OpenFed

POLICY STATEMENT | December 6, 2017

PREDICTED FED DECISION **+25 bps**

1.25%-1.50%

OPENFED OPTIMAL RATE **−25 bps**

0.75%-1.00%

KEY TAKEAWAY

The Committee unanimously expects the real Fed to raise rates 25 bps to 1.25%-1.5%, yet its own loss-minimizing framework points the other way, to a 25 bps cut, with members split 2-3 on endorsing that easing.

STATEMENT

The central tension at this meeting is not disagreement about the data but a divergence between what the Committee expects and what its own framework judges optimal. On the predictive question, all five members converged without hesitation: the real Federal Reserve is expected to raise the target range by 25 basis points, to 1.25% to 1.5%. The case rests on a labor market operating beyond full employment, with unemployment at 4.1% against an estimated natural rate of 4.74%, jobless claims low and stable at 238,000, and Beige Book reports of widespread hiring difficulty, wage increases, and signing bonuses. The Beige Book also flagged strengthening price pressures, rising input and construction-material costs, and modest-to-moderate increases in selling prices. Against a backdrop of extraordinarily loose financial conditions, a stress index of 0.03, a VIX of 11.02, and a tight Baa spread of 1.84, members judged that a move is both warranted under the prior guidance of gradual increases and already anticipated by markets, with the 3-month T-bill sitting 0.155 above the current midpoint. Soft core PCE at 1.26% was read as an argument for gradualism rather than for pausing, and no member saw a case for anything larger than a single quarter-point step.

Where members had to reason more carefully was the Committee's independent, loss-minimizing determination of optimal policy, which came out the other direction: a 25 basis point cut, toward a range of 0.75% to 1.0%. That result is driven by the inflation shortfall. Core PCE at 1.26% is well below the 2% target, inflation momentum is negative at -0.045, and the estimated neutral rate r* of -0.5 implies the current 1.0% to 1.25% stance may be tighter than it appears. The level-based reference rules pointed sharply lower still: the Taylor rule at -75 basis points, the balanced-approach rule at -75, and the ELB-adjusted rule at -75, each anchored on that large inflation gap and low neutral rate. Members who engaged with the framework generally distrusted the magnitude of those level rules, finding the first-difference rule at -25 basis points the more defensible reading. That rule responds to the change in conditions and to momentum, including unemployment momentum of -0.1, rather than reacting to the full level gap, and it matched the framework's own loss-minimizing recommendation of -25.

The optimal-side deliberation did not resolve into consensus. Those endorsing the cut argued that with inflation drifting away from target and r* negative, current policy risks being quietly restrictive, and that hard data on prices should dominate the Beige Book's forward-looking anecdote of pipeline pressure; a measured -25 insures against employment downside without the jarring overreaction of a -75 move into a tight labor market. Those declining the cut did not dispute the inflation shortfall but weighed other considerations more heavily. From an inflation-risk perspective, easing into loose conditions and a tight labor market risks unanchoring expectations toward overshoot while pipeline pressures build. From a financial-stability perspective, the absence of any stress signal is not itself a reason to ease; ultra-low volatility and tight spreads instead raise the risk of complacency and reach-for-yield, so adding accommodation now would loosen already-loose conditions with no stability rationale, and holding at 1.0% to 1.25% is the disciplined choice. From a market-signals perspective, observable pricing was decisive: the T-bill spread prices firming, not easing, credit is calm, and a cut would contradict what markets have already priced, with r* dismissed as an unobservable estimate weighted below market evidence.

Taken together, the meeting quantifies how accommodative current policy is judged to be against a rule-implied need for restraint that runs the opposite way. Members generally agreed that the current stance sits near neutral and that small moves in either direction are defensible; the gap between the expected +25 and the optimal -25 reflects genuine uncertainty between a real inflation undershoot and a labor market beyond full employment, rather than a clear error in the expected path.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, for a 25 basis point increase to 1.25% to 1.5%. On the framework's -25 basis point optimal recommendation, the Committee split 2-3, with two members endorsing the cut and three declining to support it.

NOTES

Although the predictive vote was unanimous, three members declined the framework's -25 optimal call: one citing building inflation risk from Beige Book pipeline pressures and a tight labor market, one warning that easing into froth and complacency carries no stability rationale, and one holding that observable market pricing signals firming rather than easing and outweighs the disputed negative r estimate underlying the rule.*