



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 is unable to report the total size, composition, or change from the prior release of SOMA holdings in this document. This section, and the underlying reporting, concern SOMA holdings only; it does not cover the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source currently exists. The absence of these figures should be understood as a limitation of the available data rather than a statement about the level or direction of the portfolio.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized the economy as operating at generally strong levels and expanding at a moderate pace. Core PCE inflation stood at 1.22 percent on a year-over-year basis, well below the 2.0 percent objective. The unemployment rate was 4.3 percent, considerably below the estimated natural rate of 5.14 percent, pointing to a tight labor market. Initial jobless claims of 310,000 remained low, with no sign of an upward drift. The Chicago Fed National Activity Index at 0.56 was consistent with above-trend growth. M2 stood at \$4,457.2 billion. The federal funds rate was 4.75 percent at the time of the review.

The most recent Beige Book, prepared before April 26, reinforced this picture. District reports described healthy consumer spending, led by strong motor vehicle sales, with year-over-year retail gains across most areas and inventories generally balanced. Most Districts noted improvement in manufacturing, though weak foreign demand remained a problem for some industries. Residential and commercial construction stayed at high levels, with some slowing in the rate of expansion noted in several Districts. Loan demand was generally described as strong. Most Districts continued to report tight labor markets, but these conditions were 'apparently not often translating into higher wages,' although there were reports that non-wage compensation was increasing. Prices generally remained stable, with the exceptions of oil and gas and some building materials in short supply.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were mixed but showed no acute stress. The financial stress index at 0.1722 was moderate rather than benign, and the VIX at 25.62 was somewhat elevated, signaling market caution and unresolved investor nervousness. Credit conditions, by contrast, appeared contained: the Baa corporate spread of 2.12 showed no dramatic widening of borrowing costs. The 10-year/2-year yield curve spread was positive at 0.4, flat but not inverted, offering no recession-warning signal. The 3-month Treasury bill yield sat 0.26 below the current funds rate, suggesting that markets priced in no



imminent hike and perhaps a slight bias toward easier policy. Taken together, the readings pointed to markets that were somewhat anxious in the volatility dimension while showing little distress in credit or funding markets.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff pointed in somewhat conflicting directions. With the estimated neutral rate (r^*) at 3.447 percent and inflation running near 1.22 percent, the implied real federal funds rate of roughly 3.5 percent left the stance only marginally restrictive. Inflation momentum was mildly negative at -0.105 , indicating that price pressures were easing rather than building, while unemployment momentum was flat at 0.0 , implying that labor-market tightness was stable rather than intensifying. On these readings, the projection is for continued above-trend activity and a persistently tight labor market, but without a clear engine for accelerating inflation absent a wage passthrough that has not yet materialized.

The reference rules dispersed widely around the current setting. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed 75 basis points higher, driven principally by the gap between unemployment at 4.3 percent and the 5.14 percent natural rate. The First-Difference rule, which responds to the change in conditions rather than the level of gaps, pointed 50 basis points lower, reflecting below-target inflation and cooling momentum. With the reference rules judged reliable, the loss-minimizing framework did not adopt either extreme; balancing the soft inflation reading and negative momentum against a stable labor gap, it produced a recommendation of -25 basis points. The projection thus embeds a genuine tension: level-based rules imply the economy is running hot enough to warrant tightening, while momentum-based logic implies that undershooting inflation warrants modest relief.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening positions, all five participants arrived at the same predictive judgment: hold the federal funds rate at 4.75 percent. Despite that convergence, the reasoning behind it differed meaningfully across perspectives, and the discussion surfaced real disagreement about the balance of risks. The common thread was the central tension in the data — a labor market well inside its estimated natural rate against core inflation running fully below the 2.0 percent objective — which several participants read as giving no compelling reason to move in either direction this meeting.

The participant most attentive to inflation risk framed the tight labor market as an overheating signal, noting unemployment far below the natural rate, rising non-wage compensation, building-material shortages, and climbing oil and gas prices. This participant judged that a case existed for tightening,



but concluded that with realized core inflation 0.78 percentage point below target and no wage breakout yet evident, an immediate hike would be premature; the stance was therefore to hold while retaining a clear tightening bias. The participant weighing employment most heavily approached the question from the opposite direction, asking whether any sign of labor deterioration warranted easing to support jobs, and found none: unemployment stable, claims low at 310,000, and the Beige Book describing tight markets across most Districts. With no employment weakness and inflation subdued, this participant likewise saw no urgency in either direction. The participant focused on financial stability emphasized that while the VIX at 25.62 signaled elevated volatility, the stress index and Baa spread were contained, and that the elevated volatility argued against a destabilizing surprise move of any kind. The data-dependent participant and the market-signals participant both settled on holding as the literal reading, the latter weighting the negative 3-month bill spread as a market expectation of steady policy with at most a faint easing lean too small to act on.

When the deliberation turned to the framework's loss-minimizing recommendation of -25 basis points, the prior consensus fractured. Participants generally acknowledged that three of the four reference rules pointed 75 basis points higher on the strength of the labor-market gap, but most were unpersuaded that those level-based rules captured the situation, citing the Beige Book's observation that tight labor was 'not often translating into higher wages.' Several found the First-Difference rule's momentum logic more persuasive, reasoning that with inflation below target and its momentum negative at -0.105, restraint was not warranted and the current stance — a real funds rate near 3.5 percent against r^* of 3.447 — was only marginally restrictive. On this view, the modest cut relieved genuine restraint without validating the aggressive tightening the level rules implied.

The participant most concerned with inflation did not accept this reconciliation. That member held that low inflation now is precisely when wage pressure can ignite, that cutting into a sub-natural-rate labor market risks stoking the very inflation the mandate guards against, and that market pricing is not a substitute for guarding price stability. This participant would rather err toward restraint than validate a precautionary cut, and declined to support the recommendation. The employment-focused participant, while endorsing the direction of a small easing as cheap insurance against disinflation given secure employment, expressed reservation about the full magnitude, noting that with no labor softening the urgency for the complete step was weak. The financial-stability, data-dependent, and market-signals participants each came to endorse the -25 basis point recommendation: the first as gentle relief that cushions elevated volatility without inflaming credit excess, the second as the literal answer to below-target and cooling inflation against a stable labor gap, and the third as consistent with the market-implied easing bias embedded in the negative bill spread while rejecting the sharper -50 of the First-Difference rule.



COMMITTEE POLICY ACTIONS

In the predictive vote on the policy decision itself, all five participants supported holding the federal funds rate unchanged at 4.75 percent, a unanimous 5-0 tally. On the separate question of the framework's loss-minimizing recommendation of -25 basis points, the Committee did not reach full agreement. Three participants — the financial-stability voice, the data-dependent centrist, and the market-signals realist — endorsed the recommendation as-is. The labor-market dove agreed with the direction of a modest easing but not its full magnitude, recording a partial stance. The inflation hawk declined to support the recommendation, judging that easing into a tight labor market risked stoking inflation and that the current stance was at most marginally restrictive. The recorded optimal-side outcome was thus three endorse, one partial, and one decline.