OpenFed

POLICY STATEMENT | September 14, 1999

PREDICTED FED DECISION HOLD

5.25%

OPENFED OPTIMAL RATE −25 bps

5.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 5.25% (3-2), even as its own deterministic framework judged the optimal move to be a 25 bps cut, driven by soft inflation momentum.

STATEMENT

Information reviewed by the Committee described an economy running hot in the real sector while inflation remained conspicuously soft. Core PCE stood at 1.43%, well below the 2% objective, and Beige Book accounts pointed to widespread labor shortages and supply constraints across virtually every district, alongside firm housing and construction activity and rising loan demand. Against this, unemployment at 4.2% sat far below the estimated 5.13% natural rate, a gap that several participants read as a classic precursor to future wage and price acceleration. Yet the same reports found only scattered wage acceleration and no broad-based pickup in consumer prices, and the current activity index at -0.19 indicated growth running slightly below trend. The tension between a very tight labor market and benign realized inflation ran through the entire discussion.

In assessing the likely near-term posture of the real Federal Reserve, participants divided along that same fault line. Some judged that a labor market this tight, coupled with robust demand and climbing home-construction and oil prices, warranted a preemptive 25 bps firming before inflation broadened; they emphasized that waiting for wage acceleration to become general would mean acting late, and that with financial stress contained at 0.2625 and Baa spreads at 2.25, the economy could absorb a modest move without shocking credit markets. Others countered that policy is arguably already restrictive: the 3-month T-bill trading 56 bps below the funds rate signals that markets neither expect nor demand further tightening, the yield curve at 0.25 shows no recession alarm, and with core inflation nearly 0.6 percentage point below target there was no realized-data urgency to move. On this reading, the hike case rested on a forecast of inflation the price data do not yet corroborate, and tightening into a strong-but-not-inflationary economy risked employment for a threat that had not materialized.

Balancing these views, the Committee's predictive judgment is that the real Federal Reserve will hold the target rate unchanged at 5.25% at the coming meeting.

The Committee's own deterministic framework, applied independently of that forecast, arrived at a different optimal posture: a 25 bps cut. The reference rules were themselves sharply split. The Taylor rule pointed to +50 bps, and both the balanced-approach and ELB-adjusted rules to +75 bps, each leaning heavily on the wide unemployment gap below the 5.13% natural rate, with an estimated r* of 3.624 implying a neutral nominal rate above the current setting. Working against those level-based rules, the first-difference rule returned -25 bps, and it was this rule the framework followed, because it responds to the direction of the data rather than static gaps. On that logic the case is straightforward: inflation momentum is slightly negative at -0.035, unemployment momentum is flat at 0.0, and with neither mandate variable pushing upward there is no basis for leaning restrictive against inflation already running below target. The framework therefore judged current policy modestly restrictive relative to the loss-minimizing path and recommended a 25 bps reduction as insurance, consistent with the easing the front end of the money market is already pricing.

The distance between the predicted hold and the framework's recommended cut is the defining feature of this meeting. Participants generally read that gap not as a flaw in either conclusion but as a measure of how near-neutral the current stance is: the easing direction is defensible on soft inflation and flat momentum, while firm activity and pervasive labor shortages make immediate accommodation something short of compelling. Even among those sympathetic to the framework's direction, the flat unemployment momentum and genuinely strong labor market argued for a smaller, more cautious step than a full quarter point taken into a hot economy.

COMMITTEE VOTE

On the predictive question the Committee split 3 to 2 in favor of a hold at 5.25%, with two members judging a 25 bps hike more likely. On the framework's -25 bps optimal recommendation, deliberation landed at one endorsement, three partial concurrences, and one member declining.

NOTES

The lone member declining the framework's cut, weighting inflation risk most heavily, refused to ease into evident supply-side tightness: with three of four reference rules pointing up, an r of 3.624 implying policy is not restrictive, and no labor deterioration in 281,000 jobless claims, that member read the -25 bps as the mechanical output of a single momentum rule rather than the right posture. The three partial concurrers agreed with the easing direction but resisted the full magnitude, citing flat unemployment momentum, contained financial stress, and still-firm activity as reasons a smaller step would fit better than a full quarter point.*