

Future of the Fed

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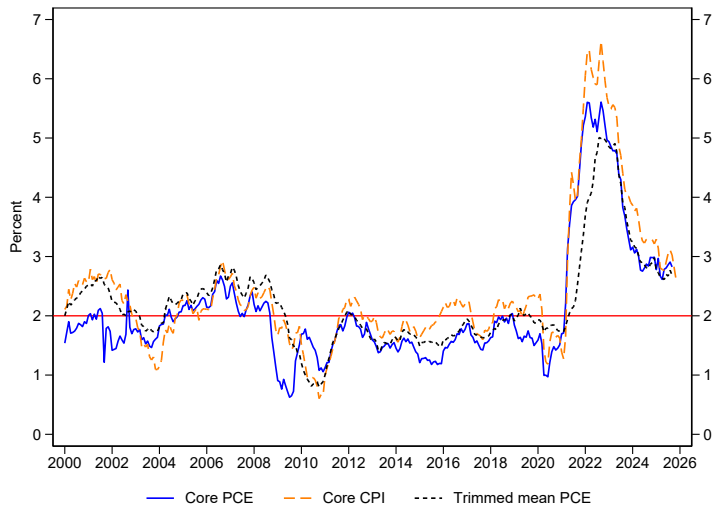
American Economic Association
Philadelphia, January 4, 2026



Central banking in the United States



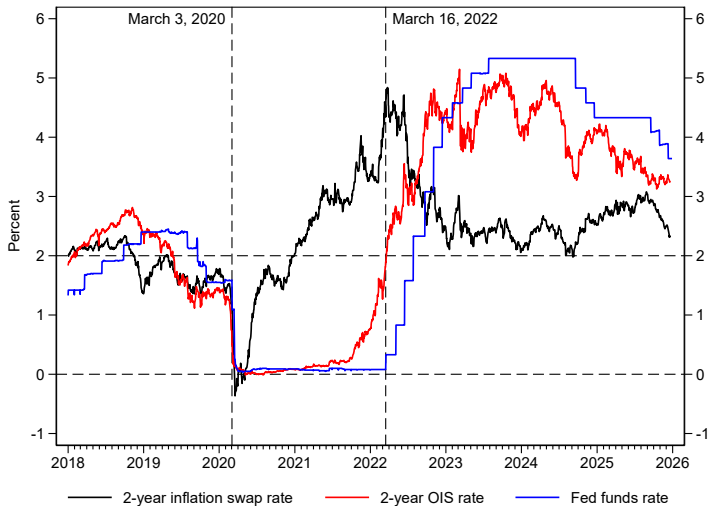
Inflation in the 21st century



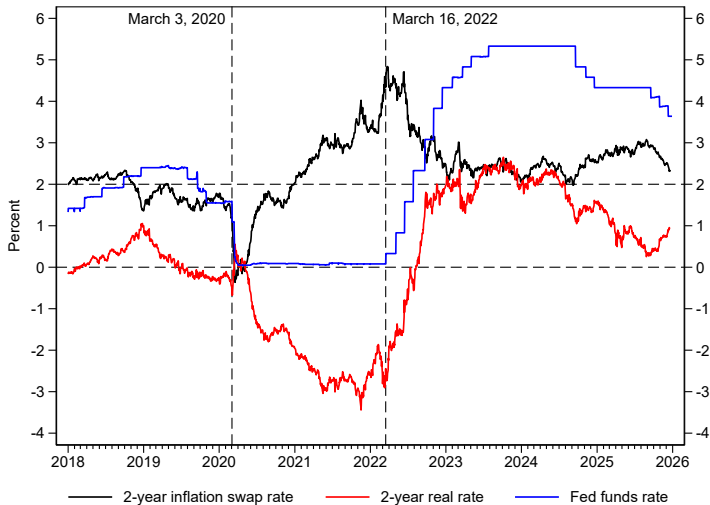
Alternative measures of year-on-year core inflation.



The pandemic policy challenge



A policy error



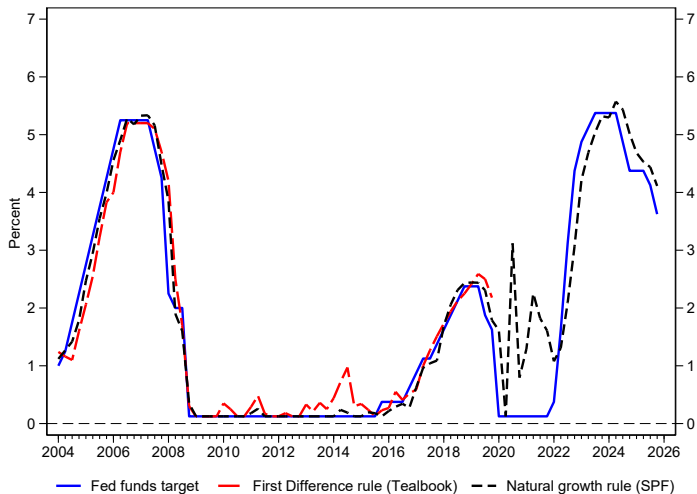
The real interest rate reflects the OIS rate minus the inflation swap rate.

Overburdening the Fed

“I know that it is fashionable to talk about a ‘dual mandate’—that policy should be directed toward the two objectives of price stability and full employment. Fashionable or not, I find that mandate both operationally confusing and ultimately illusory: ... The Federal Reserve, after all, has only one basic instrument so far as economic management is concerned—managing the supply of money liquidity. Asked to do too much ... it will inevitably fall short. If in the process of trying it loses sight of its basic responsibility for price stability, a matter which is within its range of influence, then those other goals will be beyond reach.” (Paul Volcker, 2013.)



A simple rule: Tealbook and SPF variants



$$\begin{aligned}\Delta i_t &= \theta(\pi_{t+3|t} - \pi^*) + \theta(y_{t+3|t} - y_{t-1}) \\ &\approx \theta(\pi_{t+3|t} - \pi^*) + \theta(g_{t+3|t} - g_t^*) \approx \theta(n_{t+3|t} - n_t^*)\end{aligned}$$



FOMC Economic Projections, December 2025

Percent

Variable	Median ¹				
	2025	2026	2027	2028	Longer run
Change in real GDP	1.7	2.3	2.0	1.9	1.8
September projection	1.6	1.8	1.9	1.8	1.8
Unemployment rate	4.5	4.4	4.2	4.2	4.2
September projection	4.5	4.4	4.3	4.2	4.2
PCE inflation	2.9	2.4	2.1	2.0	2.0
September projection	3.0	2.6	2.1	2.0	2.0
Core PCE inflation ⁴	3.0	2.5	2.1	2.0	
September projection	3.1	2.6	2.1	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	3.6	3.4	3.1	3.1	3.0
September projection	3.6	3.4	3.1	3.1	3.0



Back to the future

“My interest in a monetary policy directed toward a dollar of stable value is not based on the feeling that price stability is a more important national objective than either maximum sustainable growth or a high level of employment, but rather on the reasoned conclusion that the objective of price stability is an essential prerequisite for their achievement.” (William McChesney Martin, 1959.)

