OpenFed

POLICY STATEMENT | April 23, 2008

PREDICTED FED DECISION −25 bps

2.00%

OPENFED OPTIMAL RATE HOLD

2.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to cut 25 bps to support fragile credit conditions, but its own loss-minimizing framework concludes the optimal move is to hold at 0 bps.

STATEMENT

Information reviewed for this meeting pointed in two directions at once, and the Committee's predictive judgment turned on that tension. Core PCE inflation at 1.78 percent sits just below the 2.0 percent objective, which on its face leaves room to ease. But the Beige Book flagged widespread input-cost increases and wage pressures in several Districts, and the prior statement had already noted rising inflation expectations. Set against that, the signs of softening were real: the Beige Book described labor markets as 'mostly weakening' across most Districts, initial claims stood at 349,000, and the Chicago Fed activity index at -0.67 indicated growth running well below trend. Unemployment at 5.1 percent had crept modestly above the 5.05 percent natural rate, suggesting emerging but not acute slack.

The credit backdrop weighed heavily in the Committee's read of the likely policy path. A financial stress index of 0.52 and a Baa spread of 3.18 pointed to genuine borrowing-cost strain, arguing for continued support. Yet participants also emphasized that the acute phase had passed: the VIX at 20.26 was elevated but off crisis peaks, the 10-2 spread at 1.55 was positively sloped rather than inverted, and the 3-month T-bill spread of -0.92 signaled that markets had already priced in something on the order of a 25 to 50 basis point move rather than a repeat of the prior 75 basis point cut. Weighing the residual credit stress against the calmer volatility environment, the substantial cumulative easing already delivered to reach 2.25 percent, and the caution warranted by input-cost pressures, all members converged on a modest 25 basis point cut as the most likely centrist outcome for the real Federal Reserve. One member, most attentive to inflation risk, made clear a personal preference to pause but accepted the 25 basis point step as the balanced consensus.

The Committee's own deterministic framework reached a different conclusion: the loss-minimizing recommendation was 0 bps, a hold at 2.25 percent. The framework's reference rules split sharply. The Taylor rule and the first-difference rule both returned 0, while the balanced-approach and ELB-adjusted rules pointed to -75. With reference rules judged unreliable this meeting, the framework leaned on the loss function, which landed on a hold. The reasoning behind that number is grounded in near-neutral gaps: with core inflation at 1.78 percent close to target and unemployment essentially at its natural rate, neither gap called for stimulus. Inflation momentum was positive at 0.135 and unemployment momentum only 0.05, small drifts rather than sharp deterioration. Against an estimated r* of 1.728, policy at 2.25 percent was already accommodative, not restrictive, and the negative T-bill spread indicated the front end had effectively pre-eased conditions.

Engaging with this framework after the predictive vote was final, participants read the divergence as a signal that the expected easing path leaned on financial-stress insurance and market-priced expectations rather than on the underlying output and inflation gaps. Members most focused on labor and credit noted that their -25 leans reflected residual caution about slowing jobs and fragile spreads, but that stress was stabilizing rather than worsening, that prior easing was still transmitting, and that further cuts risked feeding the widespread input-cost pressures the Beige Book had flagged. The first-difference logic proved persuasive across perspectives: with only small momentum shifts, do not over-adjust from an already-eased stance, and preserve ammunition should credit stress genuinely re-accelerate. The Committee therefore concluded that holding at 2.25 percent, not cutting, would be the optimal policy this meeting.

COMMITTEE VOTE

The Committee's predictive vote was unanimous, 5-0, in expecting a 25 basis point cut. On its own framework's 0 bps recommendation, the Committee also landed in full agreement, with all five members endorsing the hold as optimal.