OpenFed

POLICY STATEMENT | September 23, 1997

PREDICTED FED DECISION HOLD

5.50%

OPENFED OPTIMAL RATE −25 bps

5.25%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 5.5%, even as its own framework judges the optimal move to be a 25 bps cut to correct an above-neutral real rate against below-target inflation.

STATEMENT

Information reviewed this meeting described an economy expanding broadly but with strikingly little price pressure to show for it. Core PCE stood at 1.62%, below the 2.0% target, and Beige Book reports indicated tight labor markets, recruiting difficulties, and growing shortages across most Districts even as two-thirds of Districts saw no general wage acceleration and goods prices 'moving very little, if at all.' Unemployment at 4.9% sat below the 5.23% natural rate, a genuinely tight labor market, while the Chicago Fed activity index at 0.63 pointed to above-trend growth. Financial conditions were calm: the stress index at 0.1122 was low, the Baa spread of 1.54 showed no credit strain, the 10-year/2-year curve was positive at 0.3, and the VIX at 22 registered moderate but not alarming volatility. Participants noted that the 3-month T-bill spread at -0.61 relative to the current funds rate implied markets already anticipated some easing rather than a hike.

On the question of what the real Federal Reserve is likely to do, participants converged early and did not move. Members weighting inflation risk acknowledged that a tight, sub-natural labor market is the classic setup for latent wage pressure, but judged that with realized inflation contained and no wage pass-through in the data, the case was for watchful holding with a tightening bias held in reserve, not action. Members focused on employment saw no rising-unemployment or slowing-jobs signal to justify a cut, and tame inflation removing any case to squeeze the labor market. Those attentive to stability and to market signals reinforced that calm credit conditions and market pricing counseled against a destabilizing surprise in either direction. The predictive judgment, held by all five members, is that the real Federal Reserve holds at 5.5% this meeting.

The Committee's own deterministic framework reached a different conclusion, and members engaged it directly. The loss-minimizing recommendation was -25 bps. Behind it, the reference rules split sharply: the Taylor rule prescribed -50 bps, the first-difference rule -25 bps, and both the balanced-approach and ELB-adjusted rules +25 bps. With an estimated r* of 3.027 and core inflation near 1.6%, a 5.5% nominal rate implies a real rate close to 3.9%, meaningfully above neutral and therefore genuinely restrictive. Both momentum terms were slightly negative, inflation at -0.09 and unemployment at -0.05, signaling disinflationary drift and modestly easing labor tightness rather than building pressure. Most members found the first-difference rule the most persuasive of the four: it adjusts gradually from the current stance without the level reset the Taylor rule's -50 would impose, a magnitude several judged too aggressive given still-strong activity and the risk of overshooting a market pricing only modest easing. The balanced-approach and ELB rules' +25 readings reflected the tight labor market, but with wage pass-through absent, members discounted them. The Committee's optimal conclusion, then, is a measured 25 bps cut to correct an above-neutral real rate that is not justified by contained, decelerating inflation.

The distance between the two conclusions is the story of this meeting. Members characterized the gap between the framework's -25 bps and the expected hold as a deliberate insurance premium: caution against reigniting wages in a still-tight labor market, weighed against the analytical judgment that current policy is mildly too restrictive. Benign credit spreads and low stress led several to conclude a small cut could proceed with little stability penalty, while the negative T-bill spread suggested markets already sense that latent restrictiveness. The direction of easing drew broad agreement; the timing and the Committee's read of the real Federal Reserve's likely caution kept the predictive vote at hold.

COMMITTEE VOTE	The predictive vote to hold at 5.5% was unanimous, 5-0. On the framework's -25 bps recommendation, the Committee's optimal-side deliberation landed 4-1 in favor, with four members endorsing the recommendation as-is and one giving partial support.
NOTES	*The lone partial position came from the inflation-focused member, who accepted the direction of a cut given contained, decelerating inflation and an above-neutral real rate, but resisted the magnitude: with unemployment below the natural rate and activity still robust, a cut into a tight labor market struck this member as premature, and the concern was pace rather than direction.*