



PREDICTED FED DECISION +25 bps

3.25%

OPENFED OPTIMAL RATE HOLD

3.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to raise rates 25 bps, but its own framework judges the optimal move to be 0 bps, with flat momentum overriding reference rules that pointed to a 75 bps cut.

STATEMENT

Information reviewed at this meeting described an economy expanding with signs of acceleration. Beige Book reports pointed to strong holiday consumer spending, strengthening manufacturing, robust residential real estate, and rising loan demand. Core PCE inflation stood at 2.25%, modestly above the Committee's 2.0% objective, while the unemployment rate at 6.4% remained well above an estimated natural rate of 5.47%, indicating that meaningful labor market slack persisted. Financial conditions were notably calm across every indicator participants examined: the financial stress index registered 0.0, the VIX sat at 9.94, the Baa spread was tight at 1.86, and the 10y-2y curve was positively sloped at +1.6, with no recession signal. Against a current fed funds rate of 3.0% and inflation near 2.25%, participants generally judged the real rate to be close to zero, leaving policy accommodative into a firming expansion.

On the question of what the real Federal Reserve is likely to do, four of five participants concluded that a preemptive 25 bps increase was the most probable step. Their reasoning turned on above-target inflation running alongside accelerating activity, with early signs of building pressure in widespread lumber price increases and scattered labor shortages, even as broad wage and price pressure remained absent. The calmness of markets figured centrally in this view rather than against it: with stress at zero and the VIX near 10, a modest, gradual step was seen as one a complacent market could absorb without disruption, whereas allowing accommodation to persist risked a sharper repricing later. Participants acknowledged the 3-month T-bill spread of -0.07, which suggested markets were pricing little imminent change, but judged that a single quarter-point move would not shock that pricing. One participant dissented from this predictive reading, emphasizing that tightening while unemployment



sat nearly a full point above its natural rate risked choking off an incomplete job recovery, and that core PCE only 25 bps above target did not constitute an inflation emergency justifying restraint.

Turning to its own determination of optimal policy, the Committee's deterministic framework recommended 0 bps. Here the reference rules diverged sharply from the recommendation: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each returned -75 bps, driven by the wide unemployment gap and an estimated r^* of just 0.5. The framework did not follow those rules, and participants explained why. The first-difference rule, which keys on change rather than level, returned 0 bps, consistent with inflation momentum at 0.0 and unemployment momentum at 0.0 — nothing was deteriorating in either mandate variable. Participants judged the deep-cut signals unreliable in this setting: basing a 75 bps cut on a fragile, noisy r^* estimate of 0.5 would overweight an uncertain level against flat momentum, and easing into an accelerating economy with inflation above target and markets already complacent would risk feeding excessive risk-taking rather than relieving any strain. With no fresh employment weakness to justify easing and no accelerating price pressure to justify a hike, holding at 3.0% was seen as the neutral reading the data most directly implied.

The Committee thus arrived at two distinct conclusions from the same deliberation. It expects the real Federal Reserve to move 25 bps, reflecting a lean against emerging inflation risk into a firming economy. Its own loss-minimizing framework, by contrast, identifies 0 bps as optimal — a stance that rejects both the reference rules' aggressive cuts and the instinct to preempt, and that treats the current 3.0% rate as roughly neutral-to-slightly-accommodative given low r^* and flat momentum. The gap between the predictive 25 bps and the optimal 0 bps is small, and participants read that narrowness as a sign of genuine ambiguity about the appropriate direction rather than a case for decisive action either way.

COMMITTEE VOTE

The predictive vote was 4 to 1 in favor of a 25 bps increase, with one participant preferring no change. On the framework's 0 bps optimal recommendation, the Committee landed 4 endorse, 0 decline, and 1 partial.

NOTES

On the optimal side, the inflation-focused participant registered a partial position: agreeing with the direction of holding and firmly rejecting the reference rules' 75 bps cuts, but unable to fully endorse 0 bps given a preference tilted toward a small preemptive hike against above-target inflation, which that participant characterized as a quarter-point of genuine ambiguity rather than a decisive disagreement.