OpenFed

POLICY STATEMENT | June 19, 2002

PREDICTED FED DECISION HOLD
1.75%

OPENFED OPTIMAL RATE −25 bps
1.50%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 1.75%, even as its own framework judges the loss-minimizing policy to be a modest 25 basis point cut.

STATEMENT

Information reviewed by the Committee described an economy expanding at a moderate but uneven pace, with the labor market lagging behind the broader recovery. Unemployment stood at 5.8%, above the 5.07% estimated natural rate, and initial jobless claims near 396,000 remained elevated; Beige Book contacts confirmed that labor markets 'remained slack in most Districts,' with retail sales flat and commercial real estate weak. Inflation gave no cause for concern in the other direction. Core PCE at 1.31% sat well below the 2% objective, and while participants flagged narrow, sector-specific cost pressures in steel, energy, and insurance worth watching for pass-through, price pressures were broadly 'in check.' Against this backdrop, and with the funds rate already at an accommodative 1.75%, participants saw no data compelling action in either direction: no inflation pressure justifying a hike, and no deterioration acute enough to force an immediate cut.

On the question of what the real Federal Reserve is likely to do, the Committee converged early and without dissent on holding steady. Several considerations reinforced one another. The market-implied path pointed to status quo, with the 3-month T-bill sitting only 7 basis points below the current rate — a mild easing bias, but far short of pricing a 25 basis point move. The yield curve remained steeply positive at 1.95, arguing against imminent recession, and although the VIX at 26.06 signaled lingering market anxiety, the financial stress index at 0.1233 was low and the Baa spread at 3.06, while somewhat wide, was not at crisis levels. Participants generally judged that tightening into this fragile, slack-heavy environment would risk destabilizing markets without an inflation rationale, while a cut now would surprise more than reassure. The predictive conclusion, held by all five members, is that the Federal Reserve holds at 1.75%.

The Committee's own deterministic framework arrived at a different answer: the loss-minimizing policy is a cut of 25 basis points. The reference rules split sharply. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all called for a level of 75 basis points, pulled upward by a high estimated r* of 3.518. Participants were skeptical that those level-based prescriptions fit the moment, since they read off an equilibrium neutral rate that sits uneasily against soft activity and below-target inflation. The first-difference rule, which responds to change and momentum rather than an assumed neutral rate, pointed instead to -50 basis points, and most participants found its logic the more persuasive read of the data: inflation momentum was negative at -0.055 and unemployment momentum negative at -0.05, evidence of disinflation and only slow labor improvement rather than overheating. The framework tempered the aggressive first-difference signal against the level rules to land on a measured -25 basis points — insurance against disinflation and a fragile labor recovery, taken while inflation runs cool enough to neutralize the usual objection to easing.

The gap between the two conclusions is instructive rather than alarming. It amounts to a single 25 basis point increment, and participants read it as a sign that the current stance is close to appropriate but perhaps marginally too tight relative to sub-target inflation and persistent slack, not badly miscalibrated. All members agreed the framework's easing direction was defensible and that the level rules' call for tightening should be rejected. The Committee therefore records its predictive judgment that the Federal Reserve holds at 1.75%, alongside its independent determination that the optimal policy at this meeting is a cut of 25 basis points.

COMMITTEE VOTE

The predictive vote to expect a hold at 1.75% was unanimous, 5-0. On the framework's -25 basis point recommendation, the Committee split 3-2: three members endorsed it as-is, and two agreed with the easing direction but not the magnitude of an immediate move.

NOTES

The two partial members accepted that policy should ease rather than tighten but questioned whether a 25 basis point cut was compelled now. One judged that, with the financial stress index low and the yield curve steeply positive, no single indicator created urgency for even a small cut and that the immediate magnitude exceeded what the data demanded; the other, anchoring on market pricing, noted the front end priced only about 7 basis points of easing, so a full 25 basis points overshot the mild market signal.