OpenFed

POLICY STATEMENT | September 16, 2009

PREDICTED FED DECISION HOLD

0.00%-0.25%

OPENFED OPTIMAL RATE HOLD

0.00%-0.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 0.0% to 0.25%, and its own framework independently arrives at the same 0 bps conclusion despite three level-based rules calling for 75 bps.

STATEMENT

Information reviewed at this meeting described an economy stabilizing but not yet recovering with conviction. Core PCE inflation stood at 1.07%, nearly a full point below the 2.0% objective, and the Beige Book pointed to weak loan demand, tight credit standards, and labor conditions that remained soft across Districts. Against this backdrop, unemployment at 9.7% sat far above the 5.04% natural rate assumed in the Committee's framework, a gap participants read as evidence of substantial resource slack. Financial conditions were characterized as fragile but healing rather than acute: the financial stress index at 0.3507 and a VIX of 23.69 were elevated but off crisis peaks, while a Baa spread of 2.91 signaled that private borrowing costs remained restrictive even as they narrowed. With the target range already at the 0.0% to 0.25% effective floor, participants generally judged that no meaningful cut was feasible and that no inflation pressure existed to justify tightening.

On the question of what the real Federal Reserve is likely to do, participants converged from distinct starting points. Those most attentive to inflation risk observed that, for once, that risk was simply absent; those focused on the labor market emphasized that the appropriate accommodation could no longer come through the funds rate at the lower bound, but through the maintained stance and the Treasury purchase program winding down through October. Participants weighing financial stability cautioned that premature tightening would risk destabilizing still-healing credit markets, and those reading market signals noted that a nearly flat 3-month T-bill spread of 0.015 and a steeply positive 10y-2y curve at 2.47 showed markets pricing no near-term move in either direction. The Committee's predictive conclusion was accordingly to hold the target range unchanged at 0.0% to 0.25%.

The Committee's own deterministic framework arrived independently at the same destination, though the path was more contested. Three of its reference rules, the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule, each prescribed 75 bps, reflecting a positive estimated r* of 1.593 applied mechanically to the large inflation and unemployment gaps. Participants treated those prescriptions as counsel rather than command: hiking to 75 bps with unemployment at 9.7% and unemployment momentum still rising at 0.5 would, in their view, be a clear policy error at the effective lower bound. The first-difference rule, which reacts to momentum rather than distant equilibrium levels, returned 0 bps, and participants generally found it the most persuasive here. With inflation momentum negative at -0.185, the change-based logic saw no case to move rates up. The loss-minimizing recommendation of the framework was therefore +0 bps, and the Committee determined that holding at 0.0% to 0.25% is the optimal policy for this meeting.

The Committee read the divergence between the 75 bps level rules and the 0 bps recommendation not as a genuine tension but as an artifact of the lower-bound constraint, one that markets had already discounted. Both the predictive judgment and the framework's optimal determination thus rested on the same argument: subdued and decelerating inflation, enormous and still-widening labor slack, and fragile but improving credit conditions together leave holding as the accommodative choice, not a passive one. Participants retained the caveat that, should slack narrow and inflation momentum turn positive, normalization would move to the front of the agenda.

COMMITTEE VOTE

The Committee's predictive vote to hold the target range at 0.0% to 0.25% was unanimous at 5-0, and on the optimal side all five members endorsed the framework's 0 bps recommendation as-is, a 5-0 endorsement.