OpenFed

POLICY STATEMENT | September 19, 1995

PREDICTED FED DECISION **HOLD**

5.75%

OPENFED OPTIMAL RATE **HOLD**

5.75%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 5.75%, and its own framework independently judges 0 bps optimal, even as the Taylor rule and two other reference rules call for a 75 bp cut.

STATEMENT

The data reviewed for this meeting described an economy running close to balance, with no single indicator forcing the Committee's hand. Core PCE inflation stood at 2.15%, only modestly above the 2.0% objective, and the framework's inflation momentum term of -0.03 indicated price pressures were edging down rather than accelerating. Unemployment at 5.6% sat somewhat above the estimated natural rate of 5.36%, pointing to mild labor slack; initial jobless claims at 376,000 were somewhat elevated, and the Chicago Fed activity index at 0.13 showed growth right at trend. Financial conditions were plainly calm, with the stress index at 0.0876, the VIX at 12.67, and the Baa spread contained at 1.76. The 10-year to 2-year spread was positive at 0.39, giving no recession signal, while the 3-month bill trading 55 basis points below the current funds rate indicated markets already anticipated easing ahead.

In predicting the near-term action of the real Federal Reserve, participants divided along familiar lines. Three members favored holding at 5.75%, judging that inflation running above target left no room to ease preemptively, that calm markets provided no stability rationale for a move, and that near-trend growth and mildly elevated claims did not yet compel action in either direction. Two members read the same data as a case for a modest 25 basis point cut, weighting most heavily the -55 basis point T-bill spread as a market signal that easing was coming, together with above-natural unemployment and rising claims as early warnings of a softening labor market that restrictive policy at 5.75% risked accelerating. Those favoring a cut acknowledged inflation was above target but argued the cost of acting early was low; those favoring a hold countered that cutting to satisfy market pricing while inflation ran above target was precisely the premature move to guard against. The predictive judgment settled on no change, 0 basis points.

The Committee's own deterministic framework arrived at the same destination by a different route, and the divergence within it is the most instructive feature of this meeting. Three of the reference rules pointed sharply lower: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each recommended -75 basis points, reading the small inflation overshoot and the labor slack against an r* of 2.511 as evidence that policy at 5.75% was meaningfully restrictive. Against that cluster, the first-difference rule recommended 0 basis points, and it was this change-based logic that the framework's loss-minimizing output followed, landing on 0 basis points. Participants found the first-difference reasoning the more persuasive here precisely because momentum was flat: with inflation momentum at -0.03 and unemployment momentum at -0.05, both small and stable, nothing was deteriorating quickly enough to justify a large, mechanical move. The level-based rules, in the Committee's reading, overweighted gaps that were genuinely minor.

Weighing these considerations together, the Committee concluded that the current stance is roughly appropriate: restrictive enough to keep inflation credibility intact, but not so restrictive as to demand correction while momentum remains flat and financial conditions calm. Even the members most attentive to labor risk judged that soft-but-stable data argued for patience this meeting, with readiness to ease decisively should claims and unemployment confirm deterioration. The Committee therefore judged both that the real Federal Reserve will hold and that holding at 5.75% is the optimal course, letting the anticipatory work already visible in the short end confirm itself before moving.

COMMITTEE VOTE

The predictive vote was 3 to 2 in favor of no change, with two members preferring a 25 basis point cut; on the framework's 0 basis point recommendation, the optimal-side deliberation was unanimous, all five members endorsing it as-is.

NOTES

The two members who did not join the predictive majority argued for a 25 basis point cut, resting their case on the 3-month T-bill trading 55 basis points below the funds rate as a clear market signal of expected easing, together with above-natural unemployment and elevated jobless claims at 376,000 as early evidence of labor softening; both held that preemptive insurance carried limited inflation cost given prices only marginally above target, though both reconverged on holding once engaging with the framework's flat-momentum reasoning.