OpenFed

POLICY STATEMENT | March 11, 2008

PREDICTED FED DECISION −75 bps

2.25%

OPENFED OPTIMAL RATE HOLD

3.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to cut 75 bps under market and credit-stress pressure, but judges the optimal move to be a hold at 3.0%, with prior easing still transmitting and inflation near target.

STATEMENT

Information reviewed at this meeting pointed to a clear tension between what the Committee expects the real Federal Reserve to do and what its own framework judges to be sound. Core PCE inflation stood at 1.94%, essentially at the 2.0% objective, and the unemployment rate at 4.8% remained below the estimated 5.05% natural rate. At the same time, the signs of strain were real: the Chicago Fed National Activity Index at -0.79 indicated meaningfully below-trend growth, and the Beige Book described softening business activity across roughly two-thirds of Districts, with weak retail sales and a deepening contraction in residential real estate. Financial conditions were tight, with the stress index at 0.5643, the VIX at 26.36, and the Baa spread at 3.39 signaling elevated corporate borrowing costs. A 3-month T-bill spread of -1.58 relative to the 3.0% funds rate indicated that markets were pricing substantial further easing well below current levels.

On the predictive question, the weight of the deliberation fell decisively toward aggressive action. Participants attentive to labor risk emphasized that jobless claims at 348,000 and slowing hiring argued for preempting a rise in unemployment rather than waiting for it to appear in the headline rate, particularly with wage pressures described as modest. Those focused on credit conditions and market pricing judged that falling short of the priced-in path risked a destabilizing repricing precisely when the credit channel was already constricting. A more inflation-cautious view initially favored only a 25 basis point cut, citing the broad-based upward price pressure from materials and energy flagged in nearly all Districts, and in the second round moved to -50 as a compromise that acknowledged financial and growth stress without validating what it saw as a self-reinforcing easing bias. On that basis the Committee's predictive judgment settled on a 75 basis point cut, matching the market-implied path.

The Committee's independent framework arrived at a materially different conclusion: the loss-minimizing recommendation was 0 bps, a hold at 3.0%. The reference rules were split and, importantly, flagged as unreliable this meeting: the Taylor rule and the first-difference rule each pointed to only -25 bps, while the balanced-approach and ELB-adjusted rules called for -75 bps. With that reliability flag off, participants discounted the aggressive rules that echoed market pricing and gave weight to the milder readings. The case for a hold rested on the fundamentals. With r* estimated at 1.744, the 3.0% funds rate already sits below neutral in real terms, so policy is accommodative rather than restrictive; inflation momentum at a positive 0.145, combined with the near-universal materials and energy pressures in the Beige Book, argued against pushing real rates deeply negative. Several participants also noted that the prior 50 basis point cut is still transmitting with a lag, that a steeply positive 10-year/2-year spread of +1.86 suggested near-term recession risk had eased, and that cutting aggressively into sub-crisis stress could itself signal panic. The divergence between the expected -75 and the optimal 0 was read as the measure of how much the priced path is driven by market pressure rather than by data near mandate.

Taken together, the Committee's two conclusions are that the real Federal Reserve is likely to cut 75 basis points, while the optimal policy this meeting is to hold at 3.0% and let prior easing work through, remaining ready to act should labor markets crack or credit conditions move from strained to genuinely dysfunctional.

COMMITTEE VOTE

The predictive vote was 4-1 in favor of a 75 basis point cut, with one member preferring -50. On the framework's 0 bps recommendation, the optimal-side stance was four endorsements and one partial endorsement, with no member declining.

NOTES

The lone partial endorsement came from the labor-focused view, which agreed with holding back from the -75 predictive path but was not persuaded to stand entirely pat: with credit stress feeding demand risk and two-thirds of Districts softening, it favored a measured -25 as insurance against labor deterioration, arguing that waiting for employment to break before acting risks being too late even if current claims and wages remain contained.