PREDICTED FED DECISION +25 bps

4.25%

OPENFED OPTIMAL RATE −25 bps

3.75%

KEY TAKEAWAY

The Committee unanimously expects a 25 bps hike to 4.25%, yet its own framework judges the optimal move to be a 25 bps cut — a divergence in direction, with the framework endorsed 4-1.

STATEMENT

The information reviewed for this meeting described an economy expanding at roughly trend, with the Chicago Fed activity index at 0.33 pointing to above-trend growth and the Beige Book reporting continued expansion across Districts. Core PCE inflation stood at 1.52%, below the Committee's 2.0% objective, while unemployment at 5.0% sat essentially at the estimated natural rate of 5.04%. Participants generally read the labor market as balanced rather than deteriorating: initial jobless claims of 321,000 remained low, and several Districts noted increased hiring with some slight tightening. Against this, the Beige Book flagged persistent input-price pressures and elevated energy costs, along with cooling residential real estate and slowing mortgage lending in a number of Districts. Financial conditions were calm, with the stress index at 0.1278, the VIX subdued at 11.52, and the Baa spread tight at 1.88. The one genuine caution running through the discussion was the yield curve: the 10y-2y spread at just 0.07 was nearly flat, and the 3-month T-bill sat about 0.1 below the current 4.0% funds rate, suggesting markets anticipate little further tightening.

On the question of what policy the Federal Reserve is likely to deliver, all five participants arrived independently at the same answer: a 25 bps increase to 4.25%. The reasoning converged from different starting points. Those weighing inflation risk most heavily judged that, even with core PCE below target, persistent energy and input-cost pressures alongside a full-employment labor market keep upside risk live enough to warrant removing accommodation. Participants focused on employment saw no current weakness — no rising claims, no rising unemployment — that would justify anything other than continued normalization. Those attentive to financial conditions and market pricing noted that a 25 bps step is well-telegraphed, that the T-bill discount already embeds roughly this move, and that a larger step would risk tipping the flattening curve toward inversion. The near-flat curve gave several participants pause, but none judged it a reason to pause or cut given the absence of distress in the current data.

The Committee's own deterministic framework, however, pointed in the opposite direction, recommending a reduction of 25 bps. With r* estimated at 1.104 and core inflation near 1.5%, the implied neutral nominal rate is roughly 2.6%, well below the current 4.0% stance — a gap that reads as materially restrictive policy. The reference rules bear this out: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each prescribed -75 bps, driven by inflation running under target and a closed unemployment gap. The first-difference rule alone returned -25 bps, and it was this rule that participants found most persuasive for the framework's final call. Its logic rests on momentum rather than level gaps: with inflation momentum at -0.095 and unemployment momentum at just 0.05, both small, an incremental step down toward neutral is warranted while the aggressive -75 prescriptions were judged to overreact and to risk signaling alarm into calm credit markets. Reference rules were assessed as reliable this meeting, and the majority concluded that easing modestly — enough to relieve pressure on the near-inverted curve without shocking orderly conditions — is the loss-minimizing path. The divergence between the expected +25 bps and the optimal -25 bps reflects the Committee's judgment that the anticipated real-world policy stance is tighter than the data alone would justify.

In sum, the Committee expects the Federal Reserve to raise the target rate by 25 bps to 4.25%, while judging that the optimal policy, on its own framework, is a 25 bps cut. Both conclusions follow from the same reading of a calm-market, full-employment economy with below-target and cooling inflation; they part ways on whether latent inflation risk or a restrictive neutral-rate gap should govern the direction of the next move.

COMMITTEE VOTE	The predictive vote for a 25 bps hike to 4.25% was unanimous, 5-0. On the framework's -25 bps recommendation, the Committee endorsed the call 4-1.
NOTES	*The one participant declining the optimal recommendation weighted inflation risk above all else, holding that persistent input-price and energy pressures alongside a tightening labor market make even a modest cut the wrong direction — easing into latent price pressure, in this view, concedes ground that below-target core readings and a flat curve do not justify surrendering.*