OpenFed

POLICY STATEMENT | October 21, 2003

PREDICTED FED DECISION **HOLD**

1.00%

OPENFED OPTIMAL RATE **−50 bps**

0.50%

KEY TAKEAWAY

The Committee unanimously expects the real Fed to hold at 1.0%, while its own policy framework judges the loss-minimizing move to be a 50 basis point cut — a gap that quantifies a stance the Committee reads as mildly too tight.

STATEMENT

Information reviewed at this meeting pointed to a recovery that is broadening even as inflation and the labor market both fall short. Core PCE inflation stood at 1.02%, roughly half the 2.0% objective, and unemployment at 6.1% remained well above the 5.05% natural rate — over a full point of labor-market slack. The Beige Book described expansion picking up in ten of twelve districts, with consumer spending strengthening, manufacturing firming, and residential construction broadly strong, yet also noted manufacturing employment 'generally weak' and wages and prices 'relatively stable.' Initial jobless claims at 387,000 remained elevated. Financial conditions were calm throughout: the financial stress index at 0.089 and the VIX at 16.55 were subdued, the Baa spread at 2.39 was moderate, and the 10-year to 2-year spread at 2.49 was steeply positive, showing no recession signal.

On the question of what the real Federal Reserve will do at its coming meeting, participants converged quickly and completely on holding the funds rate at 1.0%. The reasoning cut in one direction from several distinct starting points. With inflation running a full point below target, there was no case to tighten — the live risk was disinflation, not overheating. With rates already at 1.0% and very accommodative, and with activity broadening across districts, participants judged a further cut both risky and unnecessary, likely to consume scarce easing room before the lag from firming output to hiring had a chance to play out. Market pricing reinforced this reading: the 3-month T-bill spread at -0.09 sat just below the funds rate, implying markets expected steady policy with at most a faint residual easing bias, so a hike would register as a genuine shock and a cut was not being demanded. The Committee's predictive judgment is therefore a hold at 1.0%.

The Committee's own deterministic framework reached a different conclusion, and the Committee treats that conclusion as its considered view of optimal policy: a cut of 50 basis points. The reference rules did not speak with one voice — the Taylor rule pointed to +50 basis points, but that reading assumes inflation near target and misreads the large undershoot, while the Balanced Approach and ELB-adjusted rules both returned -75 basis points and the First-Difference rule returned -50. With r* taken at 2.488 and inflation momentum negative at -0.065 — meaning the shortfall is widening, not closing — while unemployment momentum was flat at 0.0, both mandate legs were undershooting simultaneously. The framework's -50 basis point recommendation sits as a defensible loss-minimizing point between the divergent rules. Participants gave particular weight to the passive-tightening argument: with the funds rate near the effective lower bound and inflation drifting lower, holding lets real rates creep up as prices fall, quietly tightening into a still-fragile recovery. The gap between the predicted hold and the optimal -50 measures the extent to which the current stance is judged mildly too tight relative to the mandate.

Reconciling the two conclusions, participants were candid that the divergence reflects a real tradeoff rather than a contradiction. The hold captures what the real Fed is likely to do given firming activity and calm markets, and its caution about acting from an already-low rate; the -50 reflects the unmet mandate objectives that backward-looking data still show. Several participants who accepted the easing direction nonetheless resisted the full magnitude, arguing that with expansion broadening across ten districts and no financial distress, front-loading a decisive 50 basis point step risks overshoot and spends limited ammunition — a more measured move would address downside inflation risk while respecting improving conditions. Others held that the twin gaps and negative inflation momentum dominate, and that the passive real-rate tightening bites precisely the weak labor market the framework is built to protect.

COMMITTEE VOTE

The predictive vote to hold at 1.0% was unanimous, 5-0. On the framework's -50 basis point recommendation, the Committee split 2 in full endorsement and 3 in partial agreement, with no member declining the easing direction outright.

NOTES

The three partial members agreed with easing in direction but not magnitude: reasoning that with activity broadening across ten districts, calm markets, and only a -0.09 T-bill spread offering no urgent deflation scare, a full -50 basis point cut risked overshooting and spending scarce room, they favored a smaller, more cautious step while preserving ammunition.