OpenFed

POLICY STATEMENT | January 27, 1998

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%, yet its own framework judges the loss-minimizing move to be a 25 bps cut — a one-step gap all five members endorsed as evidence policy is modestly too tight.

STATEMENT

Information reviewed by the Committee described an economy growing at or above trend with inflation running below target. Core PCE stood at 1.5%, half a point under the 2.0% objective, while unemployment at 4.7% sat well below the 5.2% natural rate. The Beige Book confirmed tight-to-very-tight labor markets across all Districts, with wage pressures emerging for skilled and retail occupations, even as prices remained generally flat — attributed to intense competition, lower import prices, and Asian financial turmoil weighing on exports. Financial conditions appeared benign: the stress index at 0.125 was low, the Baa spread at 1.62 was contained, and the yield curve at +0.24 was flat but not inverted. A VIX of 22.27 reflected Asia-related unease rather than domestic distress. The one signal pointing clearly toward easing was the 3-month T-bill trading roughly 40 basis points below the current rate, which participants read as markets already pricing an eventual cut.

On the predictive question, all five participants judged that the real Federal Reserve would hold at 5.5%. The reasoning converged from different starting points but landed in the same place. Those most attentive to inflation risk stressed that the below-target reading was largely import-driven and could reverse, and that easing into a very tight labor market would be the more dangerous error given emerging wage pressures. Those weighting employment most heavily found their usual bias to cut simply untriggered: with jobless claims low and no sign of labor deterioration, the case for preemptive easing was absent, however real the forward risk from Asian spillover. From the stability lens, there was neither acute credit stress justifying a cut nor overheating justifying a hike, and holding preserved optionality to act decisively if spreads widened. Even the participant most focused on market pricing concluded that the negative bill spread signaled a cut anticipated eventually, but not necessarily at this meeting.

The Committee's own deterministic framework reached a different conclusion, recommending a 25 basis point cut as the loss-minimizing stance. The reference rules split: the Taylor rule pointed to a sizable -75 bps, the first-difference rule to 0 bps, and both the balanced-approach and ELB-adjusted rules to -25 bps. With an estimated r* of 3.115, inflation momentum negative at -0.085, and unemployment momentum at -0.15, participants judged the Taylor rule's -75 too aggressive for a labor market this tight — a cut of that size risked reigniting the very wage pressures the Beige Book flagged. The first-difference rule's hold, by contrast, ignored that inflation was already running below target with momentum still drifting lower. The two rules converging at -25 were seen as the sensible central reading: enough accommodation to align policy with disinflation and to insure against Asian contagion before it shows up in credit spreads or hiring, without an overshoot. Several participants noted that holding while inflation drifts down leaves the real rate passively tightening near r*, which is why the framework's -25 quantifies current policy as mildly restrictive rather than badly misaligned.

Taken together, the meeting's defining feature was the modest gap between what the Committee expects and what it judges optimal — a single 25 bps step. Participants read that one-step divergence not as a sign of policy error but as a measure of institutional caution: the consensus would likely wait for confirmation, given contained credit stress and a still-tight labor market, while the framework already saw room the markets themselves were pricing. The Committee's considered view is that policy should be heading toward -25 bps, and that the case for a cut only strengthens if Asian stress or credit spreads worsen.

COMMITTEE VOTE

The predictive vote to expect a hold at 5.5% was unanimous, 5-0. On the framework's -25 bps recommendation, the optimal-side deliberation was also unanimous, with all five members endorsing the cut as-is (5 endorse, 0 decline, 0 partial).

NOTES

No member dissented on either side, but the inflation-focused participant registered the most reluctant endorsement, accepting -25 bps only because below-target inflation with negative momentum outweighed a wariness of easing into tight labor markets, and would tolerate slightly tight policy to guard against wage-driven inflation.