OpenFed

POLICY STATEMENT | June 23, 1998

PREDICTED FED DECISION **HOLD**

5.50%

OPENFED OPTIMAL RATE **−50 bps**

5.00%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 5.5%, even as its own framework judges the loss-minimizing policy to be a 50 bps cut, a divergence that hinges on magnitude rather than direction.

STATEMENT

Information reviewed at this meeting described an economy performing well by most conventional measures, and yet one whose forward-looking signals sat uneasily against that strength. Core PCE inflation stood at 0.98%, roughly half the 2% objective, and the Beige Book characterized activity as 'excellent': liberal consumer spending, robust manufacturing, and very strong construction across all districts. Against that, unemployment at 4.3% remained well below the 5.19% natural rate, a degree of labor-market tightness that participants uniformly treated as the single fact arguing against any easing. The tension in the data was genuine rather than rhetorical. Seven districts reported adverse effects from Asian economic problems; the 10y-2y spread had flattened to a near-inverted -0.04; and the Chicago Fed National Activity Index at -0.44 pointed to below-trend growth momentum even as the Beige Book narrative ran hot.

On the question of what the real Federal Reserve is likely to do, participants converged quickly and without much internal friction on holding the target rate at 5.5%. The reasoning was symmetric: with core PCE running so far below target, no participant saw a case for a preemptive hike, and the near-inverted curve, the below-trend activity reading, and the Asian drag all counseled that tightening into potential slowing would risk steepening the inversion and amplifying external stress. At the same time, with the labor market this tight and no sign of employment deterioration, participants judged that the trigger for a cut had not arrived. Initial claims at 349,000 were read as moderate, financial stress at 0.1329 as low, and the VIX at 20.17 as elevated but not alarming. The 3-month T-bill sitting 53 bps below the funds rate confirmed that markets were pricing no move, so a surprise in either direction would be jarring. Participants therefore expect a hold, keeping policy steady while watching credit spreads, the labor data, and Asian spillover.

The Committee's own determination of optimal policy pointed elsewhere. Applying its deterministic framework, the loss-minimizing recommendation was a cut of 50 bps. That figure was itself a blend of sharply divergent reference rules: the Taylor rule prescribed -75 bps, driven by the large inflation shortfall against a backdrop of low unemployment, while both the balanced-approach and ELB-adjusted rules read 0 bps out of respect for that same labor tightness; the first-difference rule landed at -25 bps, reflecting negative inflation momentum of -0.12 and unemployment momentum of -0.2. With r* estimated at 3.203 and inflation near 1%, the real funds rate of roughly 4.5% sits well above neutral, and participants across the room acknowledged that this makes current policy meaningfully restrictive. The divergence between the expected hold and the framework's -50 bps is, in effect, the distance between visible real-economy strength and the forward-looking case for insurance: the Beige Book explains why the Committee expects a hold, while the elevated real rate explains why the framework says ease.

Where the deliberation on the optimal call did break open was on magnitude, not direction. All participants came to accept that easing was defensible given the restrictiveness of the current stance, but most were unwilling to endorse a full 50 bps step into an economy still described as excellent with unemployment below its natural rate. The recurring counterweight was that two of the four reference rules read 0 bps, and that the first-difference logic of -25 bps better respected the negative momentum without overreacting from a strong base or front-running deterioration not yet confirmed in the labor data. The case for the full 50 bps rested on preemption: waiting for employment weakness to show up in the unemployment rate would mean acting too late, and the accumulating forward risks from the inverted curve and Asian spillover justified insurance now rather than later.

COMMITTEE VOTE

The predictive vote to hold at 5.5% was unanimous at 5-0. On the framework's -50 bps recommendation, the Committee split 1-4: one member endorsed the cut as recommended, while four agreed with the direction of easing but favored a smaller step.

NOTES

With the predictive vote unanimous, the substantive disagreement was on the optimal side. Four participants declined to back the full 50 bps, arguing the first-difference rule's -25 bps better fit the negative momentum and the still-benign stress readings, and that two of four reference rules at 0 bps warned against front-loading a large cut with unemployment at 4.3%; the lone endorsing member countered that a 25 bps step was too timid given below-trend growth, the -0.53 T-bill spread, and Asian drag, and that -50 bps was the appropriate preemptive insurance for employment while inflation gave full room to move.