OpenFed

POLICY STATEMENT | August 2, 2011

PREDICTED FED DECISION **HOLD**

0.00%-0.25%

OPENFED OPTIMAL RATE **HOLD**

0.00%-0.25%

KEY TAKEAWAY

The Committee expects the real Fed to hold at 0.0%-0.25%, and its own framework independently confirms that same stance as loss-minimizing, with all four reference rules returning 0 bps at a lower bound that truncates rules that would otherwise want lower.

STATEMENT

The defining feature of this meeting was the near-complete absence of tension: from the opening round through the framework deliberation, all five members arrived at the same place, and the deterministic engine landed there too. Core PCE at 1.22% sits well below the 2.0% objective, and members generally judged that the Beige Book's note of reduced commodity cost pressures corroborated the view that recent price firming is transitory rather than the start of an overshoot. On the other side of the mandate, unemployment at 9.2% remains far above the 5.2% natural rate, with initial jobless claims near 398,000 and the Chicago Fed National Activity Index at -0.46 pointing to below-trend growth. Both legs of the mandate, in other words, argued in the same direction: for maximally accommodative policy. The complication is that the target range already stands at 0.0%-0.25%, at the effective floor, so the accommodation members would otherwise favor is not available through the funds rate.

That constraint is what unifies the Committee's two conclusions. On the predictive question, participants judged that the real Federal Reserve will hold the target range unchanged at 0.0%-0.25% with continued reinvestment. Members focused on market pricing observed that the 3-month T-bill spread at -0.025 signals no expected near-term move and, if anything, a slight easing bias, while the 10y-2y spread at 2.33 remains steeply positive and gives no recession signal that would force dramatic action. Members focused on financial stability reached the hold from a different angle: the financial stress index at 0.111 is low, the Baa spread at 2.74 is moderate, and while the VIX at 24.79 is elevated, it reflects debt-ceiling uncertainty repeatedly flagged in the Beige Book rather than acute credit or funding stress. The recurring judgment was that with confidence fragile amid that fiscal uncertainty, a destabilizing move in either direction would do more harm than good.

The Committee's own framework reached the same figure and, importantly, reached it as an independent determination rather than as an echo of the predictive vote. The deterministic engine recommends 0 bps, and all four reference rules -- the Taylor rule, the balanced-approach rule, the first-difference rule, and the ELB-adjusted rule -- return 0 bps, with reference rules judged reliable this meeting. Several members were candid that this convergence is a constrained one: with an estimated r* of 0.662 and an unemployment gap this large, the Taylor and balanced-approach rules would want a rate below zero, and it is the ELB-adjusted rule, recognizing that policy is pinned at the floor, that truncates them at zero. The loss-function terms reinforce the case for holding rather than acting urgently -- inflation momentum at 0.135 and unemployment momentum at 0.100 are both weak, signaling no regime change demanding an emergency response in either direction. The Committee therefore judges 0 bps to be the loss-minimizing stance: the funds-rate tool is exhausted at the lower bound, below-target inflation offers no basis to hike, and no acute stress justifies extraordinary action.

Taken together, the predictive and optimal conclusions coincide at 0.0%-0.25%. Members were explicit that this coincidence should not be read as complacency, particularly on the employment side, where the rate tool is described as exhausted rather than the underlying labor-market risk as resolved; continued reinvestment and the extended-period stance are understood to be carrying the accommodative work the funds rate cannot. The Committee's read is that the current range is already appropriately calibrated for below-target inflation and deep slack, and that holding steady preserves optionality to respond promptly should commodity effects prove non-transitory or should debt-ceiling turmoil translate into a measurable spike in financial stress.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, in favor of holding the target range at 0.0%-0.25%. On the optimal-side deliberation, all five members endorsed the framework's 0 bps recommendation as-is, a 5-0 endorsement with no declines or partial agreements.