OpenFed

POLICY STATEMENT | January 24, 1996

PREDICTED FED DECISION −25 bps

5.25%

OPENFED OPTIMAL RATE HOLD

5.50%

KEY TAKEAWAY

The Committee expects the real Fed to cut 25 bps to support softening activity, but its own framework judges the optimal move to be no change, holding at 5.50% while inflation sits squarely at target.

STATEMENT

The defining feature of this meeting was a clear gap between what the Committee expects and what its framework judges best. Recent data described an economy losing momentum without any sign of acute strain. Core PCE inflation registered 2.01%, essentially at the 2.0% objective, with inflation momentum slightly negative at -0.005. The unemployment rate stood at 5.6%, modestly above the estimated 5.32% natural rate, and initial jobless claims at 415,000 were judged elevated. The Chicago Fed National Activity Index at -0.87 pointed to growth meaningfully below trend. Against this softening, financial conditions remained calm: the financial stress index was low at 0.0672, the VIX subdued at 12.54, the Baa spread contained at 1.83, and the yield curve positively sloped at 0.55, with no inversion signal. The 3-month Treasury bill traded 53 basis points below the current 5.50% funds rate.

On the predictive question, most participants concluded the real Federal Reserve would reduce the target range by 25 basis points. Their reasoning rested on the confluence of below-trend activity, elevated claims, and building labor slack, together with market pricing that already embedded a near-term cut, as reflected in the T-bill spread. With inflation at target and momentum slightly disinflationary, these participants saw room to lean against employment risk without endangering price stability, and viewed a follow-up cut as continuous with the prior meeting's easing rather than a new departure. One participant demurred, emphasizing that inflation exactly at target offers no cushion for further easing and that stacking a second consecutive cut before the last has propagated through the economy risks over-easing and eroding credibility; absent any credit stress or inversion, this participant favored holding to reassess whether the growth softness persists.

The Committee's own deterministic framework arrived at a different answer: the optimal policy is a change of 0 basis points. This recommendation reflected a genuine tension among the reference rules. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each pointed to +75 basis points, implying that at an estimated r* of 2.71 the current 5.50% rate is only modestly restrictive and arguably below neutral. The first-difference rule, however, returned 0, respecting the flat momentum in the data, with inflation momentum at -0.005 and unemployment momentum at 0.0. Weighing these against soft real-side activity, the loss-minimizing result settled on holding. Participants found the first-difference logic the most persuasive: the level-based rules exploit a small unemployment gap and near-target inflation to argue for tightening, but hiking into a softening labor market with elevated claims and a negative activity reading would fight the incoming data, while easing into anchored inflation and calm markets is not clearly warranted either.

The two conclusions are best understood together. The 25-basis-point cut the Committee expects reflects a real Fed reacting to soft activity and market pricing that may be running somewhat ahead of fundamentals; the framework's hold reflects a stance judged roughly neutral, where flat momentum and benign financial conditions argue against moving in either direction this meeting. Several participants noted that a hold preserves optionality: if claims keep climbing and activity stays below trend, the case to ease at a subsequent meeting remains available without having over-committed now. The Committee therefore predicts a 25-basis-point reduction while independently judging that no change is the optimal course.

COMMITTEE VOTE	The Committee's predictive vote was 4 to 1 in favor of a 25 basis point cut, with one member favoring no change. On the framework's 0 basis point recommendation, the optimal-side deliberation landed 4 endorse, 1 partial, with no members declining.
NOTES	*The lone predictive dissent came from the participant prioritizing inflation, who argued that with core PCE exactly at target and prior easing still working through the economy, a second consecutive cut risks over-easing and losing hard-won credibility, and that calm markets and a positive curve offered no case for insurance easing. On the optimal side, the labor-focused participant registered only partial agreement: accepting the hold's direction given flat momentum, but unable to fully endorse standing pat while jobless claims and below-trend activity signal downside employment risk, preferring a tilt toward easing.*