OpenFed

POLICY STATEMENT | January 19, 2022

PREDICTED FED DECISION **HOLD**

0.00%-0.25%

OPENFED OPTIMAL RATE **+75 bps**

0.75%-1.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 0.0%-0.25% this meeting, even as its own policy framework judges the loss-minimizing rate to be 75 basis points higher.

STATEMENT

Information reviewed at this meeting described an economy running hot on both mandate legs. Core PCE inflation stood at 4.12%, more than double the 2% objective, while unemployment at 3.9% had fallen below the 4.45% natural rate the Committee uses as its reference for maximum employment. The Beige Book reported robust, broad-based wage growth and persistent labor shortages, with compensation growth described as well above historical averages; initial jobless claims of 230,000 and a positive activity index reinforced the picture of a tight, above-trend economy rather than a weakening one. Financial conditions gave the Committee room to consider action: the financial stress index at 0.1161 was low, the Baa corporate spread at 1.78 was historically narrow, and the 10-year to 2-year spread of 0.79 remained positive with no inversion warning. The VIX at 23.85 was modestly elevated, which participants generally attributed to Omicron-related nervousness rather than systemic strain.

On the data alone, every member agreed the direction of policy pointed toward tightening, and no participant disputed that the current 0.0% to 0.25% range was too accommodative for these conditions. Yet all five members converged on a prediction that the real Federal Reserve would hold the target range unchanged at this meeting. The decisive consideration was sequencing. The prior meeting's guidance had accelerated the winding down of asset purchases with the intention of concluding them around mid-2022, and had tied liftoff to the labor market reaching maximum employment; the Committee's established practice is to end purchases before the first hike. Several members leaned heavily on market pricing here: the 3-month T-bill spread of only 0.045 over the current rate implied that markets expected liftoff imminently but had not discounted a move at this specific January meeting. One member whose bias runs toward acting on inflation acknowledged the case for an immediate quarter-point move was attractive on the merits, and would have voted for it had purchases already concluded, but judged that front-running the Committee's own stated timeline while purchases wind down would be premature. The predictive conclusion was therefore a hold this meeting, with liftoff to follow shortly after.

The Committee's own deterministic framework reached a different answer. All four reference rules the framework consults for this meeting -- the Taylor rule, the balanced-approach rule, the first-difference rule, and the ELB-adjusted rule -- converged on 75 basis points, and the framework judged them reliable. That agreement across differently constructed rules struck participants as robust rather than the artifact of any single model. The underlying loss-function terms pointed the same way: inflation momentum was positive at 0.33, indicating price pressures still building, while unemployment momentum was negative at -0.5, meaning joblessness was still falling into an already tight market. Even with the estimated r* at -0.458, which places neutral quite low, the rules judged policy well below where it belongs. Participants found different rules most persuasive from their own vantage points -- the inflation-focused reading turned on the Taylor rule's direct penalty for the overshoot, the employment-focused reading on the balanced approach's explicit weighting of an employment gap that now favors tightening, and the stability-focused reading on the ELB-adjusted rule still landing at 75 basis points despite accounting for the low floor. The Committee's considered optimal conclusion is that a 75 basis point increase is the loss-minimizing move, and the gap between that figure and the predicted hold measures how far current accommodation sits behind what the data warrant.

That said, the optimal-side deliberation was not fully unanimous on magnitude. While a majority endorsed the framework's 75 basis point recommendation as-is, two members accepted the direction of tightening but not the size of the step at this meeting. Their concern was concrete: with short-rate markets pricing no hike now -- the T-bill spread again the reference point -- a 75 basis point jump straight from the effective lower bound risked disorderly repricing, and skipping the stated end-of-purchases sequencing risked credibility whiplash. From that view a smaller, telegraphed step lets credit markets absorb the move without rupture, and an abrupt jump contradicts the goal of a smooth glide over a violent later adjustment. The majority countered that benign credit conditions permit decisive normalization now, and that the longer policy holds at 0.0% to 0.25% with inflation above 4%, the greater the risk of a sharper correction later.

COMMITTEE VOTE

The Committee was unanimous, 5-0, in predicting that the real Federal Reserve will hold the target range at 0.0% to 0.25% at this meeting. On the framework's 75 basis point recommendation, the optimal-side deliberation split 3-2, with three members endorsing the recommendation as stated and two agreeing with the tightening direction but not the magnitude at this meeting.

NOTES

Although the predictive vote was unanimous, two members declined to endorse the framework's 75 basis point figure in full. Both accepted that fundamentals warranted tightening but objected to the size and timing: with the 3-month T-bill spread at just 0.045 signaling markets had not priced any hike this meeting, they argued that an abrupt 75 basis point move from the lower bound risked disorderly repricing and broke the stated sequence of concluding asset purchases before liftoff, and that a smaller, well-telegraphed initial step better preserved orderly financial conditions.