OpenFed

POLICY STATEMENT | September 20, 1994

PREDICTED FED DECISION +25 bps

5.00%

OPENFED OPTIMAL RATE HOLD

4.75%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to firm policy by 25 bps, while its own deterministic framework judges the optimal move to be 0 bps — a hold — a divergence of only one increment.

STATEMENT

The information reviewed for this meeting described an economy still expanding but cooling at the margin. Core PCE inflation stood at 2.19%, modestly above the 2.0% objective, with the Beige Book noting more reports of tightening labor markets and industrial materials prices edging up, even as competitive pressures continued to restrain finished-goods prices and wage growth was described as still 'modest.' Unemployment at 6.1% remained above the 5.43% natural rate, pointing to residual labor slack, while consumer spending was decelerating and higher rates were already restraining single-family home sales and real-estate lending. Financial conditions were calm throughout: the financial stress index at 0.0738, the VIX subdued at 14.45, the Baa spread contained at 1.51, and a positively sloped yield curve at 1.09 offering no recession signal. Notably, the 3-month Treasury bill sat 13 basis points below the current 4.75% funds rate, indicating that markets were not pricing an imminent hike.

In assessing what the real Federal Reserve is most likely to do, participants worked from the prior statement's guidance that tightening was 'expected to be sufficient, at least for a time' — an explicit pause signal — and weighed it against above-target inflation and high resource utilization. Two members opened favoring a 50 basis point move, judging that calm credit markets could absorb firming without strain. On reflection, both stepped down to 25 basis points: the negative T-bill spread and subdued volatility persuaded them that a jumbo hike would surprise markets positioned for restraint, delivering avoidable financial-stress risk for only a marginal inflation benefit given an overshoot of less than a fifth of a percentage point. One member weighted labor-market slack most heavily and held to no change, arguing that piling on restriction ran against both the prior pause guidance and the still-incomplete employment recovery, while seeing no job-market deterioration that would justify a cut. The balance of members settled on continued gradual firming, and the Committee's predictive judgment is a 25 basis point increase.

The Committee's own deterministic framework arrived at a different conclusion: the loss-minimizing recommendation is 0 basis points — a hold at 4.75%. Here the reference rules diverged sharply among themselves. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each called for a substantial 75 basis point cut, driven largely by the unemployment gap and an estimated r* of 1.417. Members treated those level-based prescriptions with caution: leaning on an uncertain neutral-rate estimate to justify deep easing sat poorly against positive inflation momentum of 0.025, an economy the Beige Book described as still expanding, and materials prices edging higher. The first-difference rule, which responds to the change in conditions rather than the level gap, pointed to 0 and drew the most support. With unemployment momentum negative at -0.15 — joblessness falling rather than rising — the strongest trigger for easing was absent, and the calm-but-rate-sensitive state of credit markets argued against re-loosening conditions. Holding neither undoes the restraint already in place nor mechanically over-cuts on a noisy slack estimate.

Read together, the predictive and optimal conclusions frame the meeting's central point: the debate is genuinely hold-versus-nudge, not a question of direction. Both the 25 basis point predicted move and the framework's 0 sit far from the level rules' -75, and members took that near-agreement as evidence the current stance is close to neutral-to-mildly-restrictive — a real funds rate near 2.5% against an r* of about 1.4%. The one increment separating the two conclusions reflects the residual inflation-insurance caution embedded in the likely real-Fed path against a framework that finds no strong signal demanding movement now.

COMMITTEE VOTE

The Committee's predictive vote was 4 to 1 in favor of a 25 basis point increase, with one member preferring no change. On the framework's 0 basis point recommendation, the optimal-side deliberation landed 4 endorse, 1 partial, and none declining.

NOTES

On the predictive side, the member weighting labor-market conditions most heavily dissented in favor of no change, judging that with unemployment still above the natural rate, wage pressures modest, and activity decelerating, further restriction would needlessly endanger jobs and run against the prior 'sufficient, at least for a time' guidance. On the optimal side, the same inflation-focused member who moderated from 50 to 25 basis points registered only partial agreement with the hold, endorsing its rejection of the level rules' deep cuts but preferring one more increment of firming as insurance against above-target inflation and high resource utilization.