OpenFed

POLICY STATEMENT | November 9, 1999

PREDICTED FED DECISION +25 bps

5.50%

OPENFED OPTIMAL RATE −25 bps

5.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to raise rates 25 bps, but its own loss-minimizing framework points the opposite way, to a 25 bps cut, with four of five members endorsing that easing.

STATEMENT

Information reviewed at this meeting described an economy running warm but not overheating on prices. Core PCE inflation stood at 1.49%, below the 2.0% objective, while unemployment at 4.1% remained far beneath the 5.13% estimate of its natural rate. The Beige Book reported tight labor markets, difficulty finding and retaining workers, and a pickup in wage increases across many districts, alongside strong growth in most districts with some noted slowing in consumer loan demand, retail, and real estate. Financial conditions were judged moderate rather than fragile: the financial stress index at 0.26, a Baa credit spread of 2.16, VIX at 22.7, and a slightly positive 10-year to 2-year spread of 0.2 gave no recession warning and no credit stress. One signal cut against the grain of the activity data, however, and it recurred throughout the discussion: the 3-month T-bill sat 0.21 below the current 5.25% funds rate, suggesting markets were not pricing an imminent hike.

In predicting the action the real Federal Reserve is likely to take, four members converged on a 25 bps increase from distinct starting frameworks. The common thread was the size of the unemployment gap paired with firming wages: even with realized inflation below target, participants judged that an exceptionally tight labor market with accelerating wages was the classic setup for future price pressure, and that a modest, preemptive move would guard against overheating without shocking credit markets that contained spreads and moderate volatility showed could absorb it. Several framed the low inflation reading as tempering the size of the appropriate move rather than removing the case for one. The single dissenter weighted market-implied pricing above the overheating narrative, concluding that the negative T-bill spread, the nearly flat curve, and the absence of any financial stress compelling action argued for holding and waiting for confirmation rather than preempting a market that disagreed.

The Committee's own deterministic framework, run to minimize its loss function, reached a different conclusion: the optimal policy is a 25 bps cut. The divergence between the framework and the predictive vote is the central feature of this meeting, and it traces almost entirely to how the level-based rules treat the unemployment gap. Three reference rules -- the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule -- each pointed to +75 bps, driven by an estimated r* of 3.629 combined with unemployment far below its natural rate. The framework instead selected the first-difference rule, which alone recommended -25 bps. That rule keys on changes rather than stale gaps, and both momentum terms were essentially flat: inflation momentum at 0.015 and unemployment momentum at 0.0. With inflation undershooting the target and no acceleration in either direction, the loss-minimizing reading treated the level rules as overstating the case for restriction by assuming a tight labor market must feed prices when the realized data show it has not. On this reading, current policy at 5.25% is already modestly restrictive, and a small easing relieves that restrictiveness without stoking overheating.

Members endorsing the framework's call emphasized that below-target inflation offered ample room to ease, that Beige Book signs of 'some slowing' and softening loan demand flagged downside risk ahead, and that market pricing -- the sub-policy T-bill spread and near-flat curve -- corroborated a stance already at or past neutral. Most acknowledged their own predictive vote embedded an institutional firmness premium the numbers themselves did not validate. The tension that remained came from the inflation-weighted view: while conceding that realized inflation at 1.49% with flat momentum gave no ammunition to tighten, that perspective was uneasy about adding stimulus to an already tight labor market with wages picking up, preferring at most a token step to preserve optionality should wages accelerate. The Committee's two conclusions are therefore held with equal deliberation: it expects a 25 bps hike from the real Federal Reserve, and it judges a 25 bps cut to be the loss-minimizing policy on the data actually in hand.

COMMITTEE VOTE

The predictive vote was 4-1 in favor of a 25 bps increase. On the framework's -25 bps optimal recommendation, the Committee landed 4-1 in the same direction as well: four members endorsed the cut as-is and one supported the easing direction only partially, with none declining.

NOTES

On the predictive side, one member dissented from the 25 bps hike, weighting market-implied signals most heavily and concluding that the T-bill trading below the funds rate, the flat curve, and the lack of any financial stress meant no tightening was priced or required, favoring a hold. On the optimal side, the inflation-weighted member gave only partial support to the 25 bps cut -- agreeing that below-target inflation and flat momentum removed any case to tighten, but reluctant to ease into a tight labor market with rising wages, preferring to hold or take at most a token step.