OpenFed

POLICY STATEMENT | December 3, 2002

PREDICTED FED DECISION **HOLD**

1.25%

OPENFED OPTIMAL RATE **−25 bps**

1.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 1.25%, but its own framework judges the loss-minimizing policy to be a 25 bp cut, a modest divergence traced to soft inflation and widening slack.

STATEMENT

Information reviewed for this meeting described an economy growing slowly rather than contracting. Core PCE inflation stood at 1.53%, below the 2.0% objective, and the Beige Book pointed to nearly steady consumer and producer prices with subdued wage and salary pressures. At the same time, the labor market remained soft in nearly all Districts: the unemployment rate of 5.7% sat above the estimated natural rate of 5.06%, initial jobless claims were elevated at 377,000, and the Chicago Fed National Activity Index at -0.59 signaled below-trend growth. Financial conditions were strained but not seized. The VIX at 28.33 and a financial stress index of 0.1641 were elevated yet off crisis highs, the Baa spread of 3.35 reflected meaningful but not acutely widening credit stress, and a steeply positive 10-2 yield curve at 2.16 carried no inversion signal.

In assessing the most likely course of the real Federal Reserve, a clear majority judged that a hold at the current 1.25% was the probable outcome. Members holding this view stressed that policy is already quite accommodative after prior easing, that this accommodation needs time to work through the credit channels, and that no acute crisis or deflation spiral is forcing the Committee's hand. Several pointed to market pricing as corroboration: the 3-month T-bill spread near zero (-0.04) indicated markets expect no near-term move, and the steep positive curve suggested markets are pricing an eventual recovery path rather than deeper cuts. Against this, one member argued that the asymmetry of risks favors acting now, reasoning that with inflation muted, the danger of doing too little on employment outweighs the danger of over-easing, and that a steep curve and moderate stress readings tell us there is no crisis but not that the labor market will heal on its own. On balance, the Committee's predictive conclusion was a hold, 0 bps.

The Committee's own deterministic framework, applied independently, arrived at a different optimum: a 25 bp cut. The tension among the reference rules is what makes this call interesting. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each prescribed 75 bps, implying policy is well below neutral given an r* of 3.185. But members across stances discounted those level-based prescriptions on the grounds that the assumed neutral rate looks too high for current conditions, a reading the steep curve and market pricing tend to reinforce. The first-difference rule, which responds to the direction of change rather than a contested neutral level, pointed to -25 bps, and the framework's loss-minimizing output agreed with it. That momentum logic fit the data: inflation momentum was only 0.11, unemployment momentum was -0.15, and activity was running below trend. With core PCE below target and no inflationary pressure building, the case for the level rules' hike collapsed, and the framework read the current stance as modestly too tight.

The Committee therefore recorded two conclusions from the same deliberation. Its best estimate of the real Federal Reserve's action is a hold at 1.25%. Its independent judgment of the loss-minimizing policy is a 25 bp cut, understood as marginal insurance against widening slack at little cost while inflation sits comfortably below target. The divergence between the two is small and directional rather than sharp, and members generally agreed there is zero case for tightening at this meeting; the disagreement is only over whether a hold or a modest cut is the better step given the absence of urgency in market signals.

COMMITTEE VOTE

The predictive vote was 4-1 in favor of a hold at 1.25%, with one member favoring a 25 bp cut. On the framework's -25 bps recommendation, the optimal-side deliberation landed 3 endorse and 2 partial, with no member declining.

NOTES

On the predictive side, one member dissented in favor of easing, arguing that unemployment well above the natural rate, elevated claims, and below-trend activity, set against below-target inflation, made a modest cut a prudent insurance move against deepening labor slack rather than waiting for prior easing to transmit. On the optimal side, the two partial votes agreed with the direction of easing but resisted the full 25 bp magnitude this meeting, noting that the flat T-bill spread and steep positive curve show markets pricing no move and current policy near equilibrium, so the cut is defensible insurance but not an urgent necessity.