OpenFed

POLICY STATEMENT | January 28, 1997

PREDICTED FED DECISION HOLD

5.25%

OPENFED OPTIMAL RATE HOLD

5.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 5.25%, and its own deterministic framework independently endorses 0 bps as optimal, overriding reference rules that pointed to sizable cuts.

STATEMENT

The information reviewed by the Committee described an economy sitting close to balance. Core PCE inflation at 1.85% ran just below the 2.0% objective, while unemployment at 5.3% held essentially at the estimated 5.25% natural rate. Beige Book reports characterized activity as moderate to strong, with labor shortages intensifying in key sectors even as wage pressures were reported infrequently and prices stayed broadly stable. Financial conditions were quiet on every metric participants weighed: a financial stress index of 0.09, a Baa spread of 1.51, a moderate VIX near 20.74, and a yield curve slightly positive at 0.6 with no inversion. Against that backdrop, all five participants independently arrived at the same predictive conclusion, judging that the real Federal Reserve would leave the target rate unchanged at 5.25% at this meeting.

The reasoning behind that judgment was not uniform, even where the conclusion was. Participants weighting inflation risk emphasized that although core PCE had not yet breached target, the combination of full employment, above-trend growth in the Chicago Fed activity index at +0.27, and intensifying labor shortages was precisely the configuration in which price pressures build before they appear in the data; they resisted any impulse to ease and retained a bias toward eventual tightening. Participants attentive to employment noted that with initial claims at a moderate 340,000 and no sign of rising joblessness, a genuine dovish lean still did not warrant an actual cut into a firm labor market. Those focused on financial stability and on market pricing reinforced the hold from the other side, observing that the 3-month T-bill trading roughly 21 basis points below the funds rate signaled markets expected no move, and that disturbing calm, well-functioning credit markets carried real downside with little payoff. These opposing leans largely neutralized toward the center, and no participant was persuaded during rebuttal to shift toward action.

The Committee's own deterministic policy framework reached the same destination, though the path was more contested. Its major reference rules pointed sharply toward easing: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each prescribed -75 basis points, driven largely by the small inflation undershoot against an estimated r* of 2.928, while the first-difference rule counseled a more modest -25 basis points. The framework's loss-minimizing recommendation nonetheless came out at +0 basis points, overriding the aggressive level-based prescriptions. Participants found that override persuasive precisely because the momentum terms did not corroborate a disinflationary emergency: inflation momentum was essentially flat at -0.02, and unemployment momentum, while positive at +0.15, represented only a mild upward drift worth watching rather than acting on. Several noted that the first-difference rule, which responds to changes rather than static gaps, sat closest to their own reading, and that even -25 basis points lacked clear justification given stable labor conditions and the absence of any credit stress.

On that basis the Committee concluded that 0 basis points is not only the most likely predicted outcome but also the optimal one: current policy is only mildly restrictive rather than damagingly tight, and cutting 75 basis points into a moderate-to-strong economy at full employment would risk stimulating an already balanced economy and reigniting the very price pressures the level rules were meant to address. Holding at 5.25% preserves optionality in both directions — room to tighten should labor-market tightness finally feed into wages and prices, and room to ease quickly should claims or unemployment momentum turn genuinely adverse.

COMMITTEE VOTE

The predictive vote was unanimous at 5-0 for no change, leaving the target rate at 5.25%; on the optimal side, all five members likewise endorsed the framework's 0 bps recommendation, a 5-0 endorsement with no declines or partial dissents.