The Daily Dish

Thinking Through the Fed Decision

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If you happen to be living in a bubble, the Fed raised its policy interest rate (the federal funds rate) by 75 basis points yesterday, moving the target range to 1.50–1.75 percent. Prior to the decision, the debate was whether the increase should be 50 basis points or 75 basis points. A good case can be made for either; indeed, Kansas City Federal Reserve Bank President Esther George dissented from the decision in favor of a 50 basis point increase.

The case for 50 basis points goes roughly like this. The Fed needs to re-establish its credibility, having admitted that it got inflation wrong in 2021. The Fed had signaled a 50 point rise since its last meeting, with multiple Fed officials indicating over the past month that this was the likely action. Finally, consumer price index (CPI) inflation of 8.5 percent (March), 8.3 percent (April), and 8.6 percent (May) are essentially the same information. With no new information, the best way to establish credibility is to stick to the plan and raise by 50, thereby sending the message “this is what we expected.

The case for 75 basis points is that there really was news of higher, more persistent inflation in the most recent CPI data. The Fed has always stressed that it would make decisions on a meeting-by-meeting basis, and those decisions would depend on the data. (It repeated this again yesterday: “In assessing the appropriate stance of monetary policy, the Committee will continue to monitor the implications of incoming information for the economic outlook.”) In this view, the best way to restore credibility is to acknowledge the reality and act in the data-dependent way it had advertised, even if it was an admission of having been off the mark at the last meeting.

So, in the end, the credibility issue hinges on whether it is better to stick with the plan or get the policy right. With so many policy errors haunting the economy, the Fed made the right call.