OpenFed

POLICY STATEMENT | August 9, 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, while its own framework judges the loss-minimizing move to be 0 bps — a hold that most members endorse but two would nudge modestly firmer.

STATEMENT

Information reviewed by the Committee described an economy expanding at a solid pace. Core PCE inflation stood at 2.19 percent, modestly above the 2.0 percent objective, and the Beige Book documented a broadening range of goods with rising prices, tightening labor markets, and faster wage growth in some skilled occupations. Above-trend growth was evident in a Chicago Fed index reading of 0.82. Against that firming backdrop, the unemployment rate of 6.1 percent remained above the 5.43 percent estimate of its natural rate, leaving genuine slack in the labor market, though jobless claims of 338,000 were moderate and showed no sign of deterioration. Financial conditions were notably calm: a financial stress index of 0.0639, a VIX of 12.54, a Baa spread of 1.46, and a positively sloped yield curve at 1.07 together indicated no fragility and no recession signal.

In forming its judgment about the policy action the real Federal Reserve is most likely to take, the Committee weighed a real tension between two readings of the same data. Several members argued for a firmer 50 basis point step, emphasizing that inflation is above target, that price pressures are broadening, and that calm, liquid markets have ample room to absorb a decisive move without destabilization — acting now, in their view, reduces the risk of sharper corrections later. Others favored a more measured 25 basis point increase, giving particular weight to the 3-month T-bill sitting only about 20 basis points above the current funds rate, the cleanest market-implied read of the near-term path and one that prices roughly a quarter point rather than a half. These members also noted that inflation is only slightly above target, not an emergency, and that residual labor slack argues against front-loading an aggressive move. One member who had initially favored 50 basis points revised to 25, persuaded specifically that the T-bill spread is the most concrete market-priced magnitude available.

The Committee's predictive judgment settled on a 25 basis point increase.

Turning to its own deterministic assessment of optimal policy, the Committee arrived at a materially different conclusion: the loss-minimizing action is 0 basis points, a hold at the current 4.25 percent. The framework's level-based reference rules — the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule — each pointed to a 75 basis point cut, driven largely by the wide unemployment gap set against a small inflation overshoot. Members across the table distrusted those deep cuts, judging them backward-looking and hard to reconcile with above-target inflation and an economy the Beige Book describes as expanding solidly. The first-difference rule, by contrast, recommended a 25 basis point increase, capturing the direction of travel that momentum and market pricing also suggest. With inflation momentum essentially flat at 0.01 and unemployment momentum negative at -0.25 — slack shrinking rather than widening, but no price acceleration to fear — the framework nets these opposing signals to a hold. An r* of 1.288 alongside roughly 2 percent inflation implies a neutral nominal rate near 3.5 percent, leaving the current stance close to neutral, neither clearly restrictive nor clearly accommodative. Holding thus refuses the unwarranted easing the level rules imply while avoiding a tightening that flat inflation momentum and remaining slack do not demand.

The gap between the predictive 25 and the optimal 0 is instructive rather than stark: on the optimal side, every member rejected easing outright, and the genuine dispute was hold-versus-hike, not hold-versus-cut. Members focused on employment saw a labor recovery healing on its own and no case for a rescue cut; members focused on financial stability saw calm conditions that would be endangered, not helped, by a deep cut fueling credit froth. The Committee judged that with markets untroubled and inflation momentum near zero, there is room to wait for clearer signals before moving.

COMMITTEE VOTE

The Committee's predictive vote landed 3-to-2 in favor of a 25 basis point increase, with two members preferring 50 basis points. On the framework's 0 basis point recommendation, the optimal-side deliberation split 3 endorse to 2 partial, with none declining.

NOTES

The two partial positions came from the members whose lenses pointed firmer: one emphasizing inflation risk and a lean toward leaning against broadening price pressures before they build, the other citing market pricing — the roughly 20 basis point T-bill spread — as favoring a modest firming step; both agreed with the framework's rejection of any easing but would prefer a small hike over standing pat.