OpenFed

POLICY STATEMENT | July 29, 2008

PREDICTED FED DECISION HOLD

2.00%

OPENFED OPTIMAL RATE −25 bps

1.75%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 2.0%, even as its own policy framework judges a 25 basis point cut to be the loss-minimizing course.

STATEMENT

Information reviewed at this meeting pointed to an economy softening on the growth side while price signals remained conflicting. The Chicago Fed National Activity Index at -1.21 indicated activity well below trend, initial jobless claims at 434,000 were elevated, and the unemployment rate at 5.5% stood above the estimated 5.05% natural rate. The Beige Book reinforced this reading, describing sluggish consumer spending, declining manufacturing, weak real estate, and restrained lending. Against that softening backdrop, however, all twelve Districts reported elevated or increasing price pressures, with input costs rising across fuel, metals, food, and chemicals. Yet core PCE at 1.83% remained just below the 2% objective, and participants generally read the headline pressures as commodity- and energy-driven rather than a sign of accelerating wage-based inflation.

On the question of what the real Federal Reserve is likely to do, the Committee converged, in successive rounds, on a hold at the current 2.0%. Participants attentive to inflation risk judged that broad-based price pressures and the prior meeting's hawkish shift ruled out a cut, while conceding that a hike into fragile credit conditions would be an unwarranted shock with core inflation still below target. Participants weighing labor-market and financial-stability risks noted that a Baa spread of 3.13 and a financial stress index of 0.5151 signaled meaningful, though not crisis-level, tightness, arguing against adding any tightening while also stopping short of demanding emergency easing. Market-based readings pointed the same way: a 3-month T-bill spread of -0.29, sitting below the funds rate, and a positively sloped 10-year-2-year curve at +1.44 were viewed as inconsistent with an imminent move in either direction. The VIX at 22.03 was seen as moderately elevated but not panicked. The predictive judgment was therefore a hold at 2.0%.

The Committee's own deterministic framework reached a different conclusion, recommending a 25 basis point cut to loss-minimize under current conditions. The reference rules were split and were flagged as not reliable this meeting: the Taylor rule read 0 bps, the first-difference rule read -25 bps, and both the balanced-approach and ELB-adjusted rules read -75 bps. With an estimated r* of 1.741, inflation momentum of -0.06, and unemployment momentum of +0.35, participants supporting the optimal cut found the first-difference logic most persuasive, reading a modest, incremental easing as the appropriate response to still-rising unemployment and slightly softening, rather than accelerating, inflation. They discounted the -75 bps prescriptions as outliers given the unreliability flag, and judged that a quarter point closely matched the roughly 29 basis points of easing implied by the T-bill spread. The framework's -25 bps was thus endorsed as the loss-minimizing stance, with several participants noting explicitly that the gap between it and the predicted hold reflects institutional caution about inflation expectations rather than a difference over the direction of the underlying data.

Weighing these considerations together, the Committee affirmed both conclusions with equal standing: the real Federal Reserve is expected to leave the target rate unchanged at 2.0%, while the framework identifies a 25 basis point reduction as optimal. The divergence was understood as genuine and worth naming — a stance held modestly tighter than pure conditions would prescribe, with elevated headline inflation and expectation risk restraining action that the growth, labor, and credit data would otherwise support.

COMMITTEE VOTE

The predictive vote to expect a hold at 2.0% was unanimous, 5-0. On the framework's -25 bps recommendation, the Committee's optimal-side deliberation split 4-1 in favor of endorsement.

NOTES

The lone objection to the framework's -25 bps came from the inflation-focused view, which held that inflation momentum at -0.06 is essentially flat rather than a genuine turn lower, that all twelve Districts reporting rising prices contradicts a soft inflation reading, and that with r at 1.741 policy is already accommodative — favoring the Taylor rule's 0 bps and warning that cutting before inflation clearly recedes risks unanchoring expectations.*