OpenFed

POLICY STATEMENT | May 10, 1994

PREDICTED FED DECISION **+50 bps**

4.25%

OPENFED OPTIMAL RATE **HOLD**

3.75%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to raise rates 50 bps, but its own deterministic framework judges the optimal move to be 0 bps—a hold—leaving a sharp gap between the priced-in path and the loss-minimizing call.

STATEMENT

Information reviewed for this meeting described an economy expanding solidly across most Districts. The Beige Book pointed to near-capacity production in autos, steel, and building materials, double-digit retail gains, and lending picking up, while a recent surge in home sales—characterized as temporary and driven by prior tightening—underscored the resilience of demand. Core PCE inflation at 2.14% ran modestly above the 2.0% objective. Against that, unemployment at 6.4% remained nearly a full point above the 5.45% natural rate, and initial jobless claims at 371,000 were judged elevated-to-moderate but stable rather than deteriorating. Financial conditions were calm throughout: the stress index sat at 0.0843, the VIX at 15.19, and the Baa spread at 1.35, with the yield curve positively sloped at 1.2 and no recession signal from the bond market.

On the question of what the real Federal Reserve will do, participants converged quickly on a 50 basis point increase. The most literal market signal weighed heavily here: the 3-month T-bill sits 0.49 above the current 3.75% funds rate, a spread that anticipates almost exactly a half-point move already discounted by markets, so a firm step would validate priced expectations rather than deliver a disorderly surprise. Those emphasizing inflation risk argued that with real funds only around 1.6% and demand accelerating, policy remains accommodative and sustained action is needed to keep a 2.14% overshoot from becoming entrenched. Those most attentive to the labor market were more reluctant—with slack still real and the job recovery incomplete, some would have preferred a smaller 25 basis point step—but judged the 50 defensible given the breadth of growth, calm markets, and the absence of any labor deterioration. From a stability standpoint, minimal stress and tight spreads left ample room to move while conditions are orderly, avoiding sharper and more disruptive tightening later.

The Committee's own deterministic framework arrived at a materially different conclusion. Its loss-minimizing recommendation was 0 basis points—a hold. The level-based reference rules pointed sharply the other way: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all read -75 bps, driven mechanically by the wide unemployment gap. But the first-difference rule read 0 bps, and it was that momentum-respecting logic the framework followed, with inflation momentum flat at 0.0 and unemployment momentum only barely positive at 0.05. With an estimated r* of 0.95 placing the neutral nominal rate near current levels, the framework read the stance as roughly neutral rather than restrictive—declining both the aggressive easing the level rules implied and any further tightening. Participants across the spectrum found this reasoning credible even where they diverged from it: with momentum quiescent and no financial stress, the framework refuses to ease into an above-target, above-trend environment.

The gap between the predicted 50 basis point move and the optimal 0 is itself the central story of this meeting. It reflects a real Federal Reserve front-running inflation risk faster than the labor data and flat momentum alone would justify, while the loss function weights stability and avoids overshoot in either direction. The Committee wishes to make plain that both are its own considered conclusions from the same deliberation: it expects a 50 basis point increase, and it judges a hold at 0 basis points to be the optimal policy—neither easing into firm demand nor adding restraint onto a labor market that has not yet closed its slack gap.

COMMITTEE VOTE	The predictive vote was 4 to endorse a 50 basis point increase with 1 partial concurrence. On the framework's 0 basis point optimal recommendation, the Committee split 2 endorse and 3 partial, with none declining outright.
NOTES	*The three partial concurrences on the optimal side agreed with the direction—no easing—but not the magnitude. Those emphasizing inflation risk and financial-stability room judged a flat hold too passive given above-target inflation and firm demand, preferring a firmer step, while the member leading with market pricing argued the 0 bps hold understates the tightening markets have already discounted; the labor-focused and data-dependent members endorsed the hold as-is, seeing no momentum-driven urgency to move further against a slack labor market.*