OpenFed

POLICY STATEMENT | June 6, 2018

PREDICTED FED DECISION **+25 bps**

1.75%-2.00%

OPENFED OPTIMAL RATE **HOLD**

1.50%-1.75%

KEY TAKEAWAY

The Committee unanimously expects the real Federal Reserve to raise rates 25 bps to 1.75-2.00%, even as its own framework judges the loss-minimizing policy to be no change (0 bps) from the current 1.50-1.75% range.

STATEMENT

The unusual feature of this meeting is not disagreement over what will happen but the gap between what the Committee expects and what its own framework judges best. All five members independently arrived at a prediction of a 25 basis point increase, moving the target range to 1.75 to 2.00 percent, and none revised that view after seeing the others. The data supporting this prediction were read consistently across lenses: unemployment at 3.8 percent sits well below the 4.62 percent natural rate, jobless claims are low at 221,000, and Beige Book contacts report solid hiring, difficulty finding workers, and elevated wage and price pressures, including a retailer citing vendor-price increases of about 3 percent passed through to customers. Financial conditions are calm to the point of complacency, with the financial stress index at 0.06, the VIX at 11.64, and the Baa spread tight at 1.9, while the 10-year to 2-year spread remains positive at 0.45. Members also weighed the 3-month T-bill spread of 0.285 against the current rate, close to a full increment, as evidence that markets have already priced a near-term hike, and noted that prior guidance had signaled 'further gradual increases.' Taken together, a well-telegraphed, measured step was judged both likely and unlikely to destabilize benign conditions.

Against that predictive read stands the Committee's own deterministic framework, which recommends no change, 0 basis points. The reference rules point sharply the other way: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all indicate -75 basis points, and the first-difference rule indicates -25. Those level-based rules lean dovish because core PCE at 1.59 percent runs below the 2 percent target and the estimated r* is low, at -0.5, which implies the current 1.50 to 1.75 percent stance is less accommodative in real terms than its nominal level suggests. The framework does not follow those signals to a cut. Its loss function tempers them against a firming inflation trend, with inflation momentum positive at 0.26 and unemployment momentum flat at 0.0, and reference rules assessed as reliable. The result is a hold: with prices firming toward target from below and no labor deterioration, easing 75 basis points into calm markets and a very tight labor market was viewed as risking exactly the overheating the Committee would later have to unwind.

Both conclusions are the Committee's own, reached through the same deliberation. The predictive case rests on the signaled path of gradual normalization, market pricing that already anticipates a move, and a tight labor market that leaves room to firm without stress. The optimal case rests on the judgment that below-target realized inflation removes any urgency to tighten, while positive inflation momentum and a strong labor market remove any case for the deep cuts the level rules mechanically produce. The distance between the two, one increment, is best understood as the difference between preemptive normalization and loss-minimizing patience. Several members characterized the current stance as roughly neutral, neither loose enough to demand tightening against soft inflation nor tight enough to threaten employment, which is why the framework declines to move in either direction. The Committee predicts a 25 basis point increase while judging that no change would be the optimal policy.

COMMITTEE VOTE

The predictive vote was unanimous, 5-0, for a 25 basis point increase to 1.75-2.00 percent. On the framework's 0 basis point recommendation, the optimal-side deliberation landed 3 endorse and 2 partial, with no member declining: the labor-market, data-dependent, and market-signal members endorsed the hold as-is, while the inflation and financial-stability members agreed with the no-cut direction but leaned toward preemptive firming.

NOTES

The two partial positions came from the inflation-focused and financial-stability members. The first accepted that no cut is justified with positive inflation momentum and a very tight labor market, but preferred preemptive firming, viewing calm markets as precisely when latent inflation risk builds and holding as one increment short of leaning against it. The second saw the current 1.50-1.75 percent stance as already accommodative and judged a low-stress window the safest time to firm gradually, while explicitly not opposing the hold since below-target inflation removes urgency and the direction is right.