OpenFed

POLICY STATEMENT | March 23, 1999

PREDICTED FED DECISION **HOLD**

4.75%

OPENFED OPTIMAL RATE **−25 bps**

4.50%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 4.75%, while its own framework judged the optimal policy to be a 25 bps cut — a divergence the Committee endorsed by a 3-1-1 margin.

STATEMENT

Information reviewed by the Committee described an economy running warm even as inflation sat quiet. Core PCE inflation registered 1.14%, well below the 2% objective, while the unemployment rate at 4.4% held far under the 5.15% natural rate assumed in the Committee's framework. The Beige Book was consistent with this picture: consumer spending was strong, construction brisk, and manufacturing expanding, with labor markets tight and reports of faster wage increases described as more widespread than in recent months. Against that, participants gave weight to signs of lingering financial caution — the VIX at 27.27, a Baa credit spread of 2.33, and a financial stress index of 0.18 — none of them at crisis levels, but enough to counsel against tightening. Participants also noted that the 3-month T-bill rate sat 0.37 below the funds rate, implying markets leaned mildly toward easing, and that the 10-year to 2-year spread of 0.17 remained positive, muting any recession signal.

On the question of what the real Federal Reserve is likely to do, the Committee reached ready agreement. The most persuasive read was that realized inflation, contained roughly a point below target, created no case to hike, while the reluctance of businesses to press for price increases meant tight labor and spreading wage gains had not yet passed through to consumer prices. Participants focused on employment risk saw no labor deterioration to protect against, with jobless claims low and unemployment momentum still slightly negative at -0.15. Participants attentive to financial conditions judged that tightening into an elevated VIX and still-nervous credit markets would risk unnecessary stress, while a cut would be unwarranted given robust activity and a Chicago Fed activity index near trend at -0.08. The Committee's predictive conclusion was therefore to hold the target rate at 4.75%.

The Committee's own deterministic framework arrived at a different answer: it recommended a 25 bps cut, to 4.50%. The reference rules split sharply. Drawing on the wide unemployment gap and a 2% inflation assumption, the Taylor rule pointed to +50 bps, the balanced-approach rule to +75, and the ELB-adjusted rule to +75. But the first-difference rule, which responds to momentum rather than the level of any gap, called for -50 bps, reflecting inflation momentum of just 0.05 and unemployment momentum of -0.15. With an estimated r* of 3.32 and core inflation near 1.1%, participants judged that the level rules overstated slack-driven inflation pressure that the price data simply did not show, and that a 4.75% stance was already modestly restrictive in real terms. The framework's -25 bps split the difference — less aggressive than the first-difference signal, but rejecting the hawkish level rules — landing on a modest insurance cut that weights downside financial risk against negligible upside inflation risk.

Most participants found this reasoning compelling as a matter of optimal policy, even while expecting the real Federal Reserve to stand pat. Those endorsing the cut argued that low inflation offered ample cover to ease, that preemptive insurance against credit-spread and volatility stress is cheap when inflation is quiescent, and that a modest cut protects employment before any deterioration forces a scramble. The gap between the Committee's own hold and its framework's -25 bps thus reflects a policy that has quiet easing room masked by near-term real strength. Both conclusions stand as the Committee's own: it expects a hold, and it judges the optimal step to be a 25 bps reduction.

COMMITTEE VOTE

The predictive vote to hold at 4.75% was unanimous, 5-0. On the framework's -25 bps recommendation, the Committee's optimal-side deliberation split 3-1-1: three members endorsed the cut as recommended, one declined, and one agreed with the easing direction but not its immediate timing.

NOTES

The member weighting inflation risk declined to support the optimal cut, judging that easing while labor is this tight and wage increases are spreading is premature insurance that risks feeding the very wage acceleration the Beige Book flagged; holding preserves the option to ease later if stress materializes into real weakening. The centrist agreed the stance was at most mildly restrictive but held that an immediate cut overstates urgency with activity expanding and labor tight, favoring patience over action now.