OpenFed

POLICY STATEMENT | December 14, 1999

PREDICTED FED DECISION **HOLD**

5.50%

OPENFED OPTIMAL RATE **HOLD**

5.50%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 5.5%, and its own policy framework independently arrives at the same 0 bps conclusion despite reference rules pointing 75 bps higher.

STATEMENT

Information reviewed at this meeting described an economy running warm but without pressing price pressure. Core PCE inflation stood at 1.44%, below the 2% objective, while unemployment at 4.1% remained far beneath the 5.13% estimated natural rate. Beige Book reporting confirmed a labor market described as tight in all Districts, with moderate-to-strong growth nationally and the Chicago Fed Activity Index at 0.6 signaling above-trend activity. Against this backdrop of tightness, participants nonetheless emphasized that wage and salary increases were 'not appear to be accelerating generally' and that retail prices were 'mostly steady,' which took much of the urgency out of any preemptive tightening case. Financial conditions were judged calm but not perfectly quiet: the financial stress index at 0.25 was moderate, the Baa spread of 1.94 showed no credit distress, and the yield curve was slightly positive at 0.15, with VIX at 23.06 reflecting year-end caution rather than genuine strain.

The predictive discussion turned early and repeatedly to the Y2K year-end transition. Participants observed that the 3-month T-bill sat 27 basis points below the current funds rate, indicating that markets were pricing a pause rather than a hike, and that moving against that consensus into a sensitive funding window risked injecting unnecessary volatility. One participant argued in the opening round for a 25 basis point increase to lean against overheating risk, citing the wide labor gap and above-trend growth. That case was taken seriously as a hedge but did not survive the discussion: with inflation below target, wages not broadly accelerating, and a real cost to surprising fragile year-end markets, that participant moved to hold in the second round. Participants were united in rejecting any easing, seeing no employment deterioration and no recession signal that would justify a cut into a strong labor market. The Committee's judgment is that the real Federal Reserve will hold the target rate unchanged, a change of 0 bps.

Turning to its own determination of optimal policy, the Committee's deterministic framework also recommended 0 bps, but this outcome emerged from genuine tension among the reference rules rather than from a quiet consensus in the inputs. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each prescribed 75 basis points of tightening, driven heavily by the large negative unemployment gap against a natural rate near the r* value of 3.684 used in the calculation. Pulling the other way, the first-difference rule called for a 25 basis point cut, reflecting subdued inflation momentum of just 0.17 and unemployment momentum of -0.1. Participants read this dispersion honestly: the hawkish rules capture a real overheating risk from tight labor markets, while the muted momentum terms and below-target inflation argue against acting on that gap now. The loss-minimizing output landed at +0 bps, balancing the aggressive rules against first-difference caution.

Several participants drew the same lesson from this divergence between the 75 basis point rule prescriptions and the framework's 0 bps recommendation, namely that the current 5.5% stance is already appropriately restrictive and roughly neutral given prior firming still working through the economy. The Committee's optimal conclusion is therefore to hold at 5.5%: the tightening rules and the easing rule offset around the status quo, and with inflation contained, momentum weak in both directions, and no financial strain demanding action, neither a hike nor a cut is warranted. Participants noted a clear bias toward tightening early next year should labor tightness translate into faster wage growth once the Y2K risk has passed.

COMMITTEE VOTE	The Committee was unanimous, 5-0, in predicting the real Federal Reserve will hold at 5.5% (0 bps), and its optimal-side deliberation likewise reached full agreement, with all five members endorsing the framework's 0 bps recommendation.