OpenFed

POLICY STATEMENT | August 15, 2000

PREDICTED FED DECISION **HOLD**

6.50%

OPENFED OPTIMAL RATE **−25 bps**

6.25%

KEY TAKEAWAY

The Committee unanimously expects the real Fed to hold at 6.5%, yet its own framework judges a 25 bps cut optimal — and after deliberation all five members endorsed that easing bias.

STATEMENT

Information reviewed by the Committee pointed in two directions at once. Core PCE inflation stood at 1.47%, comfortably below the 2.0% objective, and the Beige Book indicated that easing demand was restraining price increases, that energy prices may have peaked, and that indirect energy costs had largely been absorbed by producers. At the same time, the labor market remained very tight: unemployment at 4.0% was well below the 5.1% estimate of its natural rate, with worker shortages reported as limiting activity in some Districts and wage pressures persisting. Against this, the signs of moderation were broad. Seven Districts reported slowing growth and softer consumer spending, the Chicago Fed activity index registered -0.36, indicating below-trend activity, and the 10-year to 2-year spread was inverted at -0.47, which several participants weighted heavily as a recession-risk signal.

In assessing the near-term path of policy, participants generally judged that neither a further hike nor a cut was warranted at this meeting. With core inflation below target, there was no case for tightening into a moderating economy and an inverted curve; the 3-month T-bill trading roughly 0.40 below the current funds rate was read as markets already expecting no further increases. Participants weighting inflation risk emphasized that tight labor and persistent wage gains counseled against easing prematurely, warning that a cut could reignite demand; those focused on employment agreed, noting that leading indicators had turned but no actual job losses had yet materialized to defend against. The slowdown was characterized as orderly rather than a collapse, and with the financial stress index at 0.25 and the VIX near 18, no acute market disruption required a defensive move. On that basis all five participants expected the real Federal Reserve to hold the target rate at 6.5%.

The Committee's own deterministic framework arrived at a different destination: a loss-minimizing recommendation of -25 bps. The reference rules were themselves divided. The Taylor rule returned 0 bps, consistent with the hold vote and with core PCE running close to but below target. The Balanced Approach and ELB-adjusted rules each called for +75 bps, driven by the wide unemployment gap. The first-difference rule, however, pointed to -25 bps, and it was this logic that most participants found persuasive when engaging with the optimal case. Because the first-difference approach responds to the direction of momentum rather than to level gaps, it caught what the gap-based rules missed: inflation momentum of -0.08 and flat unemployment momentum, alongside the cooling the Beige Book described. With r* estimated at 3.76 and core inflation near 1.5%, a 6.5% nominal rate leaves real policy meaningfully above neutral; a single quarter-point step would relieve excess restraint while keeping real rates above neutral, and so preserve inflation vigilance rather than abandon it.

Participants who had voted to hold explained the divergence as one of timing rather than direction. The predictive hold reflected caution about moving before confirmation and deference to the real Fed's likely stance given still-tight labor markets; the framework's cut reflected a judgment that the confirmation sought was already visible in soft inflation and moderating activity. Even the participant most anchored in inflation risk acknowledged that a disciplined, reversible 25 bps move was defensible, with his remaining concern being magnitude rather than direction. Reservations about acting ahead of confirmation were softened by the observation that markets had already priced easing, so moving in line with that path would avoid a later repricing surprise. On that reasoning, the Committee judged -25 bps to be the optimal policy at this meeting: a modest, reversible reduction that begins to unwind restraint while leaving policy above neutral.

COMMITTEE VOTE

The predictive vote to expect a hold at 6.5% was unanimous, 5-0. On the framework's -25 bps recommendation, the optimal-side deliberation also landed unanimously, with all five members voting to endorse (5-0).

NOTES

No participant declined the framework's recommendation, though the inflation-focused member endorsed the full -25 bps only reluctantly, stating his honest bias was to hold and that his concern was the magnitude, not the direction, of any easing; he stressed the need to preserve room to reverse should labor tightness reassert price pressure.