OpenFed

POLICY STATEMENT | March 24, 1998

PREDICTED FED DECISION HOLD

5.50%

OPENFED OPTIMAL RATE −25 bps

5.25%

KEY TAKEAWAY

The Committee unanimously expects the real Fed to hold at 5.5%, even as its own framework judges a 25 bps cut to be optimal, correcting a stance now modestly tighter than a subdued inflation reading warrants.

STATEMENT

Information reviewed at this meeting described an economy of broad, if unspectacular, strength. Core PCE inflation stood at 1.24%, well below the 2.0% objective, while unemployment at 4.6% remained materially below the 5.2% natural rate. The Beige Book pointed to widespread labor shortages and increased wage pressures across nearly all districts, yet product prices were described as 'eerily calm' -- restrained, participants judged, by Asian weakness, productivity gains, and competition. Financial conditions were benign: the stress index near 0.11, the Baa spread contained at 1.69, and a VIX of 20.51 that participants generally read as elevated but not alarming. The 10-year to 2-year spread of 0.08 was barely positive, giving no recession signal, while a 3-month T-bill spread of -0.47 indicated markets already priced short rates somewhat below the current 5.5%.

On the question of what the real Federal Reserve would do at this meeting, the Committee's judgment was unanimous: hold at 5.5%, a change of 0 basis points. The reasoning converged from different starting points. Participants weighting inflation risk stressed that tight labor markets and rising wages are the classic precursors to future price pressure and cautioned against easing into that risk, while conceding that realized inflation this low offers no case for a hike either. Those attentive to employment found no deterioration to defend against -- claims low and stable, unemployment still falling, hiring strong -- and so saw no trigger for an accommodative cut. Participants focused on financial stability warned that tightening amid Asian fragility would disturb calm credit conditions with no inflation justification, and those reading market pricing noted the flat curve and slight easing bias implied steady policy rather than any imminent move. The considerations that argued against a cut and those that argued against a hike offset one another, and the literal reading of the data pointed squarely to a hold.

The Committee's own deterministic framework reached a different conclusion about what optimal policy would be, recommending a reduction of 25 basis points. The reference rules bracketed the question sharply: the Taylor rule implied -75 bps, driven by inflation below target and unemployment far under the natural rate, while both the balanced-approach and ELB-adjusted rules read 0 bps, and the first-difference rule, responding to inflation momentum of 0.035 and unemployment momentum of -0.1, indicated -50 bps. With r* estimated at 3.141 and the reference rules judged reliable, the framework blended these into a -25 bps recommendation. Participants supporting that conclusion found the full Taylor cut mechanically excessive against a still-tight, still-strong economy, but noted that the roughly 4.26% real funds rate sits well above the 3.141 neutral estimate, leaving policy genuinely restrictive with inflation this subdued. The first-difference logic of adjusting gradually from current settings, and the T-bill spread already pricing about a quarter-point of easing, were cited as reasons a modest trim rather than a hold was the loss-minimizing call.

The gap between the two conclusions was small but real, and reflects prudence more than misalignment. The predictive hold rests on near-term caution -- a strong labor market, wage pressures that could reassert if the disinflationary offsets prove temporary, and market pricing that demands no immediate move. The optimal -25 bps rests on the accumulated restrictiveness of a real rate above neutral while inflation runs persistently below target. The Committee judged that a single quarter-point recalibration toward neutral, not the aggressive easing the Taylor rule alone would prescribe, best minimizes loss given this meeting's data, even as it expects the real Federal Reserve to stand pat.

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 of endorsing the reduction as recommended.
NOTES	*The lone objection to the optimal recommendation came from the inflation-focused view, which declined to support a cut: with the Beige Book flagging widespread labor shortages and rising wages against an economy showing no weakness, it argued that latent, wage-driven inflation risk made a hold the prudent floor and that low backward-looking price readings could not by themselves justify easing into a tight labor market.*