OpenFed

POLICY STATEMENT | June 20, 2001

PREDICTED FED DECISION −25 bps
3.75%

OPENFED OPTIMAL RATE HOLD
4.00%

KEY TAKEAWAY

The Committee unanimously expects a 25 basis point cut, but its own framework judges the loss-minimizing move to be a hold at 0 basis points, a divergence that split the Committee on the optimal side.

STATEMENT

Information reviewed by the Committee described an economy losing momentum with inflation running below target. Core PCE inflation stood at 1.66 percent, beneath the 2.0 percent objective, and the Beige Book characterized wage and price increases as moderate, with meaningful gains confined to energy and health care rather than broadening across sectors. Against that, the activity picture had clearly softened: the Chicago Fed National Activity Index at -0.92 pointed to meaningfully below-trend growth, initial jobless claims had risen to 394,000, and districts reported easing labor markets, weak manufacturing, and lackluster consumer spending. Participants also weighed financial conditions carefully, noting a Baa corporate spread of 2.74 and a VIX of 21.71 as signs of elevated but not acute stress, alongside a Beige Book observation that credit quality had slipped in many districts. With the 10-year to 2-year curve still positively sloped at 1.26 and the financial stress index moderate at 0.1659, participants generally agreed that markets remained orderly and that no acute crisis was at hand.

In assessing the likely policy path, participants converged quickly. The 3-month T-bill yield sitting 0.59 percentage point below the current 4.0 percent funds rate was read as markets having already priced in substantial further easing, and several judged that failing to deliver could risk a disorderly repricing and a tightening spiral in credit conditions. With inflation contained and growth weakening, participants who weight employment risk most heavily argued for getting ahead of labor-market deterioration, while those focused on inflation acknowledged that a below-target reading with momentum of only 0.07 gave no basis to resist a modest move. At the same time, the positive curve, moderate stress, and an unemployment rate of 4.4 percent still below the 5.09 percent natural rate led participants to firmly resist anything larger than a quarter point, which could itself signal alarm. On this basis the Committee's predictive judgment is that the real Federal Reserve will lower the target range by 25 basis points.

The Committee's own deterministic framework told a more divided story, and its loss-minimizing recommendation is to hold at 0 basis points. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each pointed to +75 basis points, driven mainly by unemployment sitting below the natural rate and an estimated r* of 3.92 that leaves the current 4.0 percent stance only barely restrictive. Pulling the other way, the first-difference rule, which responds to the direction of change rather than the level, read the deceleration and recommended -25 basis points. With inflation momentum near zero at 0.07 and unemployment momentum positive at 0.25, the framework balanced the hawkish level rules against the softening momentum signal and settled on a hold. Participants divided on whether that call was right. Those persuaded by it argued that below-target but stable inflation removes any urgency to cut, while visibly slowing activity removes any justification to hike, so a hold neither eases prematurely nor tightens into a slowdown. Others agreed with the framework's dovish tilt against the level rules but judged its magnitude too static: rising claims, slipping credit quality, and front-end market pricing all argued, in their view, for a modest insurance cut rather than watchful patience.

The gap between the predictive -25 and the optimal 0 quantifies how much weight markets and the majority of participants place on the growth slowdown relative to a still-firm labor level. Participants generally characterized current policy as close to neutral, with the level rules calling it slightly restrictive and the first-difference rule calling for ease. The Committee's view is that this divergence is genuine and worth recording: the case for easing rests on real-time deterioration and market-implied pricing, while the case for holding rests on contained inflation and labor conditions that remain, by the level metrics, tight.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, for a 25 basis point cut. On the framework's 0 basis point recommendation the Committee split three ways: one member endorsed the hold as-is, two declined it, and two agreed with its neutral-to-easing direction but not its magnitude.

NOTES

The two members who declined the hold, one weighting labor-market risk and one weighting market pricing, argued that the 4.4 percent unemployment level is backward-looking and that rising unemployment momentum of 0.25, elevated claims, and a front-end T-bill spread 0.59 below the funds rate warranted insurance easing now to preempt labor-market damage before it hardens.