OpenFed

POLICY STATEMENT | March 21, 2006

PREDICTED FED DECISION +25 bps

4.75%

OPENFED OPTIMAL RATE −25 bps

4.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to raise rates 25 bps in line with prior firming guidance, yet its own framework concludes the loss-minimizing move is a 25 bps cut toward a neutral the current stance has likely overshot.

STATEMENT

The most striking feature of this meeting is the gap between what the Committee expects and what it judges to be right. On the predictive side, four of five members read the near-term path as a continuation of the tightening cycle. The prior statement had signaled that 'some further policy firming may be needed,' and little in the current data was seen as reversing that direction: unemployment at 4.8% sits below the estimated natural rate of 5.04%, initial claims at 303,000 remain low, and the Beige Book described employment still increasing across most Districts alongside ongoing input cost pressures and solid resource utilization. Financial conditions offered no argument for pausing, with the stress index at 0.11, the VIX at an unusually subdued 11.62, and the Baa spread contained at 1.7. Members who weight market pricing pointed to a 3-month T-bill spread of roughly +0.02 as consistent with one more expected step. A single measured 25 bps move, on this reading, keeps policy aligned with prior guidance and with what calm markets appear to anticipate, without shocking them.

Set against this, the Committee's own deterministic framework recommends easing by 25 bps. The tension is not incidental — it turns on the same data read through a level, rather than a momentum, lens. Core PCE stands at 1.43%, well below the 2.0% objective, and inflation momentum is negative at -0.07; the recent softening in labor tightness shows through as well, with unemployment momentum at -0.1. With the estimated r* at only 0.992, a nominal funds rate of 4.5% implies a real rate on the order of 3%, meaningfully above neutral. On those inputs the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each point to -75 bps, while the first-difference rule, which adjusts incrementally from the current setting, indicates -25 bps. The framework's loss-minimizing output of -25 bps splits the difference in favor of the more gradual signal, and members judged the reference rules reliable this meeting.

In deliberating on that recommendation, members converged on the more measured step rather than the aggressive one. The first-difference logic drew the widest support: it acknowledges below-target inflation and an above-neutral real rate while avoiding an abrupt lurch that could itself unsettle otherwise stable credit conditions. Members attentive to financial stability noted that the 10y-2y curve at -0.01 is essentially inverted, a recession-risk signal that argues against pressing the curve deeper through further firming, and that a full -75 bps correction risked signaling alarm. Those weighting employment observed that although the labor market shows no distress today — momentum in fact still points toward tightening — beginning to ease before the stance bites into a slowing labor market is defensible as insurance. Even the most inflation-focused reasoning conceded that undershooting inflation and decelerating price pressures leave less urgency for vigilance than energy-price commentary alone might suggest, favoring -25 bps as a cautious acknowledgment of the undershoot rather than an abandonment of it.

Taken together, the Committee expects the real Federal Reserve to raise the target range by 25 bps, while independently judging that the optimal policy at this meeting is a 25 bps cut. The divergence is the substance of this meeting: the predictive path reflects the momentum of prior hawkish guidance, whereas the framework and the members' own reading of below-target inflation, a low r*, and a flat-to-inverted curve indicate that the stance has likely moved past neutral and that a measured correction toward it is warranted.

COMMITTEE VOTE	The predictive vote was 25 bps, carried 4 to 1. On the framework's -25 bps recommendation, the optimal-side deliberation was unanimous, with all five members endorsing the recommendation as-is.
NOTES	*On the predictive vote, one member weighting employment declined to support a further hike, judging that with core PCE at 1.43% and the yield curve near inversion the honest reading of the data favored holding at 4.5% rather than firming further, though this member stated they would not formally dissent against a single measured move.*