



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available on or before the cutoff for this meeting. As a result, the Committee was unable to review the total size, composition, or change from the prior release of SOMA holdings on the basis of a verified source. It should be noted that this section addresses SOMA holdings only; results of repurchase and reverse repurchase operations are not covered here, as no point-in-time-safe data source for those operations currently exists. The desk's operational activity is therefore described only to the extent supported by the available holdings data, which in this instance was none.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 2.27 percent on a year-over-year basis, modestly above the Committee's 2 percent objective. The unemployment rate was 6.0 percent, above the estimated natural rate of 5.45 percent, indicating that some slack remained in labor markets. Initial jobless claims at 341,000 were moderate and gave no sign of acute deterioration. The Chicago Fed National Activity Index at 0.45 pointed to growth somewhat above trend. The fed funds rate stood at 4.25 percent, reflecting substantial firming delivered over the course of the year.

The Beige Book indicated that districts generally reported continued economic expansion, though growth had moderated recently in some areas. Several districts noted slower-than-expected May retail sales, with contacts in the Atlanta, Cleveland, Dallas, New York, and Philadelphia districts citing declines in apparel sales attributed to unseasonably cool weather, alongside some signs of increasing sales in early June. Manufacturing continued to show strength in most districts, with many contacts reporting increases in new orders and shipments, while defense-related industries remained weak spots. Home sales continued at a strong pace and residential construction remained generally brisk, though some slowdowns in response to rising mortgage rates were noted. Industrial materials prices continued to rise, but competitive pressures were mitigating price increases for finished goods. Some districts reported tightening labor markets, though wage pressures appeared moderate. Loan demand was generally increasing, although rising interest rates had precipitated declines in some areas.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and orderly. The financial stress index at 0.0849 was low, and the VIX at 14.42 indicated minimal volatility concern among market participants. The Baa corporate spread of 1.54 was tight, suggesting no evident distress in borrowing costs. The 10-year/2-year yield curve spread was positive at 1.12, showing no inversion and no recession signal from the curve. The 3-month T-bill spread stood at -0.1 relative to the current fed funds rate, slightly



below current levels, which the staff read as an indication that markets were not pricing aggressive near-term tightening. Taken together, the readings suggested that credit and equity markets were functioning normally and could absorb further policy adjustment without evident strain.

STAFF ECONOMIC OUTLOOK

The staff projection drew on the estimated neutral rate and the momentum measures underlying the framework. With the real neutral rate estimated at 1.115 and inflation running near 2.3 percent, the implied nominal neutral rate lay not dramatically above the current 4.25 percent funds rate, suggesting policy was already approaching a restrictive stance. Inflation momentum was negative at -0.13 and unemployment momentum was slightly negative at -0.05, together implying that price pressures were easing rather than intensifying and that the labor market was gradually healing rather than deteriorating.

The reference rules diverged widely. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 bps, reflecting the unemployment gap relative to the natural rate. The First-Difference rule, which keys off the direction of change rather than a level-based neutral-rate estimate, pointed to +25 bps, consistent with the ongoing removal of accommodation. With the reference rules judged reliable, the framework's loss-minimizing recommendation landed at 0 bps, balancing the deep-cut signal from the level-based rules against the continued-firming logic of the First-Difference rule. On this basis the projected path suggested that prior firming would continue to transmit and that conditions were near enough to appropriate that a hold would allow those effects to work through the economy.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening assessments, participants agreed that inflation, with core PCE at 2.27 percent, was modestly above target, and that the economy remained in expansion, but they differed on the appropriate near-term action. One participant, weighting inflation risk most heavily, favored a 25 bps increase at the outset, noting that above-target inflation, rising industrial materials prices, and tightening labor markets in some districts kept price risk as the primary concern, while low financial stress and a positive yield curve indicated no recession alarm. A participant focused on labor-market conditions favored holding, observing that unemployment at 6.0 percent remained above the 5.45 percent natural rate and signaled remaining slack, though moderate jobless claims and continued expansion made a cut unjustifiable. Two participants, one attentive to financial stability and one a data-dependent centrist, opened at 50 bps, reasoning that calm markets, a subdued VIX, tight credit spreads, and above-trend activity permitted a larger move. A participant emphasizing market signals favored 25 bps, pointing to the slightly negative 3-month T-bill spread as a caution against oversizing



the step.

In the rebuttal round, positions converged toward a measured pace. The inflation-focused participant revised upward to 50 bps, persuaded that low financial stress readings permitted a larger move without destabilization while above-target inflation still warranted forceful action. The participant weighting labor considerations revised toward holding, concluding that adding restriction to a still-slack labor market was not warranted while the data gave no basis for a cut. Both the financial-stability participant and the centrist revised down from 50 bps to 25 bps, each finding the market-signal participant's point on the -0.1 T-bill spread persuasive: moving in line with market pricing preserved orderly conditions better than front-running with a larger step, and the centrist added that moderate wage pressures and remaining slack argued against acceleration. The market-signal participant held at 25 bps throughout, reasoning that calm markets permit tightening but do not compel oversizing it.

When the discussion turned to the framework's optimal recommendation of 0 bps, participants engaged directly with the divergence among the reference rules. Several noted that the level-based rules' call for -75 bps rested on the estimated neutral rate of 1.115 and the unemployment gap, and expressed skepticism that a cut mid-cycle, with the economy expanding, was appropriate. The inflation-focused participant characterized the framework's hold as a floor, confirming that cutting would be a mistake given above-target inflation, while maintaining that his own judgment justified a modest hike. The First-Difference rule's +25 bps output, which keys off the direction of policy rather than a contestable neutral-rate estimate, was cited by multiple participants as the most persuasive for current conditions, on the grounds that it respected the ongoing removal of accommodation without overreacting.

Participants also weighed the momentum measures. The negative inflation momentum of -0.13 was read as evidence that price pressures were cooling, weakening the case for aggressive moves in either direction. The slightly negative unemployment momentum of -0.05 led the labor-focused participant to note that joblessness was easing rather than rising, muting the usual instinct to ease for employment and leaving a hold as the employment-protective choice while prior firming continued to transmit. The financial-stability participant emphasized that the low stress index, the calm VIX, tight Baa spreads, and a positively sloped curve gave no sign of distress that a policy move should worsen, and that an abrupt move in either direction risked shocking still-functioning credit channels; he preferred a measured 25 bps nudge but regarded the hold as the stability-coherent anchor. The market-signal participant found that the framework's hold aligned closely with market-implied pricing near current levels, reinforcing his read that policy was near neutral.



Across the four rounds, a common thread was that the modest gap between the framework's hold and the participants' predicted quarter-point move indicated that policy was close to appropriately firm. Participants generally judged that the small size of that divergence — a hold versus a modest hike — signaled that the stance was near neutral and that the discussion concerned fine-tuning rather than a large or destabilizing action. No participant advocated the deep cut implied by the level-based rules, and none identified a recession signal that would force accommodation, with the positive yield curve, steady claims, and above-trend growth all cited in support.

COMMITTEE POLICY ACTIONS

In the predictive assessment of the likely policy action, the Committee's five members split three to two on magnitude, with three members favoring a 25 bps increase, one favoring a 50 bps increase, and one favoring no change; the median vote was a 25 bps increase. On the deterministic framework's recommendation of 0 bps, three members endorsed the recommendation as stated, and two members took a partial position — agreeing with the direction of the framework's call but not its magnitude, preferring a modest firming step. No member declined the recommendation. The labor-focused participant, the data-dependent centrist, and the market-signal participant endorsed the hold, while the inflation-focused participant and the financial-stability participant registered partial agreement, each favoring a measured 25 bps step over an unchanged stance.