



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 therefore had no reported figure for total SOMA size, its composition across security types, or any change from a prior release to review. This absence pertains specifically to SOMA portfolio holdings. It should be noted separately that the results of repurchase and reverse repurchase operations are not covered here either, as no point-in-time-safe data source for those operation results currently exists; the discussion in this section is limited to SOMA holdings only.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that the domestic economy continued to perform strongly across a broad range of measures. The unemployment rate stood at 4.3 percent, well below the estimated natural rate of 5.19 percent, indicating a notably tight labor market. Initial jobless claims registered 349,000, a level the staff characterized as moderate rather than signaling deterioration. Core PCE inflation on a year-over-year basis was 0.98 percent, less than half the 2 percent objective. Set against these readings, the Chicago Fed National Activity Index at -0.44 pointed to growth running somewhat below trend, a note of caution alongside the otherwise firm labor picture. M2 stood at 4,172 billion dollars.

The Beige Book, prepared before June 8, described the national economy as continuing its 'excellent performance,' with high output and employment and low inflation, and growth reported in all Federal Reserve districts. The pace varied, ranging from quite strong in the Northeast, much of the Midwest, and the West Coast to more modest in the Southeast and the Dallas district. Household spending was a central source of strength, with retail sales described variously as healthy, brisk, robust, or strong across most districts, though Atlanta noted somewhat softer consumer spending. Business investment in plant and equipment was solid, and the construction sector was very strong. Manufacturing was robust in several districts, notably Chicago, St. Louis, and Kansas City, but weaker in an arc running from Dallas through Atlanta and Richmond. The staff flagged that seven districts reported some adverse effects from economic problems in Asia, and that crop and livestock prices were low while oil and gas drilling remained slack.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were generally calm, though several term-structure signals warranted attention. The financial stress index was low at 0.1329, and the Baa corporate spread, at 1.67 percentage points over Treasuries, indicated no acute distress in credit markets. The VIX at 20.17 was moderate, reflecting some latent volatility but no evident dislocation. More striking were the interest-rate signals: the 10-year/2-year Treasury spread was essentially flat at -0.04, a slight inversion, and the 3-month



Treasury bill yielded 0.53 percentage point below the current 5.5 percent federal funds rate. Taken together, these readings suggested that market participants were not pricing in further tightening and may have been leaning toward an expectation of eventual easing.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on several forward-looking quantities. The estimated neutral real rate (r^*) of 3.203 percent, set against a nominal funds rate of 5.5 percent and core inflation near 1 percent, implied a real policy rate in the vicinity of 4.5 percent — meaningfully above neutral, consistent with a policy stance that was restrictive on its face. Momentum measures reinforced a picture of cooling rather than building pressure: inflation momentum was negative at -0.12 , and unemployment momentum was -0.2 , indicating that price pressures were receding while the labor market showed some early forward softening even from a strong base.

The reference rules spanned a wide range, reflecting the genuine tension in the data. The Taylor rule prescribed -75 basis points, driven by inflation running well below target; the First-Difference rule, responsive to the negative momentum readings, indicated -25 basis points; and both the Balanced Approach and ELB-adjusted rules read 0 basis points, giving greater weight to the tightness of the labor market. With the reference rules judged reliable, the loss-minimizing framework blended these into a recommendation of -50 basis points. The projection implied by these quantities was one in which restrictiveness, if left unaddressed, would continue to bear on below-trend activity, with the flat-to-inverted curve and Asian external drag posing downside risk to the growth path even as domestic demand remained firm.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, all five participants independently arrived at the view that policy should be held steady at 5.5 percent, though they reached that conclusion from different vantage points. The member most attentive to inflation risk observed that core PCE at 0.98 percent was remarkably low — less than half the objective — leaving no realized inflation to lean against, so that a hike could not be justified on price grounds. That member nonetheless emphasized the tight labor market, with unemployment at 4.3 percent far below the 5.19 percent natural rate, as a latent source of future inflation, and concluded that while easing was unwarranted, so too was tightening into a near-inverted curve and an environment showing Asian drag in seven districts.

The labor-focused member noted that the data showed no employment deterioration whatever — claims moderate, spending robust, construction strong — and that the trigger for easing in that member's framework, namely labor-market weakness, was simply absent. The financial-stability



member pointed to the low stress index, contained Baa spread, and moderate VIX as evidence of no acute distress, while taking the slight curve inversion and the sub-funds T-bill seriously as recession-risk signals that argued against adding tightening. The data-dependent centrist read the conflicting signals as balancing to a hold, and the market-signal member emphasized that the 53-basis-point gap between the T-bill and the funds rate showed markets pricing no hike and possibly eventual easing. The rebuttal round produced no movement; the convergence on hold was described by several participants as genuine and grounded rather than forced.

The optimal-framework discussion, conducted after the predictive vote was final, confronted the framework's -50 basis point recommendation and prompted a notable reassessment. Participants generally acknowledged that the divergence between their hold votes and the framework's easing call revealed something they had underweighted: with a real funds rate near 4.5 percent against an estimated neutral of roughly 3.2 percent, current policy was meaningfully restrictive at a time when inflation was undershooting and its momentum was negative. The inflation-focused member conceded that the usual objection to cutting did not apply when there was no inflation to protect, and found the First-Difference logic — incremental easing responsive to changing momentum — most persuasive. The labor-focused member argued more forcefully that waiting for deterioration to appear in the unemployment rate would mean acting too late, and endorsed the -50 as preemptive insurance for employment.

In the final rebuttal round, a clear pattern emerged around magnitude rather than direction. Four participants agreed that easing was the appropriate direction — the real rate was elevated, the curve was flat-to-inverted, and Asian spillover posed forward risk — but judged a full 50 basis points too aggressive given the still-strong Beige Book, tight labor market, and benign credit conditions. The inflation member preferred a smaller 25-basis-point step to guard against wage risk; the financial-stability member observed that nothing was breaking that demanded urgent 50-basis-point insurance and favored the incremental path; the centrist noted that two of the four reference rules read 0, so a smaller move better honored the mixed evidence; and the market-signal member argued that the -53 basis point bill spread was consistent with roughly one 25-basis-point step, not two, and that a flat curve implied gradualism. The labor-focused member alone maintained that -50 was warranted, viewing the 25-basis-point option as too timid given accumulating forward-looking downside risks.

COMMITTEE POLICY ACTIONS

On the predictive question of the current policy decision, all five members voted for no change, leaving the federal funds rate at 5.5 percent — a tally of 5 to 0 for holding steady. On the separate question of the framework's loss-minimizing recommendation of -50 basis points, the Committee did not fully



converge. One member, the labor-market-focused participant, endorsed the recommendation as-is. The remaining four — the inflation-focused member, the financial-stability member, the data-dependent centrist, and the market-signal member — gave partial support, agreeing that easing was the correct direction given the restrictiveness implied by the elevated real rate and the flat-to-inverted curve, but judging the 50-basis-point magnitude too large relative to still-firm activity, a tight labor market, and benign financial conditions; each of these four leaned toward a more incremental step. No member declined the recommendation outright.