OpenFed

POLICY STATEMENT | August 14, 2001

PREDICTED FED DECISION −25 bps

3.50%

OPENFED OPTIMAL RATE HOLD

3.75%

KEY TAKEAWAY

The Committee unanimously expects a 25 basis point cut, but its own policy framework judged the loss-minimizing move to be a hold at 0 basis points, and members split on whether to endorse that recommendation.

STATEMENT

Information reviewed for this meeting pointed consistently toward an economy growing below trend while inflation remained contained. Core PCE inflation stood at 1.46 percent, well below the 2.0 percent objective, with the Beige Book noting falling energy, fuel, and material input prices, easing wage pressures, and consumer prices held in check by domestic and foreign competition. The Chicago Fed activity index at -0.43 and initial jobless claims near 394,000 signaled softening activity, and participants described manufacturing declining across nearly all Districts, sluggish retail sales, and spillover into services. Credit conditions drew particular attention: reduced loan demand, tighter standards, and stable-to-deteriorating loan quality across most Districts, with a Baa spread of 2.89 pointing to real but not alarming borrowing-cost stress. Against this backdrop, all five participants judged that a 25 basis point cut was the appropriate expectation for policy, with none persuaded that a larger 50 basis point move was warranted given contained conditions.

Participants grounded that predictive conclusion in the balance between weakness and the absence of acute distress. With inflation subdued and slack ample, those weighting price risk most heavily saw little threat to guard against, judging that a measured cut could support activity without stoking prices, while cautioning against aggressive easing that might firm inflation if policy overshot. Those focused on employment emphasized the leading signals in claims and the softening pipeline, preferring to get ahead of deterioration rather than wait for it to surface in the 4.5 percent unemployment rate, which still sits below the 5.08 percent estimate of the natural rate. Participants attentive to markets pointed to the 3-month T-bill trading roughly 40 basis points below the current 3.75 percent funds rate as a clean signal that markets expect one more cut, not a hold, while the positively sloped yield curve at 1.23, a contained financial stress index of 0.15, and a VIX of 20.48 argued that no shock-sized response was needed. The predictive vote was that the real Federal Reserve would cut by 25 basis points.

The Committee's own deterministic framework reached a different conclusion, recommending that the loss-minimizing move was to hold at 0 basis points. The reference rules straddled the current rate rather than agreeing on direction: the Taylor rule pointed to a 75 basis point increase and both the balanced-approach and ELB-adjusted rules to 50 basis points, each reading the below-natural-rate unemployment as evidence of a tight labor market with limited slack, while the first-difference rule alone recommended -25 basis points, keying on momentum and change rather than levels. With the reference rules judged reliable this meeting, the framework reconciled that conflict toward a hold. Reinforcing that reading, the estimated r* of 3.895 sits close to the current 3.75 percent rate, suggesting policy is already near neutral rather than restrictive, and the momentum terms were both small, with inflation momentum at 0.185 and unemployment momentum at 0.1 indicating neither mandate deteriorating fast enough to force decisive action.

In deliberating on that recommendation, participants divided on whether the framework had it right. Some accepted the hold as the loss-minimizing balance: with policy near neutral, inflation contained but not dead, and credit stress strained but orderly rather than acute, they judged that holding preserves ammunition and avoids adding accommodation prematurely, with easing better deferred until credit standards or activity worsen further. Others declined, arguing that the level-based rules rest on a labor-market tightness the Beige Book directly contradicts, and that 'neutral' is still too tight when leading labor indicators are flashing and credit is tightening; for them a 25 basis point cut is prudent insurance and consistent with what markets are already pricing. A remaining participant agreed with the easing direction the data implies but not with a hold's magnitude, reading the observed indicators as favoring a modest cut while conceding that r* proximity makes that cut discretionary rather than urgent.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, for a 25 basis point cut. On the framework's own recommendation to hold at 0 basis points, the Committee split: two participants endorsed the recommendation as stated, two declined it, and one endorsed its direction but not its magnitude.

NOTES

Although the predictive vote was unanimous, the optimal-side deliberation drew substantive disagreement. Two participants declined the framework's hold: one emphasizing that leading labor signals, including elevated claims near 394,000 and the -0.43 activity reading, warrant preemptive support even with unemployment still below the natural rate, and one arguing that the negative T-bill spread and genuine credit tightening make a 25 basis point cut appropriate now rather than a hold. A further participant agreed easing was the right direction but disagreed with holding, judging that the observed data, which undercuts the level rules' tightness premise, points to a modest cut.