OpenFed

POLICY STATEMENT | December 13, 1994

PREDICTED FED DECISION **+25 bps**

5.75%

OPENFED OPTIMAL RATE **HOLD**

5.50%

KEY TAKEAWAY

The Committee unanimously expects a 25 bps hike, but its own framework judges the loss-minimizing move to be 0 bps, a hold — a modest gap that reflects markets pricing more firming than pure optimization justifies.

STATEMENT

Information reviewed at this meeting described an economy running modestly warm rather than one under strain. Core PCE inflation at 2.18% sits just above the 2.0% objective, unemployment at 5.6% is only a touch above the 5.41% estimated natural rate, and the Chicago Fed activity index at 0.62 points to above-trend growth. Participants found little in the financial data to counsel caution: the stress index at 0.1668 and the VIX at 14.48 pointed to calm markets, the Baa spread at 1.28 signaled healthy credit conditions, and the 10-year/2-year spread at +0.12, while flat, gave no inversion warning. Initial claims at 329k rounded out a picture with no recession or labor-deterioration signal. Against that backdrop, the debate was never about direction — every participant favored further firming or, at most, holding — but squarely about magnitude.

The opening round split between those arguing for a 50 bps move and those favoring 25 bps. The case for the larger step leaned on the prior meeting's aggressive tightening, above-target inflation, and benign financial conditions judged capable of absorbing a firm move. The case for the smaller step turned decisively on market pricing: with the 3-month T-bill sitting 28 bps above the current 5.5% rate, markets appeared to have already discounted roughly one 25 bps hike, and delivering exactly that would avoid a policy surprise. By the second round that argument had carried the room. Participants who had favored 50 bps came around to the view that piling another large increase on top of recent aggressive action risked over-tightening — pulling an already-flat curve toward inversion, or over-restricting a labor market with little slack left to burn but no sign of weakness. Inflation running only modestly above target, they judged, did not justify accelerating. The Committee's predictive conclusion is therefore a 25 bps increase.

The Committee's own deterministic framework arrived at a different answer: the loss-minimizing recommendation is 0 bps, a hold. That figure nets sharply opposing reference-rule signals. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all called for -75 bps, driven by an estimated r* of 1.703 against a 5.5% funds rate — an arithmetic that implies a real policy rate of roughly 3.3%, already well into restrictive territory. Pulling the other way, the first-difference rule returned +25 bps, reflecting firming momentum consistent with recent policy. With inflation momentum flat at 0.0 and unemployment momentum slightly negative at -0.15, the framework judged the reference rules reliable and settled between these poles at a hold. Participants engaging with this output broadly accepted its logic: with real policy already restrictive, no fresh inflation breakout, and no labor stress, holding preserves the effect of prior tightening without either shocking calm markets or abandoning inflation vigilance.

The gap between the predictive 25 bps and the optimal 0 bps is real but narrow, and participants read it as informative rather than troubling. Several took the view that policy is near the point where further tightening becomes optional — the stance is roughly appropriate, and the divergence mainly reflects that market-embedded expectations price slightly more firming than pure loss-minimization would prescribe. Others were more comfortable erring on the side of restraint, trusting the momentum-based first-difference signal and the T-bill spread over the level rules' aggressive easing bias, which they distrusted given uncertain r* estimates and inflation still above target. What no participant endorsed was the deep cut the Taylor and balanced-approach rules implied; the calm-conditions argument, they noted, removes the case for cutting as readily as it removes any urgency to hike hard.

COMMITTEE VOTE

The predictive vote for a 25 bps increase was unanimous, 5-0. On the framework's 0 bps recommendation, the Committee's optimal-side deliberation split 2-3: two members endorsed the hold as-is, while three agreed with its near-neutral direction but preferred a modestly firmer stance.

NOTES

The three partial concurrences — reflecting an inflation-vigilance emphasis, a data-literal read of momentum, and a market-pricing discipline — accepted that direction was near-neutral but held that the magnitude should lean firmer than zero, citing the first-difference rule's +25 bps and the 28 bps T-bill spread as evidence markets embed some tightening the framework's hold does not capture.