OpenFed

POLICY STATEMENT | May 14, 1996

PREDICTED FED DECISION **HOLD**

5.25%

OPENFED OPTIMAL RATE **−25 bps**

5.00%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 5.25%, even as its own policy framework judges a 25 bps cut to be the loss-minimizing choice given inflation running below target.

STATEMENT

Conditions reviewed for this meeting described an economy sitting close to both mandate objectives with an unusually calm financial backdrop. Core PCE inflation at 1.86% ran just below the 2.0% target, while unemployment at 5.4% stood only marginally above the 5.3% natural rate, leaving the labor market roughly in balance. Participants weighed a Chicago Fed activity index of 0.39, indicating above-trend growth, against initial jobless claims of 352,000, described as moderately elevated but not alarming. Across the board, financial conditions offered no reason to move: the financial stress index registered 0.09, the VIX was calm at 14.9, the Baa credit spread of 1.58 pointed to healthy corporate borrowing conditions, and the positively sloped 10y-2y curve at 0.65 carried no recession signal. Several participants placed particular weight on the 3-month T-bill trading 0.24 below the current funds rate, reading it as evidence that markets anticipate no hike and perhaps a slight easing bias.

On the predictive question, the Committee reached full agreement that the real Federal Reserve is most likely to hold the target rate at 5.25%. Those attentive to inflation risk judged that core PCE near but below target does not constitute an emergency, while above-trend growth and a tight labor market would make a cut premature and risk overheating. Participants focused on employment found no evidence of the labor deterioration that would justify preemptive easing, and those weighting financial stability saw no strain in credit or volatility measures that a move should address. Participants attentive to market pricing added that the negative T-bill spread argues against a surprise hike, while the positive curve and stable conditions remove any urgency to ease. The consensus reading was that with the economy near both objectives and markets calm, holding steady and remaining ready to respond is the most defensible course.

The Committee's own policy framework, applied independently, reached a different conclusion: the loss-minimizing action is a cut of 25 bps. Here the below-target inflation reading did real work. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each called for -75 bps, driven by inflation running under target against an estimated r* of 2.782, which places the neutral nominal rate well below the current 5.25% and marks present policy as modestly restrictive. Pulling the other way, the first-difference rule returned 0 bps, reflecting that inflation momentum of -0.09 and unemployment momentum of -0.05, while both mildly soft, are stable rather than deteriorating. The framework's -25 bps recommendation splits these signals: it acknowledges the persistent inflation shortfall that three level-based rules flag without lurching into the aggressive easing they imply, given that low financial stress, calm volatility, and above-trend growth argue against urgency. Participants noted that the modest cut would also validate the easing already implied by the T-bill spread rather than surprise markets.

The divergence between the two conclusions was itself the most instructive feature of this meeting. A hold and a 25 bps cut stand only a quarter-point apart, and most participants characterized the gap as quantifying how mildly restrictive current policy is rather than as a genuine conflict. The predictive hold reflects expected institutional caution amid strong activity; the framework's optimum rewards the inflation shortfall. Both are the Committee's own considered conclusions from the same deliberation.

COMMITTEE VOTE

The predictive vote to expect a hold at 5.25% was unanimous at 5-0. On the framework's -25 bps recommendation, the Committee's optimal-side deliberation landed at 4 endorsing, 0 declining, and 1 partial.

NOTES

The single partial stance came from the inflation-focused view, which accepted that the easing direction is not wrong given inflation below target and negative momentum, but resisted acting at the full -25 bps now; weighting inflation-reignition risk asymmetrically and citing above-trend growth, this participant preferred a smaller or delayed step and would hold this meeting pending clearer data.