OpenFed

POLICY STATEMENT | July 19, 2017

PREDICTED FED DECISION HOLD

1.00%–1.25%

OPENFED OPTIMAL RATE −25 bps

0.75%–1.00%

KEY TAKEAWAY

The Committee expects the real Federal Reserve to hold at 1.00–1.25%, while its own framework judges optimal policy to be a modest 25 basis point cut, a one-increment gap that measures the current stance as mildly restrictive.

STATEMENT

The striking feature of this meeting is the quiet distance between what the Committee expects and what it judges best. On the predictive question, the five members converged early and without dissent: hold the target range at 1.00–1.25%. Core PCE inflation at 1.16% sits well below the 2% objective and has declined recently, so the case for accelerating tightening is thin. Labor markets, by contrast, are tight—unemployment at 4.4% is below the 4.74% natural rate, jobless claims are low at 247k, and the Beige Book documents worker shortages limiting hiring alongside wage gains described only as 'modest to moderate.' Members generally read that combination as a prospective inflation risk rather than a realized one. Because the Committee raised the range only last meeting and emphasized 'gradual adjustments,' participants judged that back-to-back hikes would break that framing without confirming data, while soft inflation and slightly below-trend growth (CFNAI at -0.26) left no case for a cut in the near term. The result was a straightforward hold.

Financial conditions reinforced the patience. With the financial stress index at 0.03, the VIX at an exceptionally low 9.79, and the Baa spread contained at 2.08, no market signal compelled action in either direction. The 10y-2y spread at 0.9 remains positive, giving no recession alarm, and the 3-month T-bill sitting 7.5 basis points below the current midpoint indicated markets were pricing no near-term hike. Several members took that front-end pricing as an early sign that the current stance may already be somewhat tighter than warranted—a reading that pointed toward the Committee's second, independent conclusion.

Applying its own deterministic framework, the Committee determined that optimal policy at this meeting is a cut of 25 basis points. The reference rules pulled harder still: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each returned -75 bps, driven by the large inflation shortfall against target and an estimated neutral real rate (r*) of -0.5. Members found those magnitudes too aggressive given labor-market strength, and gravitated instead to the first-difference rule at -25 bps, which adjusts incrementally from the current setting rather than closing the full level gap. The loss function landed at the same place: inflation momentum of -0.1 and unemployment momentum of -0.25 both argue for easing, but a labor market at or beyond full employment tempers how far to go. The 25 basis point figure is therefore the measured response—correcting a stance that is mildly restrictive relative to a low neutral rate, in the direction every rule points, without the disruption a -75 bps move would carry into such calm markets.

The gap between the predicted hold and the optimal -25 bps is exactly one increment, and it quantifies how the Committee understands the current stance: only slightly tight, not dangerously so. Members were candid that their predictive hold reflects institutional caution—the cost of whipsawing policy one meeting after a hike, and a genuine vigilance about whether tight labor markets eventually push wages into prices. On the signals alone, however, below-target inflation with negative momentum, a below-neutral r*, and market pricing that already leans easier make the modest easing the cleaner call.

COMMITTEE VOTE

The predictive vote to hold at 1.00-1.25% was unanimous, 5-0. On the framework's -25 bps recommendation, the optimal-side deliberation was also unanimous: all five members endorsed the cut as-is.