PREDICTED FED DECISION HOLD

1.00%-1.25%

OPENFED OPTIMAL RATE −50 bps

0.50%-0.75%

KEY TAKEAWAY

The Committee expects the real Fed to hold at 1.00-1.25%, a unanimous predictive call, even as its own framework judges the loss-minimizing move to be a 50 basis point cut to address a widening, below-target inflation shortfall.

STATEMENT

The most striking feature of this meeting is the gap between what the Committee expects and what it judges optimal. All five members predict the real Federal Reserve will hold the federal funds target range at 1.00-1.25 percent, yet the Committee's own deterministic framework recommends easing by 50 basis points. That divergence, and the reasons for it, is the story of this deliberation. On the predictive side the reasoning was unusually convergent. Core PCE inflation at 1.08 percent sits well below the 2 percent objective and appears to be drifting lower rather than stabilizing, which removes the primary case for a hike. At the same time the labor market remains tight, with unemployment at 4.4 percent against an estimated natural rate of 4.74 percent and Beige Book reports of worker shortages in numerous industries, giving no case for a cut either. Members observed that the Beige Book described employment growth as slowing 'some on balance,' ranging from slight to modest, but judged that slowing from a strong pace within a still-tight labor market is not the rising-unemployment scenario that would call for accommodation.

Several considerations reinforced the expectation of a hold. Financial conditions were characterized as calm and accommodative: the VIX at 10.5, a financial stress index of 0.045, a tight Baa spread of 2.16, and a positive 10-year to 2-year spread of 0.85 with no inversion warning. The 3-month T-bill spread of -0.105 was read as evidence that markets are not pricing an imminent hike, and members weighing market signals most heavily anchored on that. Members also noted that with balance sheet normalization signaled 'relatively soon,' pairing a rate move with that action risked overtightening into complacent conditions, and that Hurricane Harvey introduced near-term uncertainty arguing against a rate move now. Low stress meant no urgency to cut; soft inflation meant no urgency to hike. The Committee thus expects a hold, and did so with genuine unanimity rather than a marginal balance of views.

The optimal case, developed under the Committee's own loss-minimizing framework, points in a different direction and rests squarely on the inflation shortfall. The reference rules were reported as reliable, and three of them, the Taylor rule, the balanced approach rule, and the ELB-adjusted rule, each pointed to -75 basis points, driven by inflation running roughly 0.9 percentage point below target. The first-difference rule pointed to -50, and the framework settled on -50 as its recommendation, tempering the more aggressive rules with a more gradual step. Inflation momentum of -0.16 indicated the shortfall is widening rather than closing, and with an estimated r* of -0.5, members recognized that the current 1.00-1.25 percent range may be more restrictive than it appears relative to a very low neutral rate. Members repeatedly emphasized that the tight labor market has not been generating price pressure, with the Beige Book confirming limited wage growth and limited pass-through of input costs to selling prices, so the mechanism that would justify holding restrictive is weak. Even the member most predisposed to guard against inflation risk acknowledged that the risk here is undershooting, not overshooting, and that persistent below-target inflation carries its own danger of unanchoring expectations downward.

Weighing both mandates, the Committee's considered optimal conclusion is a 50 basis point cut. The predictive hold reflects, in members' own framing, institutional gradualism and an anchoring to prior guidance, while the framework identifies a stance too tight for the data it is meant to serve. Two members endorsed the -50 recommendation outright, judging that slowing employment momentum and a widening inflation gap together warrant preemptive easing that benign financial conditions make safe to execute. The remaining three agreed with the direction but not the full magnitude. Some cautioned that a 50 basis point move in a single step is large given still-firm labor and elevated jobless claims; one worried that easing into an already complacent, potentially frothy market could amplify risk-taking; and the member weighting market pricing most heavily argued the negative T-bill spread implies a mild easing bias, not a front-loaded cut that large at one meeting. The Committee records both conclusions with equal weight: a predicted hold at 1.00-1.25 percent, and an optimal policy of easing 50 basis points to address a persistent and worsening inflation shortfall.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, to expect a hold at 1.00-1.25 percent. On the framework's -50 basis point recommendation, the Committee split 2 to 3: two members endorsed the recommendation as-is, and three agreed with the easing direction but not the full magnitude, with none declining outright.

NOTES

Although the predictive vote was unanimous, the optimal-side deliberation showed real disagreement on magnitude: three members declined to endorse the full -50 basis point step, variously citing still-firm labor and elevated jobless claims, the risk of amplifying risk-taking by easing into complacent and potentially frothy markets, and market pricing that implied only a mild easing bias rather than a 50 basis point cut in a single meeting.