OpenFed

POLICY STATEMENT | March 12, 2002

PREDICTED FED DECISION HOLD

1.75%

OPENFED OPTIMAL RATE −50 bps

1.25%

KEY TAKEAWAY

The Committee unanimously expects the real Fed to hold at 1.75%, yet its own loss-minimizing framework calls for a 50 bps cut to counter disinflation and rising labor slack.

STATEMENT

Information reviewed at this meeting described an economy that is soft but tentatively mending. Core PCE inflation stood at 0.91%, well below the 2.0% objective, and the Beige Book characterized wage and price pressures across most districts as 'subdued' to 'largely nonexistent,' with frozen wages, suspended bonuses, and skipped raises. The unemployment rate at 5.5% remained above the 5.07% natural rate, and initial claims near 399,000 were still elevated. At the same time, a majority of districts reported signs of improvement, temporary-help firms suggested employment was bottoming out, and the Chicago Fed activity index at -0.03 pointed to roughly trend growth. Financial conditions were calm: the stress index at 0.1533 and VIX at 19.59 showed no acute strain, the Baa spread of 2.78 was contained, and the yield curve at 1.76 was steeply positive with no inversion.

On the question of what the real Federal Reserve is likely to do at its coming meeting, all five participants arrived independently at a hold, and the Committee's predictive judgment is that policy will remain unchanged at 1.75%, a move of 0 basis points. The reasoning converged from different vantage points. With inflation this far below target, participants attentive to price risk saw no case to tighten; with the labor market slack but stabilizing, participants attentive to employment judged that further easing risked overshooting just as the recovery was consolidating. Participants weighing financial conditions observed that a cut could signal an alarm the credit data did not support, while the reading of market pricing was decisive for others: the 3-month bill sat only about 6 basis points above the current rate, so markets had no near-term move priced in, and the slight premium if anything leaned toward eventual tightening rather than easing.

The Committee's own deterministic policy framework reached a different conclusion, recommending a cut of 50 basis points as the loss-minimizing action. The reference rules were sharply split. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each prescribed +75 basis points, but those level-based rules lean on a neutral-rate estimate of 3.641, and several participants judged that figure stale against a below-trend activity reading and sub-target inflation. The first-difference rule, which responds to the direction of change rather than the level, prescribed -75 basis points, reflecting inflation momentum of -0.035 and unemployment momentum of +0.45 — disinflation deepening and joblessness still rising. The framework blended these opposing signals to land on -50 basis points, giving weight to the momentum case over the level rules' hawkishness. In reconciling this with their hold votes, participants generally accepted the easing direction as well grounded: with inflation more than a point below target and financial conditions comfortably permissive, a preemptive cut would insure against entrenched disinflation and further labor slack at little stability cost. The gap between the predicted hold and the optimal -50 measures the caution embedded in a wait-and-see posture that awaits firmer confirmation of recovery.

Taken together, the Committee's considered view is that the real Fed will hold at 1.75%, while its own framework judges that policy is modestly too tight and that 50 basis points of easing would better serve both mandate legs given below-target inflation, negative inflation momentum, and a still-rising unemployment rate.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, for no change at 1.75%. On the framework's -50 bps recommendation, the Committee split 2-3: two members endorsed the cut as-is, and three agreed with the easing direction but not its magnitude.

NOTES

Though the predictive hold was unanimous, three participants declined to endorse the full 50 bps on the optimal side, favoring a smaller step: with the T-bill spread flat and no cut priced in, and with the Beige Book noting tentative district-level improvement and labor bottoming, they judged that 50 basis points outran both market signals and residual inflation vigilance, preferring roughly a 25 bps move or awaiting confirmation.