OpenFed

POLICY STATEMENT | December 10, 1996

PREDICTED FED DECISION **HOLD**

5.25%

OPENFED OPTIMAL RATE **HOLD**

5.25%

KEY TAKEAWAY

The Committee expects the real Fed to hold at 5.25% and, independently, judges 0 bps optimal as well — a full convergence, even as three reference rules called for cuts of 50 to 75 bps.

STATEMENT

What stands out about this meeting is how completely the two sides of the Committee's work aligned, and how firmly they did so against a set of reference rules pointing the other way. Core PCE inflation at 1.86% sits just below the 2.0% objective, close enough that members saw no disinflationary emergency, yet close enough on the other side that easing was judged to risk reigniting price pressures. Unemployment at 5.4% is only marginally above the estimated natural rate of 5.27%, a gap participants characterized as essentially balanced rather than as meaningful slack. Beige Book reports described moderate growth across nearly all Districts, with labor markets tight but wage pressures generally contained, and only isolated firming in materials and intermediate-goods prices in several Districts. Against that backdrop, all members opened at a hold and none moved off it through the deliberation.

Financial and market conditions reinforced the case for standing pat. The financial stress index at 0.0732 was read as calm and well-functioning, the Baa spread of 1.61 as showing no credit strain, and the VIX at 17.88 as benign. The yield curve remained positively sloped, with the 10-year to 2-year spread at +0.52, ruling out any recession signal that might have justified a defensive cut. Members did note one crosscurrent: the 3-month Treasury bill sitting 42 basis points below the current rate, a mild hint that markets lean toward eventual easing. But that lean was judged consistent with 'no move now, possibly slight easing later' rather than a demand for action at this meeting, and no other indicator corroborated any urgency. On that basis, the Committee's predictive judgment is that the real Federal Reserve will hold its policy rate at 5.25%, a change of 0 basis points.

The Committee's independent determination of optimal policy landed at the same place, 0 basis points, but the path there involved genuine tension worth setting out. The deterministic framework's reference rules diverged sharply: the Taylor rule prescribed a cut of 50 basis points, the balanced-approach rule 75 basis points, and the ELB-adjusted rule 75 basis points, each keying off the small inflation undershoot and the modest employment gap against an estimated r* of 2.908. The first-difference rule, by contrast, returned 0 bps, and the framework's loss-minimizing output settled there as well. Members found the first-difference logic the more persuasive here precisely because it responds to changes rather than to level gaps built on an uncertain neutral-rate estimate. Inflation momentum was slightly positive at 0.115 and unemployment momentum slightly negative at -0.1 — prices gently firming, joblessness edging down, neither deteriorating in a way that would warrant easing. Several members emphasized that cutting into positive inflation momentum, or into calm credit markets, would loosen conditions unnecessarily and risk asset froth or an inflation overshoot for the sake of closing a gap of barely a tenth of a percentage point.

The Committee therefore concluded that the current 5.25% stance is roughly neutral relative to r* — mildly restrictive, but not urgently so — and that the divergence between the level-based rules and the 0-bps outcome reflects judgment tempering a mechanical inflation-gap response rather than a signal that policy is miscalibrated. Both the predictive expectation and the optimal determination are a hold at 5.25%. Members were explicit that this stance preserves optionality in both directions: if labor data turned, with claims rising or unemployment momentum flipping positive, the case for the Taylor-rule cut would strengthen, and if inflation risk clearly escalated, a firmer posture could be considered. For now, with the economy near equilibrium and no stress to counter, patience was judged the disciplined course.

COMMITTEE VOTE

The predictive vote was unanimous at 0 basis points, 5 to 0. On the framework's optimal recommendation of 0 bps, the Committee's optimal-side deliberation also landed in full agreement, with all five members endorsing the recommendation as-is.