OpenFed

POLICY STATEMENT | April 29, 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%, while its own framework judges the loss-minimizing move to be a 50 bps cut — a divergence rooted in the same disinflation the hold camp acknowledges.

STATEMENT

The most striking feature of this meeting is that the case against cutting rested almost entirely on caution, not on any competing read of the underlying data. Core PCE stood at 1.23%, well below the 2.0% target, and the framework's inflation momentum term of -0.18 confirmed that prices were drifting lower, not stabilizing. Unemployment at 5.8% sat above the 5.05% natural rate; initial jobless claims at 444,000 were elevated; and the Chicago Fed activity index at -0.63 pointed to below-trend growth. The Beige Book described activity as 'lackluster' and labor markets as 'soft' or 'mixed' across most Districts. On the direction of risk, participants did not really disagree — even the member most attuned to inflation risk conceded there was no price pressure to resist and that sustained sub-target inflation was itself a threat worth guarding against.

Where participants divided was on whether soft-but-stable conditions warranted acting now. Two participants favored a 25 bps cut, weighing the labor-market slack and the -0.12 three-month T-bill spread, which they read as markets already pricing a modest easing bias consistent with a single move rather than an aggressive one. Three participants preferred to hold. Their argument turned less on strength than on the absence of acute stress and on the acknowledged uncertainty of the moment: the financial stress index at 0.0954 was low, the yield curve at 2.34 was positively sloped rather than inverted, VIX at 20.76 reflected post-war-onset jitters short of panic, and the Baa spread of 2.77 showed caution in corporate credit but no dysfunction. With the funds rate already at 1.25% and limited conventional room, and with the Beige Book itself noting it was 'too early to ascertain the full effect of the war' on confidence, the hold camp judged it prudent to observe post-war data before easing further. On that basis, the Committee's predictive conclusion is that the real Federal Reserve will leave the rate unchanged at 1.25%, a move of 0 bps.

The Committee's own deterministic framework reached a different conclusion: the loss-minimizing policy is a cut of 50 bps. That figure sits more dovish than any single reference rule. The Taylor rule, weighed against an r* estimate of 2.888, returned +75 bps, which participants across stances rejected as overweighting an inflation gap that is running below target rather than above it. The balanced-approach and ELB-adjusted rules each returned +25 bps, and the first-difference rule, which responds to deteriorating momentum, returned -25 bps. The framework's -50 bps recommendation reflects the weight it places on undershooting inflation and on scarce downside room near the effective lower bound — the logic that front-loading eases against a deflationary trap when conventional space is limited. Read together, the two conclusions frame the choice plainly: the framework judges the current 1.25% stance modestly too tight relative to the optimum, while the expected hold reflects the caution the data soften but do not overturn.

In deliberating on that recommendation, every participant accepted the easing direction, and each anchored on the first-difference rule's -25 bps as the more restrained signal that respects gradualism while acknowledging disinflation. The disagreement was one of magnitude and timing, not of sign. Participants repeatedly returned to the same restraint: with financial stress low, the curve steep, and war effects still 'too early to ascertain,' spending the ELB's limited room on a full 50 bps step risked overreacting to weakness that could prove transitory and to signaling an alarm the credit data did not support. The result is a framework that identifies real room to ease and a Committee that would move there more slowly than -50 bps alone would prescribe.

COMMITTEE VOTE

The predictive vote was 3-2 in favor of a hold at 1.25%, with two participants favoring a 25 bps cut. On the framework's -50 bps recommendation, the optimal-side deliberation split 0-0-5: no member endorsed the cut as-is and none declined it outright, with all five in partial agreement, backing the direction while judging the magnitude too large.

NOTES

The two predictive dissenters favored a 25 bps cut, arguing that labor-market slack at 5.8% unemployment, elevated claims, and falling inflation left ample room to ease without inflation risk, and that the -0.12 T-bill spread and weak fundamentals jointly justified a proportionate, orderly move now rather than waiting.