OpenFed

POLICY STATEMENT | June 8, 2016

PREDICTED FED DECISION **HOLD**

0.25%-0.50%

OPENFED OPTIMAL RATE **−25 bps**

0.00%-0.25%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to hold at 1/4 to 1/2 percent, even as its own framework judges the loss-minimizing policy to be a 25 basis point cut.

STATEMENT

The information reviewed at this meeting described an economy growing at a modest-to-moderate pace, with tight labor markets widely noted but only slight price pressure building. Core PCE inflation stood at 1.33%, close to a full percentage point below the 2% objective, while the unemployment rate at 4.7% sat just under the 4.8% natural rate. Beige Book reports pointed to a mixed picture beneath the calm surface: growth slowed in Chicago and Kansas City, activity in New York was flat, and the energy sector remained weak, even as loan demand rose moderately and credit availability held steady to good. Financial conditions were benign rather than fragile, with the financial stress index at 0.102, the VIX subdued at 14.08, a moderate Baa spread of 2.86, and a positive 10-year to 2-year spread of 0.93 that carried no recession signal.

In assessing the likely course of policy, participants converged quickly. The one member drawn initially toward a preemptive 25 basis point hike, citing labor tightness and firming prices, revised toward holding on the recognition that inflation running a full point below target represents downside, not upside, risk, with wage growth described only as 'modest' and price pressure only as 'slight'. Others weighted the 3-month T-bill spread of -0.095 as the most direct signal that markets do not price an imminent move; going against that pricing would risk a surprise tightening of financial conditions with no offsetting stress to justify it. With inflation soft, the labor market healthy but not deteriorating, and no credit-market distress demanding either action, the Committee judged that the real Federal Reserve will hold the target range at 1/4 to 1/2 percent, a change of 0 basis points, while retaining a data-dependent, gradual posture.

The Committee's own deterministic framework arrived at a different conclusion. All four reference rules — the Taylor rule, the balanced-approach rule, the first-difference rule, and the ELB-adjusted rule — pointed to a 25 basis point cut, and the framework judged those rules reliable this meeting. The logic rests on an estimated neutral real rate (r*) of -0.5, deeply negative, against which the current real policy stance is mildly restrictive given the persistent inflation shortfall. Inflation momentum registered a trivial 0.025 and unemployment momentum a flat 0.0, so no overheating pressure argued against easing. The balanced-approach reasoning was persuasive to several members: with the inflation gap wide and no labor overheating, symmetric weighting of the two gaps points toward accommodation, and the ELB-adjusted logic reinforces leaning against a sustained undershoot. On this basis the Committee determined that the optimal policy would be a reduction of 25 basis points from the current range.

The gap between the two conclusions reflects a stance the framework exposes as marginally too tight relative to its loss-minimizing benchmark. Members who preferred to hold in the predictive vote acknowledged this directly: institutional caution, calm financial conditions, and the absence of any acute signal argued for patience, even as the rules and the negative neutral rate argued for removing some restraint. A cut of this size was seen as advancing the undershooting inflation objective toward 2% without stoking any inflation risk worth guarding against, given the benign volatility and stress readings that make such a move carry little stability cost.

COMMITTEE VOTE

The predictive vote to expect a hold at 1/4 to 1/2 percent was unanimous, 5-0. On the framework's recommendation of a 25 basis point cut, the optimal-side deliberation landed 4 to 1 in favor, with four members endorsing the recommendation as-is and one endorsing its direction but not its full magnitude.

NOTES

The single divergence on the optimal side came from the member weighting market pricing most heavily, who agreed policy should drift lower but read the modest -0.095 T-bill spread and the picture of moderate growth, tight labor, and optimistic firms as consistent with a gradual adjustment rather than a decisive full quarter-point cut now.