OpenFed

POLICY STATEMENT | April 20, 2016

PREDICTED FED DECISION HOLD

0.25%-0.50%

OPENFED OPTIMAL RATE −25 bps

0.00%-0.25%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 1/4 to 1/2 percent, even as its own deterministic framework judges the loss-minimizing move to be a 25 basis point cut.

STATEMENT

The defining feature of this meeting is a clean divergence between what the Committee expects the real Federal Reserve to do and what its own framework identifies as optimal. On the predictive side, all five members read the incoming data the same way and converged on holding the target range at 1/4 to 1/2 percent. Core PCE inflation stood at 1.31 percent, well below the 2 percent objective, so there was no inflation case for tightening; unemployment at 5.0 percent sat close to the estimated 4.8 percent natural rate, and initial jobless claims near 253,000, together with Beige Book reports of labor markets continuing to strengthen, offered no employment weakness that would argue for easing. Financial conditions were benign across the board, with the stress index at 0.111, the VIX subdued at 13.28, a positively sloped yield curve, and a moderate Baa spread of 2.96, so nothing in markets was forcing the Committee's hand in either direction. Members observed that the 3-month T-bill spread of -0.165 showed the front end trading below the current range midpoint, indicating markets themselves expected no near-term hike. With below-trend growth signaled by a Chicago Fed activity reading of -0.29, only one week of new data, and prior guidance stressing 'only gradual' moves and data-dependence, participants judged that a move in either direction was unwarranted. Predictive outcome: hold.

The Committee's own deterministic framework, applied independently, reached a different conclusion. It recommended a 25 basis point cut, and all four reference rules the framework consulted -- the Taylor rule, the balanced-approach rule, the first-difference rule, and the ELB-adjusted rule -- agreed on -25 bps and were judged reliable this meeting. The engine's inputs make the logic transparent: with the neutral real rate estimated at -0.5, the current 0.25 to 0.50 percent stance is mildly restrictive rather than accommodative, and a 1.31 percent inflation reading roughly 0.7 percentage point below target pulls the rules toward easing. Inflation momentum registered a bare 0.07 and unemployment momentum -0.05, so there was no accelerating price pressure to lean against and no push toward tightening. Members engaging with the framework found its math hard to dismiss. Those weighting inflation risk acknowledged that the overshoot their instincts assume simply was not in the data, and that Beige Book input-price pressure had not passed through to selling prices; those focused on employment leaned on the balanced-approach rule, noting that below-trend activity risked eroding labor gains if policy waited too long; the financial-stability perspective favored the ELB-adjusted rule, reasoning that with no froth in spreads or the VIX, easing near the lower bound preserved credit accommodation cheaply. Optimal conclusion: -25 bps.

The gap between the two conclusions is itself the substance of this meeting, and members were candid about its source. Several described their predictive hold as reflecting institutional caution -- gradualism, previously flagged global risks, and a reluctance to surprise calm markets -- rather than a data-based case against easing. The framework, by their own reckoning, correctly reads the fundamentals: a persistent inflation shortfall, a deeply negative r*, modest labor slack, and a front-end market signal that quietly leans in the same direction. That the negative T-bill spread aligns market pricing closer to the framework than to a hold was noted as reinforcing, not contradicting, the -25 bps call. The one genuine reservation, raised from the inflation side, was that upward input-price pressure could eventually feed through to selling prices; on that view, any cut should remain gradual and reversible. Even accounting for that caveat, the Committee's assessment is that the current stance is a touch tighter than loss-minimizing policy would set it, while the most likely real-world outcome remains a hold.

COMMITTEE VOTE

The predictive vote to hold the target range at 1/4 to 1/2 percent was unanimous, 5-0. On the framework's -25 bps recommendation, the Committee's optimal-side deliberation was also unanimous, with all five members endorsing the cut as recommended.

NOTES

No member dissented on either side. The nearest thing to reservation came from the inflation-focused position, which endorsed the -25 bps call but insisted any easing stay gradual and reversible in case Beige Book input-price pressure begins passing through to selling prices.