



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data was available on or before the point-in-time-safe cutoff for this meeting, and the Committee was therefore unable to review the total size, composition, or period-over-period change in SOMA holdings as it ordinarily would. Members were reminded that this limitation pertains to SOMA holdings data only; results of repurchase and reverse repurchase operations were likewise unavailable, as no point-in-time-safe source for those figures currently exists. Accordingly, this section records the absence of the data rather than any change in the portfolio itself, and the discussion of financial conditions below draws instead on the market-based indicators available for the period.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data suggesting an economy growing at roughly a trend pace with mild signs of cooling. Core PCE inflation stood at 2.09 percent on a year-over-year basis, marginally above the 2.0 percent objective but not accelerating. The unemployment rate was 5.7 percent, somewhat above the estimated natural rate of 5.38 percent, pointing to the emergence of a modest degree of labor-market slack. Initial claims for unemployment insurance were 358,000, a level the staff characterized as somewhat elevated and consistent with a gradual softening in labor demand. The Chicago Fed National Activity Index reading of 0.23 indicated growth slightly above trend, though momentum appeared to be fading rather than firming. M2 stood at \$3,657.4 billion.

The most recent Beige Book, released June 21, presented commentary across the twelve Federal Reserve Districts. The staff drew on this District-by-District summary in describing conditions as broadly consistent with the quantitative indicators: an economy expanding but without evidence of overheating. Taken together, the price, labor, and activity data pointed to an economy near equilibrium, with inflation close to target and the labor market loosening at the margin rather than tightening.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were notably calm. The financial stress index registered 0.0954, a very low reading, and the VIX at 11.59 pointed to subdued volatility and little sign of market anxiety. The Baa corporate spread of 1.71 was moderate and gave no indication of credit-market distress or elevated borrowing costs. The 10-year/2-year Treasury yield spread was positive at 0.39, though thin enough that the staff noted a mild flattening. The clearest signal came from the money market: the 3-month Treasury bill traded 50 basis points below the current 6.0 percent funds rate, a configuration the staff read as market participants already pricing in near-term easing. Overall, the picture was one of orderly, benign conditions with no acute stress in either direction.



STAFF ECONOMIC OUTLOOK

The staff outlook pointed toward a gradual easing of policy restraint as the most likely path implied by the available forward-looking quantities. With the estimated neutral real rate (r^*) at 2.305, the current 6.0 percent nominal funds rate stood well above a neutral setting given inflation near 2 percent, indicating that policy was meaningfully restrictive. Inflation momentum was slightly negative at -0.06, suggesting price pressures were easing rather than building, while unemployment momentum was positive at 0.2, consistent with continued, if modest, labor-market loosening in the period ahead.

The reference rules diverged in magnitude while agreeing on direction. The Taylor rule, Balanced Approach rule, and ELB-adjusted rule each pointed to a 75 basis point reduction, reflecting how far current policy sat below neutral once the output and employment gaps were weighted. The First-Difference rule, which adjusts incrementally from the prevailing rate rather than resetting to an estimated equilibrium, indicated a 25 basis point cut. The loss-minimizing recommendation from the framework was -25 basis points, aligning with the First-Difference rule; the staff noted the reference rules were assessed as reliable in the present configuration. The gap between the level-based rules and the incremental result was itself informative, implying that policy was tight enough that further easing could follow should labor data continue to soften, even as no single reading justified a larger immediate move.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants generally agreed that the economy was near equilibrium, with inflation close to target and the labor market showing early signs of loosening. Most members judged that the current 6.0 percent funds rate was restrictive relative to near-target inflation and a natural rate estimated at 5.38 percent, and that a modest step toward easing was warranted. Four of the five participants favored a 25 basis point reduction, while one preferred to hold the rate unchanged.

The member most focused on inflation risk made the case for holding. In this participant's view, core PCE at 2.09 percent remained above the 2.0 percent objective and was not yet convincingly contained, and cutting while inflation exceeded target would be premature. This member was unpersuaded by the emphasis others placed on the negative 3-month bill spread, cautioning that market pricing of a cut is not itself a reason to validate that pricing. Extremely calm markets, in this reading, removed any urgency to act rather than invited easing; a positive yield curve at +0.39 and moderate credit spreads at 1.71 offered no recession signal strong enough to justify a preemptive move.

The participant most attentive to employment risk pressed the opposing case most forcefully, arguing that unemployment at 5.7 percent above the natural rate, together with initial claims of 358,000,



signaled softening labor demand that restrictive policy risked aggravating. With inflation essentially at target and not accelerating, this member saw the 0.09 percentage point overshoot as trivial and no barrier to supporting employment. The participant oriented toward financial stability reached the same conclusion by a different route: with the stress index at 0.0954 and the VIX at 11.59, conditions were benign, and a small precautionary cut would neither destabilize calm markets nor signal alarm, while delivering the modest ease markets had already priced avoided the disruption of surprising them by holding. The member weighting market signals most heavily treated the 50 basis point gap between the bill and the funds rate as the dominant read, corroborated by the flat yield curve, and the data-dependent participant favored the same modest cut as the most literal, consensus-aligned interpretation of softening labor data and market pricing.

When the discussion turned to the framework's recommendation, participants examined why the Taylor, Balanced Approach, and ELB-adjusted rules all called for 75 basis points while the First-Difference rule and the loss-minimizing output pointed to 25. Several members observed that the aggressive rules leaned on level gaps and an uncertain r^* estimate of 2.305, whereas the incremental First-Difference logic adjusted from current conditions without overreacting to those estimates. Members noted that inflation momentum at -0.06 and unemployment momentum at 0.2 were consistent with measured rather than aggressive easing, and that a 75 basis point move would risk an abrupt shock to markets that showed no distress. The employment-focused and market-focused participants read the divergence between the -75 rules and the -25 outcome as a signal that policy remained meaningfully tight and that additional easing could follow if labor data continued to weaken, while preserving optionality now.

Even the member who had preferred to hold in the predictive discussion found the framework's incremental result congenial to a cautious temperament, noting that inflation momentum was slightly negative and that a 25 basis point cut acknowledged softening labor conditions without the recklessness of a larger move; should prices firm, the Committee would not have over-eased and could pause. Across both the predictive and framework discussions, the recurring themes were near-target inflation with easing momentum, mild labor loosening, benign financial conditions, and market pricing already leaning toward a cut, which together supported a gradual, calibrated step rather than either a hold or a jumbo reduction.

COMMITTEE POLICY ACTIONS

In the predictive vote, the Committee split four to one, with four members forecasting a 25 basis point reduction and one member forecasting no change (a hold). On the framework's loss-minimizing recommendation of -25 basis points, the Committee reached full agreement: all five members



endorsed the recommendation as-is, with none declining and none registering only partial support. The member who had favored holding in the predictive round nonetheless endorsed the -25 basis point recommendation, finding the incremental First-Difference basis for the move consistent with a cautious, inflation-vigilant stance.