OpenFed

POLICY STATEMENT | November 8, 1994

PREDICTED FED DECISION **+75 bps**

5.50%

OPENFED OPTIMAL RATE **HOLD**

4.75%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to raise rates 75 bps, while its own framework judges the loss-minimizing move to be 0 bps — a hold — leaving a sharp gap between anticipated policy and optimal policy.

STATEMENT

Information reviewed by the Committee described an economy expanding broadly, with above-trend growth registered by a Chicago Fed activity index of 0.53 and expansion reported across all districts, several accelerating. Core PCE inflation stood at 2.19%, modestly above the 2.0% objective, and members gave particular weight to Beige Book evidence that manufacturers were increasingly passing rising materials and intermediate-goods costs into selling prices — a sign that price pressure was building rather than fading. The labor market gave no counterweight: unemployment at 5.8%, near the 5.41% natural rate, initial claims of 328k that were low and stable, and reports of tight or tightening conditions in most districts left no case, even among the most employment-focused members, for policy support. Financial conditions were uniformly calm, with a stress index of 0.126, a VIX of 16.3, a Baa credit spread of 1.36, and a positively sloped yield curve at 0.99 — no fragility to restrain a firmer move.

On the question of what the real Federal Reserve is likely to do, the Committee's judgment turned heavily on market pricing. The 3-month Treasury bill sitting 48 bps above the current 4.75% funds rate was read as a concrete, aggregated forecast of meaningful near-term tightening — a move larger than 25 bps, and one that benign credit and volatility conditions could absorb without a destabilizing surprise. Members who had opened at +50, including the most inflation-focused participant, revised upward over the course of deliberation, persuaded that undershooting a market already priced for a larger hike carried its own risks and that the pass-through evidence reinforced the case for getting ahead of inflation. The Committee's predictive conclusion is a 75 bps increase.

The Committee's own deterministic framework arrived at a very different place: the loss-minimizing recommendation is 0 bps — a hold. The divergence is stark, and it originates in how the reference rules read the data. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each prescribed -75 bps, driven by unemployment sitting above the natural rate and inflation only modestly above target against an estimated r* of 1.58, which places the current 4.75% rate above their prescription. But those rules lean on backward-looking level gaps. The first-difference rule, which adjusts off recent momentum rather than levels, returned 0, and the framework judged it the most reliable guide here. With inflation momentum slightly negative at -0.04 and unemployment momentum essentially flat at 0.05, no directional pressure argues for an aggressive move in either direction. The framework thus rejects the reflexive -75 easing the level rules demand — cutting into building price pressure would be wrong — while declining to firm into calm markets and flat momentum. Holding is the loss-minimizing anchor.

Set side by side, the two conclusions frame the meeting's central tension. The predictive path of +75 bps reflects a committee reading of preemption endorsed by market pricing and Beige Book pass-through; the optimal path of 0 bps reflects a momentum-neutral framework that sees policy already at or near an adequately restrictive stance. Members were candid that the +75 predictive vote runs hotter than the flat-momentum data strictly requires, and several observed that the gap itself quantifies how far anticipated policy is being pushed toward restriction ahead of the mechanical optimum — a front-loading against future inflation risk that, in calm markets, carries little near-term stability cost, but is not what the loss function selects.

COMMITTEE VOTE

The predictive vote was 75 bps, carried 4 to 1. On the framework's 0 bps recommendation, the Committee's optimal-side deliberation landed 3 to 2 — three members endorsing the hold as-is, two agreeing with the direction against easing but judging the magnitude too passive.

NOTES

On the optimal side, the two 'partial' members diverged from the framework's full hold: the inflation-focused participant, while strongly agreeing that easing would be wrong given above-target core PCE and building pass-through, judged 0 bps too passive and preferred some firming to get ahead of entrenching inflation; the market-focused member similarly held that the 48 bp forward T-bill spread endorsed an upward move that a hold understates, risking falling behind the curve.