OpenFed

POLICY STATEMENT | September 9, 2003

PREDICTED FED DECISION HOLD

1.00%

OPENFED OPTIMAL RATE −50 bps

0.50%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 1.0%, even as its own policy framework judges optimal policy to be a 50 basis point cut to counter disinflation and widening labor slack.

STATEMENT

Information reviewed at this meeting pointed in one direction on the fundamentals and, at first glance, offered little reason to move policy in either direction. Core PCE inflation stood at 0.94%, less than half the 2.0% target, while unemployment at 6.1% remained well above the 5.05% natural rate, with initial jobless claims elevated at 422,000. Financial conditions, by contrast, were calm: the financial stress index was low at 0.10, the VIX was moderate at 18.85, the Baa credit spread was contained at 2.53, and the 10-year to 2-year spread was steeply positive at 2.66 with no inversion. The Beige Book described activity as picking up 'a notch,' with growing optimism and manufacturing edging higher, though consumer spending remained lackluster. Participants generally read this mix as offering no case to hike — subdued and, by some readings, decelerating inflation removes any overheating concern — and no acute crisis demanding emergency easing.

Against that backdrop, participants converged on the same predictive judgment: the real Federal Reserve is most likely to hold the federal funds rate at 1.0%. The reasoning ran along familiar lines. With the rate already historically low, the room and marginal benefit of a further cut are limited, and cutting near the effective lower bound was seen by some as a risk to stability rather than a salve for it. Market pricing reinforced the read — the 3-month T-bill spread of -0.06, essentially flat against the current rate, prices in no near-term move, and the steep curve signals expected recovery without imminent tightening. Disinflation argues against a hike; the modest improvement in activity and the absence of sharp labor-market deterioration argue against a cut. On that logic the predictive conclusion was a unanimous hold.

The Committee's own deterministic framework reached a materially different conclusion, and the divergence is the central story of this meeting. The loss-minimizing recommendation was -50 bps, a cut of a full 50 basis points from the current 1.0%. Three of the four reference rules converged on that figure — the balanced-approach rule, the first-difference rule, and the ELB-adjusted rule all at -50 — against the Taylor rule as the lone outlier at +75. Participants judged the reference rules reliable this meeting and treated the Taylor rule's hawkish print as a misread, since it leans on an unemployment gap while implicitly assuming inflation near target and ignores how far below target prices actually sit. The framework's loss terms sharpened the case: inflation momentum of -0.135 indicates disinflation still deepening rather than stabilizing, and unemployment momentum of +0.2 indicates slack widening, not closing, with r* taken at 2.583. The two mandate legs point the same way. The ELB-adjusted logic drew particular support — at a 1.0% rate the conventional floor is near, and acting now while stress is low was framed as cheap insurance against disinflation hardening into deflation, a far more destabilizing and harder-to-reverse outcome. Even a participant whose instinct is to resist cuts conceded the point, reasoning that when inflation is this low and falling, the honest inflation concern is that it is too low, and easing becomes the loss-minimizing choice.

The gap between the two conclusions — a predicted hold, an optimal 50 basis point cut — was read by participants not as a contradiction but as a signal that current policy at 1.0% is modestly too tight relative to the mandate, and that a hold, however defensible given contained stress and a steady curve, likely leaves the economy under-supported. The Committee therefore states both conclusions with equal weight: it expects the real Federal Reserve to hold at 1.0%, and it independently judges the optimal policy to be a 50 basis point cut.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, for a hold at 1.0%. On the framework's -50 bps recommendation, the Committee's optimal-side deliberation landed 4-1, with four members endorsing the cut as recommended and one supporting the direction but not the full magnitude.

NOTES

The lone qualification came from the member weighting market signals most heavily, who supported easing in direction but not in size: while the front-end T-bill spread of -0.06 validates a downward tilt, a 6 basis point spread is small, and with broad conditions calm — low stress at 0.10, a steep curve at 2.66, and a Beige Book showing activity up a 'notch' — a smaller precautionary step was judged to match what markets are actually pricing better than a full 50 basis point move.