OpenFed

POLICY STATEMENT | January 22, 2003

PREDICTED FED DECISION **HOLD**

1.25%

OPENFED OPTIMAL RATE **−50 bps**

0.75%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 1.25%, but judges optimal policy to be a 50 basis point cut, a gap that quantifies how much the current stance leans against slack and disinflation.

STATEMENT

Information reviewed for this meeting described an economy that is soft but not deteriorating sharply. Core PCE inflation stood at 1.44%, well below the 2.0% objective, while the unemployment rate at 6.0% remained nearly a full point above the 5.05% estimate of its natural rate. The Beige Book characterized activity as 'sluggish,' 'subdued,' and 'soft,' with weak consumer spending and labor demand described as 'mostly flat,' and with compensation and final prices 'held down by competitive supply conditions.' Financial conditions were unsettled but not acute: the VIX at 29.01 signaled elevated anxiety rather than panic, the financial stress index at roughly 0.15 read as moderate, and the Baa spread of 3.33 pointed to meaningful borrowing-cost strain for lower-rated credit. The yield curve, at 2.29 on a 10-year/2-year basis, was steeply positive with no inversion signal, and the 3-month T-bill sat about 10 basis points below the funds rate, consistent with a mild easing bias rather than a priced-in cut.

Against that backdrop, most participants concluded that the appropriate near-term expectation for the real Federal Reserve is to leave the target unchanged at 1.25%. Participants favoring a hold emphasized that with inflation below target there was no case for tightening, and that with conditions soft but not collapsing—a positive Chicago Fed index of 0.39, a non-inverted curve, and credit still expanding—there was likewise no acute deterioration compelling a cut. Several stressed that policy at 1.25% is already low, that ammunition is limited, and that easing absent a genuine crisis could itself signal alarm and add volatility to fragile market confidence; with markets pricing only a slight easing tilt, moving more dovishly than expected carried its own risk. One participant dissented from this reading, weighing the employment mandate most heavily: with unemployment a full point above its natural rate and initial claims elevated at 402,000, and with inflation posing no constraint, this member argued a modest 25 basis point cut was warranted as insurance against continued labor-market weakness, while acknowledging the majority would likely hold.

The Committee also determined, through its own deterministic framework, what it judges optimal policy to be, and here the conclusion diverged sharply from the predictive call: the loss-minimizing recommendation was a cut of 50 basis points. Notably, the level-based reference rules pointed the other way, with the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all prescribing +75 basis points, each leaning on an estimated r* of 3.082 that implies current policy is well below neutral. The framework overrode those rules. Participants engaging the optimal case judged the level rules to be misreading a forward-looking, disinflationary environment: inflation momentum was negative at -0.325, signaling further drift below target rather than any overheating, and the wide unemployment gap dominated the loss calculation. The first-difference rule, which responds to the change in conditions rather than the level, aligned with this reading at -25 basis points, and the loss function integrated the depth of the employment gap and the disinflation to arrive at the fuller -50. Members reading the framework favorably concluded that the current 1.25% stance is not accommodative enough on a pure loss-minimizing basis, and that the gap between the hold and the -50 recommendation measures how much room remains to support both mandate legs.

The tension on the optimal side was less about direction than magnitude. Participants broadly accepted that the framework's easing bias was correct given below-target inflation and labor slack, but most were unwilling to endorse the full 50 basis points in a single step. Those weighting financial stress and market pricing argued that only moderate stress and a roughly 10 basis point front-end easing tilt justified something closer to the first-difference rule's -25 than a decisive -50, cautioning that the larger move risked overshooting relative to what conditions and markets actually signaled. The employment-focused view alone embraced the recommendation as-is, finding the -50 the correct answer when both mandate legs point to weakness. One member declined the framework's easing direction outright, holding that with disinflation modest rather than deflationary and three reference rules pointing to +75, adding stimulus while inflation risk lingered would be premature.

COMMITTEE VOTE

On the predictive question, the Committee voted 4 to 1 that the real Federal Reserve will hold the target at 1.25%. On the framework's -50 basis point optimal recommendation, the Committee split 1 endorse, 3 partial, and 1 decline—broad agreement on the easing direction but not on its full magnitude.

NOTES

The lone predictive dissent favored a 25 basis point cut, weighting the employment mandate most heavily: unemployment nearly a point above its natural rate, initial claims at 402,000, and no inflation constraint made the case for insurance against labor weakness, though that member conceded the majority would likely hold. On the optimal side, one participant declined the framework's easing direction entirely, arguing that with disinflation modest and the Taylor rule, balanced-approach, and ELB-adjusted rules all at +75 basis points against an r near 3.08, current policy is already accommodative and a cut would risk reigniting inflation prematurely.*