OpenFed

POLICY STATEMENT | January 26, 2000

PREDICTED FED DECISION +25 bps

5.75%

OPENFED OPTIMAL RATE −25 bps

5.25%

KEY TAKEAWAY

The Committee unanimously expects a 25 bps hike, yet its own loss-minimizing framework recommends a 25 bps cut — a full 50 bps gap between what it predicts and what it judges optimal.

STATEMENT

The information reviewed at this meeting described an economy running warm. Activity was strong across nearly all Districts, with rapid consumer spending, broad-based manufacturing expansion, and tight labor markets everywhere. Unemployment stood at 4.1%, far below the 5.12% natural rate estimate, and initial jobless claims at 284,000 gave no hint of deterioration. Against that backdrop, core PCE at 1.54% remained below the 2.0% target, and participants noted repeatedly that the tight labor market had not yet been matched by large wage increases and that consumer prices were holding steady. Rising petroleum prices were flagged as the one visible cost pressure worth watching. Financial conditions were accommodative but not carefree: the financial stress index at 0.24 was moderate, the Baa spread at 1.59 was contained, and the 10y-2y curve was barely positive at +0.24, while a VIX near 23 signaled some residual market nervousness.

In predicting the real Federal Reserve's likely action, all five participants converged, through distinct lenses, on the same reading. The negative slack in the labor market, robust demand, and latent upside risk from petroleum argued for continued gradual firming; the absence of any recession or credit-stress signal removed the case for caution. Several observed that the 3-month T-bill sitting about 9 bps below the funds rate was consistent with a modest hike already being discounted, not a cut, and that the elevated VIX argued against anything larger than a measured step. Participants generally judged that a below-target inflation reading removed the urgency for an aggressive move but did not overturn the preemptive logic. The Committee therefore expects a 25 bps hike, to 5.75%.

The Committee's own deterministic framework arrived at the opposite conclusion, recommending a 25 bps cut. The tension is instructive. Three of the four reference rules — the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule — each pointed to +75 bps, driven overwhelmingly by the wide unemployment gap. The first-difference rule alone pointed to -25 bps, and it was the rule the loss-minimizing output tracked. The reason is momentum: inflation momentum registered at 0.005 and unemployment momentum at -0.05, essentially flat readings that describe an economy that is stable rather than accelerating. With realized inflation below target, no wage pass-through, and an estimated r* of 3.702 implying that the current 5.5% stance is already meaningfully restrictive, the framework read the picture as a persistent undershoot worth correcting rather than an overheating to be leaned against. Where the level rules react to how tight the labor market already is, the first-difference logic responds to change — and there is little change to respond to.

Participants engaged this framework case seriously, and most found the direction persuasive even as they resisted the magnitude. The argument that the level rules overstate the tightening case, given contained realized prices and a flat curve that further hikes could invert, drew broad agreement. But the recurring objection was that nothing in the actual data — low claims, no credit widening, no labor deterioration — affirmatively demands easing, and that a full 25 bps cut into a hot labor market overreads a modest 0.46-percentage-point undershoot. The stability-minded view added that an outright cut amid a jittery VIX could itself unsettle markets. The result was a Committee that endorsed the framework's disinflation reading over the level rules' hawkishness, while judging the recommended cut larger than the stable, contained data warrants.

COMMITTEE VOTE	The predictive vote was unanimous, 5-0, for a 25 bps hike. On the framework's -25 bps optimal recommendation, the Committee split 4-1 partial-to-decline: four members agreed with the easing direction but not the full magnitude, and one declined outright.
NOTES	*The lone decline came from the inflation-focused view, which rejected the direction of the cut altogether: with a labor market at 4.1% far below the natural rate and strong nationwide demand, easing would stimulate an already-hot economy and invite the overheating it most fears. Conceding that below-target inflation and flat momentum ruled out a further hike, it favored holding as the defensible middle rather than either tightening or cutting.*