OpenFed

POLICY STATEMENT | December 4, 2007

PREDICTED FED DECISION −25 bps	OPENFED OPTIMAL RATE −25 bps
4.25%	**4.25%**

KEY TAKEAWAY

The Committee expects the real Federal Reserve to cut 25 bps, and its own loss-minimizing framework independently arrives at the same -25 bps, with three reference rules pointing to a deeper -75 that both the framework and the members declined to follow.

STATEMENT

The defining feature of this meeting is how cleanly the Committee's forecast of policy and its own judgment of optimal policy converged, even as the mechanical reference rules pulled sharply in a more aggressive direction. Core PCE stood at 1.67%, below the 2.0% objective, and inflation momentum was mildly negative at -0.21 — enough to give every member room to contemplate easing without setting aside their concern about prices. The labor market remained relatively firm, with unemployment at 4.7%, still below the estimated natural rate of 5.05%, though unemployment momentum of +0.1 pointed to a gradual upward drift. Against that backdrop, participants pointed to genuine downside signals: a Chicago Fed activity index of -0.45 consistent with below-trend growth, initial claims around 344,000 that were elevated but not spiking, and a Beige Book describing slower activity across seven Districts, soft retail, a housing glut, and slowing loan demand.

Financial conditions did much of the work in moving members toward action. A financial stress index of 0.4443, a VIX near 23.8, and a Baa spread of 2.53 were read as meaningful but not panic-level strain, while a 3-month T-bill spread of -1.42 relative to the 4.5% funds rate was taken as an unambiguous market signal that easing is expected — and, several participants noted, that markets anticipate more than a single move over time. Members whose primary concern is credit conditions argued that reduced C&I; lending and softening loan demand warranted insurance easing to head off a self-reinforcing contraction. Those weighing employment most heavily read the same activity data as an early warning of hiring risk, arguing for a preemptive but measured step. The member most focused on inflation was the closest to holding, citing the Beige Book's flagged food and energy pass-through and lingering commodity-price risk, but was ultimately persuaded that the credit-stress evidence justified a modest cut so long as it was not the opening of an aggressive path. On that reasoning, the Committee judges that the real Federal Reserve will cut 25 bps at this meeting.

The Committee's independent policy framework arrived at the same destination, though the reference rules did not make it obvious. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each called for -75 bps, reflecting core inflation below target and unemployment beneath the natural rate against a real r* of 1.584. The first-difference rule, by contrast, recommended -25 bps, and it was this rule that the loss-minimizing recommendation followed. Members found the first-difference logic the more persuasive anchor precisely because it adjusts incrementally from the current stance rather than recomputing a full gap, avoiding overreaction to a noisy r* estimate and a single soft activity reading. The divergence between the three level rules at -75 and the framework's -25 was itself read as informative: it suggests the current stance is only modestly restrictive and needs gradual adjustment rather than shock easing.

Several considerations argued specifically against going to -75. The 10-year/2-year spread was positive at 0.99, showing no acute inversion and therefore no market demand for emergency-sized action. With unemployment still below the natural rate and the Beige Book's food and energy pass-through unresolved, participants judged that a jumbo cut risked both signaling alarm to fragile markets and undercutting inflation credibility at the wrong moment. Weighing the negative inflation momentum and building-but-not-acute employment risk against the elevated financial stress, the Committee concludes that the optimal policy at this meeting is a 25 bps cut — measured insurance that steadies credit conditions and honors market-implied expectations while preserving the option to ease further if labor or credit conditions deteriorate.

COMMITTEE VOTE

The predictive vote was unanimous at 5-0 for a 25 bps cut, and on the optimal side all five members endorsed the framework's -25 bps recommendation as-is, a 5-0 endorsement with no declines or partial dissents.