OpenFed

POLICY STATEMENT | February 25, 2020

PREDICTED FED DECISION −50 bps

1.00%-1.25%

OPENFED OPTIMAL RATE −25 bps

1.25%-1.50%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to cut 50 bps as a decisive response to coronavirus-driven market stress, while its own framework judges the loss-minimizing move to be a more measured 25 bps.

STATEMENT

The Committee's predictive judgment and its own optimal-policy determination diverge this meeting, and that gap is the central story. The hard data reviewed remain solid: unemployment at 3.6% sits below the estimated 4.44% natural rate, initial claims are low at 210,000, the financial stress index is contained at 0.051, and the Baa spread at 2.13 shows credit conditions that, while worth watching, are not in distress. Against that backdrop, however, forward-looking signals have moved sharply. The VIX has spiked to 27.85, well above calm-period norms, and the 3-month T-bill trades roughly 12.5 basis points below the current 1.50-1.75% range, which participants read as markets already pricing in near-term easing. The coronavirus outbreak, flagged as an uncertainty at the prior meeting, is now viewed by participants as a fast-moving downside shock. With core PCE at 1.51%, well below the 2% objective, and inflation momentum negative at -0.04, participants agreed there is essentially no inflation cost to easing.

On the predictive question, a clear majority concluded the real Federal Reserve will move decisively and cut 50 basis points, to a range of 1.00-1.25%. The reasoning turned on the reading that market-based indicators are moving faster than the lagging stress and labor gauges, and that a token move would risk being seen as behind the curve as the shock repriced. Participants weighting employment and financial-stability risk argued for front-running deterioration to buffer jobs and credit markets before stress became systemic, and the market-focused view held that the scale of the T-bill dislocation together with the VIX spike represented a coordinated signal too large for a 25 bps move to satisfy. One participant resisted this framing throughout, judging that a 50 bps action on volatility that has not yet transmitted into hard credit or labor data would over-react and squander policy space, and favoring instead a measured, precautionary step.

The Committee's independent optimal-policy determination, arrived at through its deterministic framework, lands at a cut of 25 basis points. Here the reference rules themselves are split in an instructive way. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all point to -50 bps, driven by the inflation shortfall and an estimated r* of -0.207 that implies the current range is genuinely restrictive relative to a very low neutral rate. The first-difference rule, by contrast, prescribes only -25 bps, because it adjusts incrementally from current policy rather than reacting to level gaps, and momentum is flat: inflation momentum at -0.04 and unemployment momentum at 0.0. The loss-minimizing recommendation follows the first-difference logic. In deliberating on that recommendation, participants who had voted for the larger predictive move nonetheless came to accept the 25 bps figure as the disciplined call, emphasizing that hard labor data has not turned, that contained credit spreads argue against signaling alarm, and that a measured step meaningfully reduces restrictiveness while preserving ammunition should the coronavirus shock escalate.

Taken together, the Committee reads the divergence as quantifying the distance between what markets are pricing and what backward-looking momentum justifies: a 50 bps cut is the expected real-world response to a repricing shock, while a 25 bps cut is the framework's judgment of the loss-minimizing first step from 1.50-1.75%, addressing genuine stress and a below-target inflation path without overshooting on volatility that has not yet reached the hard data.

COMMITTEE VOTE

The predictive vote favored a 50 bps cut, 4 to 1, with a single participant preferring 25 bps; on the framework's own 25 bps recommendation, the Committee split 4-1 as well, with four members endorsing it outright and one supporting the direction but not the magnitude.

NOTES

On the optimal side, the market-focused participant registered a partial dissent, agreeing that easing was warranted but arguing that 25 bps was insufficient: with the 3-month T-bill already priced a full step below the range, the VIX elevated at 27.85, and r at -0.207 leaving current policy restrictive, this participant held that forward-looking market pricing justified faster, deeper easing than the flat-momentum, backward-looking rules allowed.*