OpenFed

POLICY STATEMENT | September 26, 2000

PREDICTED FED DECISION HOLD

6.50%

OPENFED OPTIMAL RATE −25 bps

6.25%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 6.5%, yet its own framework judges the optimal policy to be a 25 bps cut, an easing four of five members endorsed.

STATEMENT

Core PCE inflation stood at 1.36%, below the 2.0% objective, while unemployment at 4.1% remained a full percentage point under the 5.1% natural rate. Against this backdrop the Committee read a genuinely balanced picture. Participants generally judged that the current 6.5% funds rate is already restrictive, and with core inflation running below target, no member saw a case for further tightening. At the same time, the labor market was still tight and the Beige Book documented widespread wage increases, with firms calling higher labor, health care, and energy costs an increasing problem that could eventually pass through to consumers. Set against that were clear early signs of cooling: softening growth in Atlanta, Chicago, St. Louis, and Minneapolis, weakening home sales and construction, an inverted 10-year to 2-year spread at -0.26, and a 3-month T-bill sitting 0.5 below the funds rate. Financial conditions were contained but not calm, with the Baa spread at 2.52, VIX at 21.88, and the stress index at 0.24.

On the near-term decision, participants converged quickly and unanimously. The employment-focused reading was that while a slowdown would eventually reach jobs, there was no realized labor-market weakness yet to justify easing now, with claims at 288,000 and unemployment still well below its natural rate. The market-signal reading agreed that although the T-bill spread and curve inversion point to a softer path over coming quarters, markets are not pricing an imminent cut, and front-running that signal was unwarranted. Those weighing inflation risk most heavily added that easing before wage and energy pass-through visibly recede could reignite the very price pressures they guard against, and that limited pass-through so far is a comfort, not a green light. The Committee therefore expects the real Federal Reserve to hold the target rate unchanged at this meeting, a decision of 0 bps.

The Committee's own deterministic framework, applied independently, reached a different conclusion: the loss-minimizing recommendation was a cut of 25 bps. The reference rules diverged sharply, which itself signals a balanced moment. The Taylor rule returned 0 bps, consistent with inflation near target offset by firm activity. The Balanced Approach and ELB-adjusted rules each returned +75 bps, leaning heavily on the wide employment gap. Only the First-Difference rule pointed to -25 bps, and it was that rule the framework followed, because it responds to the direction of change rather than to a possibly stale level. The momentum terms drove the result: inflation momentum of -0.125, indicating price pressures easing rather than building, against only a marginal +0.05 drift in unemployment momentum, with an r* of 3.787 and the reference rules judged reliable. Members who examined this case read the +75 rules as overstated, resting on a labor-market level while ignoring the inverted curve and cooling credit-sensitive sectors. Below-target inflation, negative inflation momentum, and the recession-risk signal in the yield curve together made a modest, single-increment cut the analytically cleaner call, and one member framed it plainly as prudent insurance against an inversion-driven downturn rather than aggressive easing.

The gap between the expected hold and the optimal -25 bps is one 25 bps increment, and the Committee read that narrow divergence as revealing that the current 6.5% stance is modestly, though only marginally, too restrictive for emerging conditions. The predictive hold reflects caution warranted by a still-tight labor market and unresolved pass-through risk; the framework, less deferential to that caution, treats the same softening signals as already justifying a small step down.

COMMITTEE VOTE	The predictive vote to expect a hold at 6.5% was unanimous, 5-0. On the framework's -25 bps recommendation, the Committee's optimal-side deliberation split 4-1, with four members endorsing the cut and one declining.
NOTES	*The lone decline came from the member weighting inflation risk most heavily, who accepted the framework's math but not its conclusion: with unemployment at 4.1% against a 5.1% natural rate sustaining wage-cost pressure, and the Beige Book flagging potential energy and health care pass-through, this member held that easing would be premature until those upside risks visibly recede, noting that the Balanced Approach and ELB-adjusted rules' +75 bps readings validated the anti-easing posture.*