OpenFed

POLICY STATEMENT | January 22, 2020

PREDICTED FED DECISION HOLD

1.50%-1.75%

OPENFED OPTIMAL RATE −25 bps

1.25%-1.50%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 1.50-1.75 percent, while its own framework judges the optimal move to be a modest 25 basis point cut, an insurance easing four of five members endorse.

STATEMENT

Information reviewed for this meeting described an economy expanding modestly, with a labor market that remains exceptionally tight. Unemployment stood at 3.5 percent, well below the 4.56 percent estimated natural rate, and initial jobless claims were low at 204,000. The Beige Book characterized employment as steady to rising, with widespread labor shortages nationwide, even as it noted scattered job cuts in manufacturing, transportation, and energy and lingering trade uncertainty. Against this backdrop of strength, inflation remained soft: core PCE at 1.4 percent sits below the 2.0 percent objective, though not falling sharply, while wage growth was described as only modest to moderate and the Employment Cost Index at 138.0 showed no alarming acceleration in labor costs. Financial conditions were calm and accommodative throughout, with the financial stress index at 0.063, the VIX at 12.91, the Baa corporate spread tight at 1.97, and the 10-year to 2-year spread positive at +0.24, having moved past its earlier inversion.

On the question of what the real Federal Reserve is likely to do, participants converged from distinct analytical vantage points on the same answer: hold the target range at 1.50-1.75 percent. Those focused on inflation saw no overheating to lean against, but resisted easing into a labor market this tight for fear of a future overshoot. Those weighing employment risk found their mandate already being met, with no systemic labor softening to justify a preemptive cut. Participants attentive to financial stability and to market pricing reached the same place: with conditions already loose, a cut risked encouraging excessive risk-taking, and the 3-month T-bill spread of -0.095 signaled only a mild easing lean, not a demand for action. Several observed that the range midpoint of 1.625 percent sits essentially at the Committee's own projected 1.6 percent path, so policy is already where it is expected to be. The prior meeting's unanimous pause, which had called the stance appropriate, and the absence of new data cutting against it, reinforced the judgment that no move is expected.

The Committee's own deterministic framework, applied independently of that predictive read, arrived at a different conclusion: the loss-minimizing policy is a cut of 25 basis points. The reference rules split sharply on magnitude. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all pointed to -75 basis points, driven by the 0.6 percentage point inflation shortfall and a low estimated r* of -0.265. The first-difference rule, by contrast, indicated only -25 basis points. In discussion, participants judged the larger prescriptions excessive at face value, faulting them for overweighting the level of the inflation gap while ignoring a 3.5 percent unemployment rate and the latent wage pressure a tight labor market implies. The first-difference logic proved most persuasive precisely because it responds to momentum rather than the full level gap, and momentum was only mildly negative: inflation momentum at -0.095 and unemployment momentum at -0.05 describe conditions that are drifting, not deteriorating. The framework's landing on -25 rather than -75 reflected that restraint, and with the real rate sitting slightly above r*, participants read it as measured insurance against soft inflation and below-trend growth (the Chicago Fed activity index at -0.35) without inflaming already-calm markets.

The gap between the two conclusions, a hold in the predictive read against a 25 basis point cut in the optimal read, is itself informative: it places current policy close to neutral, where reasonable analysis can split between standing pat and a single precautionary step. Participants who supported the framework's recommendation stressed that a modest, reversible cut better honors the inflation objective and cushions early-stage sectoral job losses before they broaden, while stopping well short of the aggressive rules. The one reservation came on magnitude rather than direction, from the member most concerned that easing into a tight labor market and soft-but-not-collapsing inflation invites a later overshoot. On balance, the Committee affirms both conclusions: it expects the real Federal Reserve to hold at 1.50-1.75 percent, and it identifies -25 basis points as the framework-optimal policy for this meeting.

COMMITTEE VOTE

The predictive vote to expect a hold at 1.50-1.75 percent was unanimous, 5-0. On the framework's optimal recommendation of a 25 basis point cut, the Committee landed 4-1, with four members endorsing it as-is and one offering partial support.

NOTES

The single reservation on the optimal side came from the inflation-focused member, who agreed the framework was right to reject the -75 basis point rules but accepted the -25 direction only reluctantly; with core PCE below target and no overheating to defend against, this member judged a hot labor market at 3.5 percent unemployment a latent wage-price risk and held that a single 25 basis point cut was the maximum tolerable move, leaning toward the smaller step or none.