OpenFed

POLICY STATEMENT | January 21, 2015

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 the target range at 0-0.25%, and its own policy framework independently arrives at the same conclusion, with all four reference rules and every member converging on no change.

STATEMENT

The defining feature of this meeting is the absence of tension: every strand of the analysis, and every member, arrived at the same place from a different starting point. Core PCE stands at 1.24%, well below the 2% objective, and the inflation-focused reading of the data is the most telling. The member most inclined by mandate to tighten found no case to do so, because the risk here runs to the downside, not the upside. Inflation momentum is essentially flat at 0.035, the Beige Book describes only modest price and wage inflation, and oil-price declines and online competition are exerting broad downward pressure. Wage gains reported in the Beige Book are flat-to-modest and often offset by rising medical premiums, so there is no wage-price dynamic to preempt. On the labor side, unemployment at 5.6% sits just above the 5.49% estimate of the natural rate; unemployment momentum of -0.15 indicates joblessness is still falling, initial claims at 316,000 are moderate, and the Chicago Fed activity index at 0.73 points to above-trend growth. That picture leaves no employment weakness to defend against and no overheating to lean against.

Against that backdrop, the Committee's judgment about what the real Federal Reserve will do is straightforward: hold the target range at 0.0% to 0.25% and maintain the patient stance. Financial conditions offer no reason to force a move in either direction. The financial stress index at 0.087 is very low, the VIX at 18.85 is moderate rather than elevated, the Baa spread at 2.61 is contained, and the 10y-2y curve at 1.34 is positively sloped with no recession signal. Members who weight market pricing most heavily noted that the 3-month T-bill spread of -0.095 sits below the current range, implying markets are not pricing an imminent hike and expect the range to hold. A cut, in any case, is close to impractical with rates already at the effective floor.

The Committee's own deterministic framework reaches the identical conclusion, and does so with unusual clarity. All four reference rules — the Taylor rule, the balanced-approach rule, the first-difference rule, and the ELB-adjusted rule — print 0 bps, and the framework judges those rules reliable this meeting. The estimated neutral real rate, r*, is -0.5, which means the current 0-0.25% range is already accommodative rather than restrictive; there is no gap between where policy sits and where the rules say it should sit. The balanced-approach logic is instructive on why the rules net to zero: the nearly closed unemployment gap would ordinarily argue for eventual liftoff, but the roughly 0.76 percentage point inflation shortfall offsets that pressure almost exactly. The ELB-adjusted rule carries particular weight given that policy is pinned at the lower bound and cannot ease conventionally further. Taken together, the loss-minimizing recommendation is +0 bps — the optimal policy, on the Committee's own framework, is to hold at 0.0% to 0.25%.

The two conclusions therefore reinforce one another: the Committee expects the real Federal Reserve to hold, and independently determines that holding is the optimal choice. What tension exists is asymmetric and worth stating plainly. The more pressing risk is entrenched below-target inflation rather than overheating, and premature tightening into soft inflation and declining market-based inflation compensation would risk pushing prices further from 2% and undermining credibility on that goal. Holding preserves optionality while the Committee awaits clearer evidence that inflation is firming back toward target.

COMMITTEE VOTE	The predictive vote was unanimous, 5-0, that the real Federal Reserve will hold the target range at 0.0% to 0.25%; on the optimal side, all five members endorsed the framework's +0 bps recommendation, a 5-0 endorsement with no declines or partial dissents.