OpenFed

POLICY STATEMENT | January 26, 1999

PREDICTED FED DECISION HOLD

4.75%

OPENFED OPTIMAL RATE −25 bps

4.50%

KEY TAKEAWAY

The Committee unanimously expects the Federal Reserve to hold at 4.75%, even as its own policy framework judges a 25 basis point cut to be the loss-minimizing choice.

STATEMENT

The information reviewed by the Committee described an economy growing solidly with contained inflation. Core PCE stood at 1.34%, well below the 2.0% objective, and the Beige Book characterized prices as mostly stable to declining across the districts. At the same time, the labor market remained tight: unemployment at 4.3% sits far below the 5.15% natural rate, initial jobless claims were low at 311,000, and several districts reported heightened wage pressures, with worker 'poaching' cited in St. Louis. Financial conditions carried a note of unease that participants did not dismiss. The VIX at 29.23 and a Baa spread of 2.57 pointed to lingering market nervousness, the 3-month T-bill traded roughly 40 basis points below the funds rate, and the 10y-2y curve was nearly flat at 0.06. Participants generally read the stress as moderate rather than acute, with the financial stress index at 0.2238.

On the question of the most likely action by the Federal Reserve, all five participants converged on a hold at 4.75%. The reasoning ran in the same direction from several vantage points. With core inflation below target, no participant saw an urgency to tighten; with unemployment falling and claims low, no participant saw employment weakness that would compel easing. Those weighing financial conditions most heavily judged that elevated volatility argued against a hike that might destabilize markets, but that conditions were not stressed enough to justify a preemptive cut given solid growth. Those attentive to market pricing acknowledged that the negative T-bill spread and near-flat curve lean toward eventual easing, yet judged that signal too mild to override a firm real-economy backdrop. The balance of considerations, in the Committee's view, points to steady policy this meeting.

The Committee's own deterministic framework reached a different conclusion, recommending a reduction of 25 basis points as the loss-minimizing stance. The tension is real and worth stating plainly. Three of the four reference rules called for tightening: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each returned +75 basis points, driven mechanically by the wide gap between 4.3% unemployment and the 5.15% natural rate. Only the first-difference rule returned -25 basis points, and the framework sided with it. Participants found that choice defensible because the level rules assume a Phillips-curve pass-through the actual price data contradicts: tight labor is not translating into broad inflation. The first-difference logic instead responds to momentum, and both inflation momentum at 0.05 and unemployment momentum at -0.1 were muted. With an estimated r* of 3.318 implying a fairly restrictive real stance against 1.34% inflation, several participants concluded that current policy is modestly tight relative to the data, and that a small insurance cut against soft inflation and financial fragility carries low cost.

The gap between the unanimous hold and the framework's cut, in the Committee's judgment, quantifies how much the current stance leans restrictive rather than signaling a policy error. Participants who held did so out of caution: labor data remains strong, growth is solid per the Beige Book, and the case for immediate action is not yet compelling even where the direction of eventual easing is granted. The framework, by weighting below-target inflation and market stress over labor tightness alone, judged that direction worth acting on now.

COMMITTEE VOTE

The predictive vote to hold at 4.75% was unanimous, 5-0. On the framework's -25 basis point recommendation, the Committee split: two participants endorsed it as-is, two agreed with the easing direction but not the immediate timing or full magnitude, and one declined it.

NOTES

On the optimal side, the inflation-focused participant declined the -25 basis point recommendation as premature, holding that easing into a tight labor market with wage pressures flagged in Atlanta, Chicago, and Richmond risks re-igniting demand, and that below-target inflation lowers the cost of a cut without compelling one while three of four reference rules still point to tightening.