



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, and so the Committee was unable to review the total size, composition, or change from the prior release of SOMA holdings. Members were reminded that this limitation pertains to SOMA holdings only; separately, no point-in-time-safe data source currently exists for the results of repurchase and reverse repurchase operations, and those results were likewise not reviewed.

STAFF REVIEW OF THE ECONOMIC SITUATION

The information reviewed by the staff indicated that economic activity continued to expand at a solid pace. The most recent Beige Book, prepared before the reference period closed in late April, reported that the economy had continued to grow during March and the first three weeks of April, with a majority of Districts describing moderate to strong growth. Only two Districts noted signs that overall growth had slowed slightly. Consumer spending was strong and retail sales were generally in line with merchants' expectations, with nearly all Districts reporting strong sales of home-related items such as appliances, furniture, and lawn and garden equipment, as well as light vehicles. Commercial construction remained robust, though several Districts noted softening demand on the residential side. Manufacturing activity was strong, with factories running near capacity in some areas. Labor markets were exceptionally tight: the unemployment rate stood at 3.9 percent, well below the estimated natural rate of 5.11 percent, and initial jobless claims were low at 293,000. The Beige Book reported intensifying wage pressures and persistent worker shortages in all Districts.

On the price side, core PCE inflation was 1.72 percent on a twelve-month basis, below the 2 percent objective. However, the Beige Book noted increasing input prices in nearly every region, wider use of fuel surcharges by shipping and transportation firms, and higher prices for petroleum-related inputs such as rubber and plastics. Notably, there were only a few reports that these higher input costs were being passed through to higher prices at the retail level. The Chicago Fed National Activity Index registered -0.35, indicating growth somewhat below trend, and the M2 money supply stood at \$4,719.8 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions presented a mixed picture. Market volatility was elevated, with the VIX at 28.93, and the Beige Book indicated that recent equity market volatility had not affected real activity as of the reference period, though it had altered some contacts' expectations. Credit market indicators were more contained: the Baa corporate bond spread stood at 2.36, a moderate level, and the broad financial stress index registered 0.2949, elevated but not indicative of systemic strain. The term structure



showed clear signs of a mature cycle. The 10-year/2-year Treasury spread was inverted at -0.33 , and the 3-month T-bill traded at a spread of just -0.04 relative to the current 6.0 percent federal funds rate, suggesting that near-term money markets were pricing little in the way of further tightening.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available at this meeting. With the estimated neutral rate (r^*) at 3.725 percent, a federal funds rate of 6.0 percent placed the stance of policy meaningfully above a neutral setting even after allowing for the inflation objective, implying that policy was already exerting restraint on demand. Inflation momentum was modestly positive at 0.23, consistent with the building wage and input-cost pressures reported across Districts and pointing to some upward drift in realized inflation over the projection horizon even as the current core PCE reading remained below target. Unemployment momentum was flat at 0.0, indicating that the labor market, while very tight, was no longer tightening further.

The reference rules diverged widely. The Taylor rule, Balanced Approach rule, and ELB-adjusted rule each prescribed 75 basis points of additional tightening, reflecting the large gap between the current unemployment rate and its estimated natural level. The First-Difference rule, by contrast, prescribed -25 basis points, giving greater weight to the recent flattening in momentum. The reference rules were judged reliable this meeting. Reconciling the level rules against the momentum-based rule, and weighing the restrictive existing stance together with the below-trend activity reading and the inverted term structure, the loss-minimizing recommendation was for no change in the funds rate. The projection was thus one of an economy running hot on the labor side but with policy already positioned to slow demand, and with the balance of forward signals suggesting that additional tightening carried meaningful overshoot risk.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants agreed that the real economy showed unmistakable signs of overheating. The tight labor market was the common starting point: unemployment at 3.9 percent well below the 5.11 percent natural rate, low jobless claims, and the Beige Book's account of intensifying wage pressures and worker shortages in all Districts. Several participants emphasized that input prices were rising nearly everywhere and that fuel surcharges were spreading, classic early indications of building cost pressure. Even the participant most attentive to employment risk acknowledged that there was no labor slack to defend and therefore no trigger for easing; with jobs booming, the usual dovish caution about restrictive policy simply did not apply in this environment.



In the predictive discussion, four participants favored a 50 basis point increase and one favored 25 basis points. The participant focused on inflation risk argued for preemptive tightening, contending that although core PCE at 1.72 percent remained below the 2 percent objective, the forward risk was clearly to the upside given labor tightness and broad-based cost pressures, and that front-loading now would reduce the risk of larger, more destabilizing moves later. The participant attentive to financial stability concurred, noting that the credit indicators that mattered most from that lens, the Baa spread at 2.36 and the financial stress index at 0.2949, remained contained and that orderly credit conditions left room to act. The data-focused participant, reading the numbers at face value, was persuaded to align with the majority, judging the recession signals not strong enough to override the broad overheating evidence and warrant only a quarter-point step.

The dissenting voices on magnitude drew on market-based and recession-risk signals. The participant emphasizing market pricing argued that the flat 3-month T-bill spread of -0.04 indicated markets were not pricing aggressive further tightening, and that the inverted 10-2 curve warned that policy was already near a restrictive bound; that participant revised toward 25 basis points, favoring continued firming that market pricing would bear without overtightening into an already-inverted curve. The employment-focused participant reached a similar conclusion by a different route, resisting a 50 basis point move on the grounds that it risked tightening too aggressively into a labor market that could turn, given the inverted curve, the VIX at 28.93, and the negative Chicago Fed index.

When the discussion turned to the framework's loss-minimizing recommendation of no change, the balance of views shifted. Four participants endorsed the hold. The financial-stability participant judged that adding restraint into an inverted curve and elevated volatility risked systemic credit strain, and that a 6.0 percent funds rate was already sufficiently tight. The market-signal participant reasoned that with r^* at 3.725 percent, real policy was meaningfully restrictive and that forward markets were already doing the tightening work, making the job essentially complete. The data-focused participant stressed that the current rate exceeded r^* plus the inflation objective, that realized inflation was below target, and that the concrete recession-risk signals offset the tight-labor overshoot. The employment-focused participant found the hold employment-neutral, since jobs were strong regardless, and prudent given the softening activity reading.

One participant declined to support the recommendation. Weighting forward inflation risk most heavily, that participant contended that tolerating overheating now would invite a costlier tightening later, that three of four reliable reference rules pointed to 75 basis points, and that market volatility had not yet affected real activity per the Beige Book. That participant could not endorse a hold when the level rules and the predictive vote both called for meaningful tightening. Other participants recognized



the tension between the hawkish level rules and the momentum-based and market signals, but generally concluded that the restrictive existing stance, sub-target realized inflation, and the flashing slowdown indicators together supported patience.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely policy action, the Committee's five members split 3 to 2 in favor of a 50 basis point increase, with two members favoring a 25 basis point increase. On the separate question of the framework's loss-minimizing recommendation of no change in the federal funds rate, four members endorsed the recommendation as stated, and one member declined to support it. The single dissent came from the member most focused on inflation risk, who judged that the upside risk to inflation from the tight labor market and building cost pressures warranted meaningful tightening rather than a hold; the members emphasizing financial stability, employment, the literal data reading, and market pricing all endorsed the recommendation.