OpenFed

POLICY STATEMENT | September 19, 2018

PREDICTED FED DECISION +25 bps

2.00%-2.25%

OPENFED OPTIMAL RATE HOLD

1.75%-2.00%

KEY TAKEAWAY

The Committee expects the real FOMC to raise rates 25 bps to 2.00-2.25%, yet its own deterministic framework judges the optimal move to be 0 bps, a hold that a low neutral rate and soft inflation together justify.

STATEMENT

The Committee expects the real Federal Reserve to raise the target range by 25 basis points, to 2.00 to 2.25 percent. The case for that step, as members developed it, rests less on the level of inflation than on the balance of pressures around it. Core PCE at 1.73 percent sits below the 2 percent objective, but participants pointed to a labor market running well beyond its estimated equilibrium: unemployment at 3.9 percent against a natural rate of 4.62 percent, with initial claims very low. Beige Book reports of tight labor markets, broad moderate-to-strong wage growth, and two-thirds of manufacturers passing along rising input costs were read as evidence that cost pressures are building rather than fading. Against a backdrop of prior guidance signaling 'further gradual increases' and a prior median projection of 2.4 percent, members judged that a well-telegraphed step fits both the data and market expectations. The 3-month T-bill spread of 0.255 above the current range was cited as markets having already priced in one near-term move, and calm financial conditions -- a stress index of 0.042, a VIX of 11.75, and a Baa spread of 1.88 -- were seen as leaving ample room to act without disturbing markets. On this predictive question the five members were unanimous in expecting a 25 basis point increase.

When the Committee turned to its own deterministic framework, the reasoning did not simply carry forward. The framework's loss-minimizing recommendation is a hold -- 0 basis points -- and members found that conclusion more defensible on the merits than the hike they expect the real Fed to deliver. The tension is visible in the reference rules themselves: the Taylor rule, the balanced-approach rule, and the ELB-adjusted rule all point to 75 basis points above the current setting, reflecting the wide unemployment gap and near-target inflation, while the first-difference rule alone reads -25 basis points. What reconciles that spread is the estimated neutral rate. With r* taken at -0.5, the current 1.75

to 2.00 percent range is far closer to neutral in real terms than the level rules imply, so their aggressive prescriptions overstate how much tightening conditions actually warrant. The change-based logic drew the most support: with inflation momentum at only 0.075 and unemployment momentum at -0.05, there is little upward drift in prices to preempt and no sharp labor dynamic to respond to.

Two further considerations pushed members toward the hold as the optimal call. The first is the yield curve. The 10-year to 2-year spread at 0.27 is positive but flattening, and several members treated it as the more forward-looking signal -- one that cautions against pushing the front end higher into what may already be near-neutral territory. The second is the absence of any stress that would compel action in either direction. Financial conditions are not merely calm but arguably complacent, and while that froth was raised as a reason one might lean against, members concluded that complacency alone does not justify tightening when inflation remains below target and the neutral rate is low. Weighing the reliable but level-anchored rules against a deeply negative r*, soft momentum, and a flattening curve, the Committee judged that 0 basis points is the policy the framework can actually defend. The divergence between the expected 25 basis point move and the optimal hold quantifies the sense that the anticipated path reflects the inertia of prior guidance more than what current indicators literally justify.

In short, the Committee expects a hike it does not regard as necessary. It anticipates the real FOMC will move a quarter point in keeping with gradualism and market pricing, while its own framework counsels patience -- holding at the current range until inflation momentum or labor dynamics give a clearer reason to move.

COMMITTEE VOTE	The predictive vote was unanimous, 5 to 0, for a 25 basis point increase to 2.00-2.25 percent. On the framework's 0 basis point recommendation, the optimal-side deliberation split 4 to 1 in favor: four members endorsed the hold as stated, and one endorsed the direction but not the decision to stand pat.
NOTES	*The single reservation came from the inflation-focused member, who supported holding over cutting but argued a gradual hike remained the more defensible move. On this view, positive inflation momentum of 0.075, broad wage pressures, and Beige Book concern about future inflation mean that with a real policy rate near zero and financial conditions loose, holding lets accommodation persist while upside risk visibly builds -- and the 0 basis point call is direction-neutral rather than the continued vigilance the level rules point toward.*