OpenFed

POLICY STATEMENT | March 11, 2003

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%, while its own framework judges a 25 bps cut optimal—a divergence the Committee reads as insurance-driven caution rather than disagreement over direction.

STATEMENT

The information reviewed pointed to an economy that is soft but not collapsing. Core PCE inflation stood at 1.17%, well below the 2.0% target, and the Beige Book noted that businesses have been unable to pass along rising energy and insurance costs—weak pricing power consistent with disinflationary rather than overheating conditions. Labor indicators leaned in the same direction: unemployment at 5.8% remained above the 5.05% estimate of its natural rate, initial jobless claims were elevated at 424,000, and the Chicago Fed National Activity Index at -0.18 signaled below-trend growth. Overlaying this was a large uncertainty premium, with the VIX at 33.61 and geopolitical concerns broadly constraining spending, even as the financial stress index at 0.1371 remained moderate and the yield curve, at a 2.22 spread, stayed positively sloped with no imminent recession signal.

Against that backdrop, four of five participants judged that the real Federal Reserve would most likely hold the funds rate steady at 1.25%, a 0 bps move. The reasoning for patience was less about the direction of the economy than about the nature of the shock: with much of the elevated VIX reflecting war-driven risk aversion, participants generally judged that a rate cut could not directly resolve geopolitical uncertainty, and that spending scarce policy room at an already-low 1.25% was hard to justify on those grounds. The modest 17 bps undershoot of the 3-month T-bill relative to the funds rate was read as a mild easing lean rather than a demand for immediate action—markets appearing to wait on resolution rather than press for a cut. One participant dissented from this predictive read, weighing employment risk more heavily and favoring a 25 bps insurance cut given widening labor slack and the absence of any inflation constraint.

The Committee's own deterministic framework arrived at an optimal recommendation of -25 bps. The reference rules diverged sharply: the level-based Taylor rule prescribed +75 bps and the balanced-approach and ELB-adjusted rules +50 bps, all anchored to a relatively high r* of 2.981, while the first-difference rule, responding to the change in conditions rather than gaps from an uncertain neutral rate, pointed to -50 bps. Several participants distrusted the level rules here, judging that their tightening prescription simply contradicted below-target inflation and rising slack. What tilted the framework's loss-minimizing answer toward easing was momentum: inflation momentum essentially flat at -0.01, and unemployment momentum rising at 0.2. The -25 bps figure splits between the aggressive first-difference reading and the moderate stress environment, delivering preemptive support without appearing panicked.

Participants generally characterized the gap between the expected hold and the optimal -25 bps not as a disagreement about direction but as the cost of caution—a stance held steady out of deference to geopolitical uncertainty while conditions soften. Several observed that a hold at 1.25% leaves real rates passively elevated as inflation drifts below target, effectively leaving accommodation on the table amid fragile credit markets, where the Baa spread at 3.28 signaled meaningful borrowing-cost stress. From the financial-stability perspective, insuring against credit strain was judged cheap while inflation is quiescent. The Committee concluded that a 25 bps cut represents the genuinely optimal call given deteriorating momentum and disinflation, even as it expects the real Federal Reserve to wait.

COMMITTEE VOTE

The predictive vote was 4-1 in favor of a hold at 1.25% (0 bps). On the framework's -25 bps recommendation, the optimal-side deliberation landed 4-1: four participants endorsed the recommendation as-is, and one endorsed the easing direction but not the full magnitude.

NOTES

On the optimal side, one participant registered a partial position—accepting the easing direction as defensible insurance while inflation runs 0.83 point below target and momentum is flat at -0.01, but favoring a smaller or delayed step over the full 25 bps to preserve optionality amid unresolved geopolitical uncertainty.