OpenFed

POLICY STATEMENT | June 7, 2017

PREDICTED FED DECISION +25 bps

1.00%-1.25%

OPENFED OPTIMAL RATE −25 bps

0.50%-0.75%

KEY TAKEAWAY

The Committee unanimously expects a 25 bps hike to 1.00-1.25%, yet its own framework identifies a 25 bps cut as optimal—a 50 bps gap that split the panel 2-3 on whether easing is warranted.

STATEMENT

Information reviewed for this meeting described an economy running warm against a backdrop of unusually calm financial conditions. Unemployment, at 4.3%, sits below the 4.74% natural rate; jobless claims are low; and the Beige Book confirms tight labor markets, labor shortages, and wage pressures across districts, alongside input cost pressures that participants characterized as fairly widespread. Financial conditions were judged extremely loose, with a stress index of 0.054, a VIX of 10.39 that several participants read as complacency bordering on froth, and a benign Baa spread of 2.25. The yield curve remained positively sloped at 0.86, and activity, while described in the Beige Book as having 'flattened out,' showed no contraction. Against this, core PCE at 1.28% stood well below the 2.0% objective and appeared softer than the prior meeting's characterization—a genuine caution that no participant dismissed.

On the question of what the real Federal Reserve is likely to do, all five participants independently arrived at the same place: a 25 bps increase, moving the target range to 1.00-1.25%. The reasoning converged from different lenses. Those weighting inflation risk argued that tight labor and widespread pipeline cost pressures warrant preemptive normalization even with a soft current print. Those attentive to employment found no rising unemployment or slowing job growth to protect against, and so no case for easing. Those focused on financial stability judged that a well-telegraphed move would be easily absorbed and would reduce the risk of abrupt action later, while those reading market signals noted that the 3-month T-bill trading 8.5 bps above the current rate, together with the FOMC's own prior 1.4% median projection, already priced a near-term hike. Soft inflation was treated throughout as a reason to move no more than a quarter point, not as a reason to hold.

The Committee's own deterministic framework pointed the other way, and pointed hard. Its loss-minimizing recommendation was a cut of 25 bps. The level-based reference rules were more aggressive still: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each returned -75 bps, driven by the large shortfall of core inflation below target against an estimated r* of just -0.5, which implies the current 0.75-1.00% stance may already be near or above neutral. The first-difference rule returned -25 bps, and it was this rule the framework's final call tracked—anchoring on momentum (inflation momentum of 0.09, unemployment momentum of -0.1) rather than a full re-leveling to an uncertain neutral rate. Participants who accepted the -25 bps figure as optimal did so on the framework's own terms: with inflation persistently undershooting and no credit-market stress, restrictive policy is hard to justify, and a single measured cut eases it without the shock of a 75 bps move.

The divergence between the expected +25 bps and the optimal -25 bps—a full 50 bps—was, in the end, the meeting's central story, and it did not resolve into consensus. Some participants read the gap as evidence that the anticipated stance runs too hawkish for flattening activity and sub-target inflation. Others held that easing into tight labor and loose conditions would be procyclical and would risk fueling the very imbalances low volatility and tight spreads can build, judging the framework's cut to rest on a poorly-measured negative r* rather than any observed stress. The honest reading the Committee records is that mechanical rules respond to the inflation gap while several members weight forward inflation risk, financial fragility, or market pricing—and that these lenses genuinely disagree about direction.

COMMITTEE VOTE	The predictive vote was unanimous, 5-0, for a 25 bps increase to 1.00-1.25%. On the framework's -25 bps optimal recommendation, the Committee split 2-3, with a minority endorsing the cut as-is and a majority declining it.
NOTES	*Although the predictive vote was unanimous, the optimal-side deliberation divided sharply: two members endorsed the -25 bps recommendation, one reading multiple reliable rules as showing policy too restrictive amid flattening activity and the other taking the sub-target inflation reading at face value. Three declined—one weighting forward inflation risk from tight labor and widespread cost pressures, one holding that easing into extremely loose conditions and tight spreads would worsen financial-imbalance risk, and one objecting that every market signal, including a rising T-bill premium and a positive curve, pointed toward tightening rather than a cut.*