OpenFed

POLICY STATEMENT | October 30, 2002

PREDICTED FED DECISION −50 bps

1.25%

OPENFED OPTIMAL RATE HOLD

1.75%

KEY TAKEAWAY

The Committee expects the real Fed to cut 50 basis points to cushion broad-based weakness, yet its own framework judges a hold at 1.75% optimal, with policy already accommodative relative to a 3.271% neutral rate.

STATEMENT

The most striking feature of this meeting is the wide gap between what the Committee expects and what its own framework judges best. Members read the incoming data as uniformly soft: core PCE inflation of 1.46% sits well below the 2.0% objective, unemployment at 5.6% stands above an estimated natural rate of 5.06%, and initial jobless claims of 409,000 are elevated. The Beige Book described activity as sluggish, with weak retail sales, declining manufacturing, and labor markets characterized as 'lackluster in all Districts,' while the Chicago Fed activity index at -0.35 confirmed below-trend growth. Financial conditions reinforced this picture, with the VIX at 31.23, a Baa spread of 3.83, and a 3-month T-bill spread of -0.27 signaling that markets already anticipate easing. On this reading, most members concluded that the balance of risks lies clearly to the downside for growth and employment, and that subdued inflation leaves ample room to act.

Weighing these considerations, the Committee's predictive judgment is that the real Federal Reserve will cut its policy rate by 50 basis points. Members favoring the larger move argued that broad-based weakness, elevated credit stress, and market pricing together justify a decisive rather than a token step, and that the cost of acting too late on employment exceeds the cost of a modest overshoot while inflation remains contained. One member resisted this magnitude, judging that with the funds rate already low at 1.75% and the yield curve steep rather than inverted, the market was pricing closer to a 25 basis point move; on this view, a smaller cut would acknowledge the soft data and preserve limited policy room without the aggressive easing an inflation-weighted mandate counsels against. The Committee nonetheless expects the -50 basis point outcome to prevail.

The Committee's independent assessment of optimal policy points the other way, and the framework recommends no change to the policy rate. The reference rules span a striking range: the Taylor rule prescribes +75 basis points, the balanced-approach and ELB-adjusted rules each +50, while only the first-difference rule leans toward easing at -25. Three of the four level-based rules therefore judge policy already accommodative relative to an estimated neutral rate of 3.271%, and the loss-minimizing calculation balances those tightening signals against the lone easing signal to arrive at a hold. Several members found this reconciles with the underlying momentum terms: inflation momentum is positive at 0.435, suggesting price pressure is building rather than fading, while unemployment momentum is essentially flat at -0.05, indicating that labor slack, though real, is stable and not sharply deteriorating. The steep, un-inverted curve was read as a sign that easing is anticipated by markets but not fundamentally demanded now.

Members thus distinguished between insuring against a fragile economy and adding stimulus to a stance that rule logic already judges stimulative. From an inflation-weighted perspective, cutting with momentum positive would court risk not yet visible; from a data-at-face-value perspective, the literal center of gravity of the rules sits above the current rate and does not justify a cut. Members also cautioned that easing amid a VIX of 31.23 could itself signal panic. The Committee therefore concludes that a hold at 1.75% is the loss-minimizing choice, even as it expects the real Fed, weighting market fear and downbeat sentiment more heavily, to ease by 50 basis points. The divergence between the two conclusions quantifies that difference in emphasis.

COMMITTEE VOTE

The Committee's predictive vote was 4-1 in favor of a 50 basis point cut, with one member preferring 25 basis points. On the framework's recommendation to hold, the optimal-side deliberation split 3-1-1: three members endorsed the hold, one declined, and one agreed with the direction but not the magnitude.

NOTES

On the optimal side, the labor-focused member declined to endorse the hold, distrusting the high 3.271% neutral-rate estimate given uniformly sluggish activity and arguing that persistent slack above the 5.06% natural rate, elevated claims, and lackluster labor markets in all Districts warrant easing to insure against deterioration rather than awaiting lagging confirmation; the financial-stability member concurred in direction but only partially, judging that elevated volatility and wide credit spreads still called for a modest cut rather than standing pat.