what the data strictly justify, with the current 4.5% stance judged restrictive under either reading.

COMMITTEE VOTE	The predictive vote was 4-1 in favor of a 50 bp cut, with one member favoring 25 bps. On the framework's 25 bp recommendation, the optimal-side deliberation split 2-3: two members endorsed it as-is, and three agreed with the direction but not the magnitude, with none declining.
NOTES	*On the predictive side, the lone dissenter favored 25 bps rather than 50, arguing that with core inflation comfortably contained but not collapsing, unemployment still below the natural rate, and energy-cost pass-through a live risk, an aggressive cut risked over-easing; a measured 25 bp move would support growth while preserving optionality. On the optimal side, three members registered a partial stance — agreeing easing was the right direction but judging 25 bps insufficient, the labor-focused view wanting fuller insurance against rising jobless claims and the market-weighted view holding that the -0.88 bill spread justified going further.*