OpenFed

POLICY STATEMENT | July 25, 2018

PREDICTED FED DECISION **HOLD**

1.75%-2.00%

OPENFED OPTIMAL RATE **HOLD**

1.75%-2.00%

KEY TAKEAWAY

The Committee expects the real FOMC to hold at 1.75-2.00% and, in a rare full convergence, judges that hold optimal too, with its own framework reconciling deep -75 bps level-rule signals down to 0 bps.

STATEMENT

Information reviewed for this meeting described an economy expanding above trend with a genuinely tight labor market. Core PCE inflation stood at 1.72%, still modestly below the 2.0% objective, while the unemployment rate at 4.0% held well beneath the 4.62% estimate of its natural rate, and initial jobless claims of 207,000 pointed to no softening in hiring. Beige Book reports reinforced this picture: labor markets were tight across all Districts, with worker shortages in some cases constraining growth, and firms across Districts flagged tariff-driven increases in input costs for metals, lumber, freight, and fuel, with pass-through to consumer prices described as slight-to-moderate. Financial conditions were calm throughout, with the stress index at 0.051, the VIX at 12.29, and the Baa spread at a tight 1.88; the 10-year to 2-year spread remained positive at 0.28, flattening but not inverted.

On the question of the likely near-term policy action, participants divided. Two members, weighing building inflation risk and market-implied pricing most heavily, favored a further 25 basis point step: they emphasized that the current 1.75-2.00% range remains accommodative relative to the FOMC's 2.4% median path, that tight labor markets and rising tariff-driven input costs are a forward inflation signal worth leaning against before it materializes, and that a 3-month T-bill spread of 0.105 above the range signals markets expect gradual tightening that calm conditions can readily absorb. The three members favoring no change did not contest the strength of the data. Rather, they stressed that a 25 basis point hike had just been delivered at the prior meeting to reach the current range, that a gradual normalization path implies spacing moves out rather than acting at consecutive meetings, and that with inflation still below target and no market or credit stress to respond to, there was no urgency in either direction. One member cautioned specifically that a further hike risked inverting the flattening yield curve. On balance, the Committee judged that the real FOMC will most likely hold the target range at 1.75% to 2.00% at this meeting.

The Committee's own deterministic framework arrived independently at the same destination: a recommended change of 0 basis points. That recommendation required reconciling sharply divergent reference signals. The Taylor rule, the balanced-approach rule, and the ELB-adjusted rule each pointed to -75 basis points, pulled down mechanically by core PCE below target and by a negative estimated r* of -0.5%. The first-difference rule, by contrast, read 0 basis points. Participants found the first-difference logic the more persuasive here, precisely because it responds to changes in conditions rather than to a level gap measured against a contested neutral rate. Inflation momentum was slightly positive at 0.04 and unemployment momentum was -0.15, indicating unemployment falling and prices firming rather than any emerging slack. Members generally judged that anchoring a 75 basis point cut to a deeply negative r* estimate overstated the case for easing when the real-economy data showed a hot labor market and building price pressure. The loss-minimizing recommendation of 0 basis points captured this, and the Committee concluded that optimal policy at this meeting is likewise no change, leaving the range at 1.75% to 2.00%.

Taken together, the gap between the level rules' -75 basis points and the framework's 0 basis point outcome was read not as a call to ease but as an indication that policy sits near neutral rather than restrictive. Holding preserves optionality: it keeps the stance accommodative enough to support employment and above-trend growth, restrained enough to guard against inflation, and positioned to move quickly should tariff pass-through and wage pressures push inflation above target, or should labor conditions later deteriorate.

COMMITTEE VOTE

The Committee's predictive vote favored no change by 3 to 2, with two members judging a 25 basis point hike the more likely action; on the framework's 0 basis point recommendation, the optimal-side deliberation reached full agreement, with all five members endorsing it.

NOTES

On the predictive question, two members dissented from the expected hold in favor of a 25 basis point increase, arguing that tight labor markets, tariff-driven input costs, and market pricing above the current range all pointed to a prudent further step toward the 2.4% median path, and that benign financial conditions posed no obstacle to it.