OpenFed

POLICY STATEMENT | June 29, 1994

PREDICTED FED DECISION +25 bps

4.50%

OPENFED OPTIMAL RATE HOLD

4.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to raise rates 25 bps, but its own framework judges the optimal move to be 0 bps — a hold — with the modest gap reflecting residual inflation vigilance over above-target core PCE.

STATEMENT

Information reviewed at this meeting described an economy in continued expansion. Core PCE inflation stood at 2.27%, modestly above the 2% objective, while the unemployment rate at 6.0% remained above the 5.45% estimate of its natural rate, indicating that some labor-market slack persists. The Beige Book pointed to broadening activity: brisk construction, rising demand for loans, strengthening manufacturing, and rising industrial materials prices, though wage pressures were reported as moderate and finished-goods prices restrained by competition. Financial conditions were notably benign. The financial stress index at 0.0849 was low, the VIX at 14.42 was subdued, the Baa credit spread at 1.54 was tight, and the yield curve at 1.12 was positively sloped with no recession signal. Members generally read this as a setting in which prior tightening in 1994 had removed much of the accommodation carried over from the year before, and in which credit markets could absorb further firming without strain.

In predicting the action the real Federal Reserve would take, participants converged on a measured 25 bps increase, though not without genuine tension over the appropriate size. Two members entered the meeting favoring a 50 bps move, arguing that above-target inflation combined with calm markets and above-trend growth left room for more decisive firming; one hawkish member briefly revised upward to 50 bps on that same logic. What pulled the group back toward a measured pace was the market-signal reading: the 3-month T-bill spread at -0.1 sits slightly below the current 4.25% funds rate, implying markets anticipate modest continued tightening rather than an aggressive jump. Participants attentive to financial stability judged that moving 50 bps against a short end not pricing it risked a disorderly repricing, and that rising mortgage rates were already slowing housing in some districts. Weighing moderate wage pressures and persisting slack against inflation only modestly above target, the majority settled on 25 bps as the step that preempts inflation while respecting what pricing actually implied. One member, weighting employment most heavily, declined to support any hike at all, favoring a hold on the view that adding restriction to a still-slack labor market was unwarranted while no cut was justified either.

The Committee's own deterministic framework arrived at a different conclusion: the loss-minimizing recommendation was 0 bps, a hold. The reference rules diverged sharply. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each called for -75 bps, driven by the unemployment gap and an estimated r* of only 1.115. The first-difference rule, which keys off the direction of policy change rather than a contestable neutral-rate level, pointed the other way at +25 bps. The framework balanced these against negative momentum in both series — inflation momentum at -0.13 and unemployment momentum at -0.05 — indicating that price pressures are easing and joblessness slowly declining, and landed on a hold. Participants found this reading coherent. The case for the level rules' deep cut rested on a shaky r* estimate and ignored that substantial 1994 tightening is still transmitting; a 75 bps cut mid-cycle, against above-target inflation, would look erratic and destabilize expectations. With the nominal neutral rate not far above the current 4.25%, and with calm credit conditions arguing against any abrupt move in either direction, holding lets prior firming work.

The gap between the predicted 25 bps and the optimal 0 bps is therefore small, and the Committee read that narrowness as a sign policy is already near appropriately firm. The members endorsing the framework's hold emphasized easing inflation momentum, a healing rather than deteriorating labor market, and market pricing near current levels. Those preferring a modest step characterized their divergence as residual inflation vigilance — a fine-tuning nudge, not a change in direction — noting that competitive margins can compress quickly and that firmness remains safe given benign markets. Both readings reject the level rules' call for aggressive easing; the disagreement is confined to whether to hold or add one measured step.

COMMITTEE VOTE

On the predictive question, the Committee voted 3-1-1 for a 25 bps increase (three members for 25 bps, one for 50 bps, one for no change). On its own framework's 0 bps recommendation, the optimal-side deliberation split 3-2: three members endorsed the hold as-is, and two agreed with the direction but preferred a modest 25 bps step.

NOTES

On the optimal recommendation, two members entered partial dissents: while accepting that no cut was warranted, they read the framework's hold as a floor rather than the preferred outcome, judging that above-target core PCE at 2.27% and the risk of quickly compressing margins justified a modest 25 bps firming on top of the framework's zero, with calm financial conditions making that step safe.