OpenFed

POLICY STATEMENT | January 23, 2019

PREDICTED FED DECISION HOLD

**2.25%-2.50%**

OPENFED OPTIMAL RATE −25 bps

**2.00%-2.25%**

KEY TAKEAWAY

**The Committee unanimously expects the real Federal Reserve to hold at 2.25-2.50%, while its own framework judges the loss-minimizing move to be a 25 basis point cut — a divergence over timing, not direction.**

## STATEMENT

Information reviewed for this meeting described an economy still expanding, with a labor market that remained tight but signs of momentum beginning to soften. Unemployment at 3.9 percent stood well below the 4.61 percent estimate of its natural rate, and initial claims of 213,000 gave no indication of layoffs. The Beige Book reported tight labor across all Districts, with firms struggling to find workers at any skill level and wages growing moderately, though pass-through of cost increases into final prices was mixed. Against this backdrop, core PCE inflation of 1.48 percent sat below the 2 percent target, removing any urgency to tighten further. Participants also weighed a set of financial signals pointing the same way: the VIX at 19.52 reflected elevated market anxiety, the Baa credit spread at 2.38 was moderate but consistent with tightening conditions the Beige Book flagged, and the 10-year to 2-year spread at just 0.18 was flattening toward inversion. With the 3-month T-bill spread over the current rate at 0.005, markets were pricing essentially no further hike.

On the question of what the real Federal Reserve will do at this meeting, participants converged quickly and unanimously on holding the target range at 2.25 to 2.50 percent. The case ran in two directions and closed off both. There was no inflation basis to hike, with core PCE below target and price pressures soft; and there was no basis to cut, with labor tight, jobless claims low, and the CFNAI at 0.22 signaling activity near or above trend. Participants noted that prior minutes had already revised down the appropriate policy path amid global and financial risks, and that the softened 'realized and expected economic conditions' language was fully consistent with a pause. Hiking into fragile sentiment and a near-flat curve struck participants as an unnecessary risk; cutting, with financial stress low at 0.075, could signal an alarm the data did not support. Holding to assess conditions after four hikes over the year was judged the most balanced, data-consistent choice.

The Committee's own deterministic framework reached a different conclusion, recommending a 25 basis point cut. The tension here is instructive, and it turns on the low estimate of the neutral real rate. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all prescribed +75 basis points, but those calls lean on level gaps and assume a positive r*; with the framework's r* set at -0.5, a current midpoint of 2.375 percent against inflation of 1.48 percent implies a positive real rate that is likely restrictive relative to neutral, which undercuts the hawkish prescription. The first-difference rule, at -25 basis points, keyed instead off the direction of change — inflation momentum of -0.11 and unemployment momentum of -0.10, both softening. Participants across lenses found this the more persuasive reading: with a negative neutral rate and decelerating momentum, current policy is already meaningfully restrictive, and the loss-minimizing response is to ease modestly rather than hold restrictive policy against weakening data. That -25 basis point recommendation is the Committee's considered view of optimal policy for this meeting.

The gap between the two conclusions is one of timing and magnitude rather than direction. Every member agreed the hiking cycle should stop, and most accepted that an easing bias is warranted. Where the predictive hold and the framework's cut part ways is whether to act now. Several participants observed that market pricing shows no imminent cut, only a done hiking cycle, and that moving from 2.25-2.50 percent ahead of any priced-in expectation risks signaling an alarm markets do not feel. On that reasoning, the majority preferred to hold now and ease only once softening in the hard data — particularly employment — confirms the trajectory.

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| COMMITTEE VOTE | The predictive vote to hold the target range at 2.25 to 2.50 percent was unanimous, 5-0. On the framework's -25 basis point recommendation, the Committee split 0 endorse, 4 partial, and 1 decline — four members agreeing with the direction of easing but not its immediate timing, and one declining outright. |
| NOTES | *The single decline came from the member weighting inflation risk most heavily, who accepted that the stale 75 basis point rules no longer justify a hike but rejected cutting outright: with unemployment below its natural rate and wages firm, an immediate ease was judged to risk stoking wage-driven inflation, making insurance against reacceleration more valuable than relieving policy that is only modestly restrictive.* |