OpenFed

POLICY STATEMENT | December 4, 2001

PREDICTED FED DECISION −25 bps
1.75%

OPENFED OPTIMAL RATE −25 bps
1.75%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to cut 25 basis points and independently judges that same 25-basis-point cut, to 1.75%, to be optimal — predictive and framework conclusions coincide.

STATEMENT

Information reviewed by the Committee described an economy still soft in the aftermath of the September shock. Initial jobless claims stood at 465,000, and the unemployment rate at 5.4% remained above the estimated natural rate of 5.07%, with the direction of travel still unfavorable — unemployment momentum was positive at 0.2, indicating that slack was widening rather than stabilizing. The Chicago Fed National Activity Index at -0.32 pointed to below-trend growth, and the Beige Book described broadly soft conditions, weakening manufacturing, widespread layoffs and downsizings, and business lending that was contracting under tighter standards. Against this weakness, inflation posed no active constraint: core PCE at 1.42% sat well below the 2.0% objective, inflation momentum was negative at -0.115, and prices were generally stable with outright declines noted in autos, gasoline, and computers. Even participants most attentive to inflation risk found little to guard against here, observing that their usual objection to easing simply had nothing to bite on when disinflation, not inflation, was the operative risk.

In forming its predictive judgment, the Committee weighed the market-implied path heavily. The 3-month Treasury bill spread of -0.29 relative to the current 2.0% funds rate was read as the market pre-pricing a move of roughly a quarter point — not the -0.40 to -0.50 that a larger cut would imply — and the steeply positive 10-year/2-year curve at 1.89 suggested that markets anticipated accommodation working through toward eventual recovery rather than signaling panic. With financial stress moderate (index at 0.19, VIX at 24.08) and credit stress real but manageable (the Baa spread at 3.15 reflecting lingering strain), most participants judged a measured 25-basis-point cut both warranted and expected. The dissenting view held that with claims this elevated a quarter point risked being insufficient to protect employment, and argued for 50 basis points to front-load support. Others countered that an outsized move at an already-low 2.0% rate could itself signal alarm and unsettle still-fragile markets, and that market pricing indicated what was expected, not a jumbo cut. The Committee's predictive conclusion is that the real Federal Reserve will lower the target rate by 25 basis points.

Turning to its own deterministic framework, the Committee reached the same figure by an independent route. The reference rules diverged sharply: the Taylor rule pointed to +75 basis points, the balanced-approach and ELB-adjusted rules to +50, while the first-difference rule alone pointed to -25. Participants were persuaded that the level-based rules were stale in these conditions, since each anchors on an estimated neutral rate of 3.773% that assumes an economy near a healthy neutral — an assumption the credit and labor data directly contradict, and one the front-end market pricing appeared to reject. The first-difference rule, by responding to the change in conditions rather than to fragile level estimates of r-star, better captured the direction of travel: negative inflation momentum and rising unemployment momentum together argue for continued easing. The framework's loss-minimizing recommendation was -25 basis points, and the Committee judges that a cut of 25 basis points, bringing the target to 1.75%, is the optimal setting — enough to cushion impaired credit conditions and offset widening slack without risking overheating while inflation is falling below target, and not so aggressive as to broadcast alarm.

That the predictive expectation and the optimal determination coincide is, in the Committee's view, itself informative. The convergence indicates that the current 2.0% stance is modestly too tight for the softening trajectory, and that a proportionate quarter-point step both matches what markets have already priced and closes that gap without overshooting.

COMMITTEE VOTE

The predictive vote was 4-1 in favor of a 25-basis-point cut, with one participant favoring 50 basis points; on the framework's -25 basis point recommendation, the Committee endorsed the recommendation unanimously, 5-0.

NOTES

One participant, prioritizing labor-market risk, dissented from the predictive quarter-point call in favor of a 50-basis-point cut, arguing that claims at 465,000 signaled accelerating rather than stabilizing weakness, that a 25-basis-point move might be insufficient to defend employment, and that contained inflation gave ample cover to front-load support; this participant nonetheless joined the unanimous endorsement of the framework's -25 basis point recommendation as directionally acceptable.