



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on the System Open Market Account was available on or before the cutoff for this meeting, and the Committee accordingly had no current reading of the total size, composition, or period-over-period change in SOMA holdings to review. The desk's report was necessarily limited to what could be sourced without risk of anachronism, and in the absence of that series the staff did not present SOMA holdings figures. It should be noted that this discussion pertains to SOMA holdings only; results of repurchase and reverse repurchase operations are not covered, as no point-in-time-safe source for those operation results currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity was little changed or decelerating across most of the country. The Chicago Fed National Activity Index stood at -0.92 , indicating growth meaningfully below trend. In the labor market, the unemployment rate was 4.4% , still below the estimated natural rate of 5.09% , but initial jobless claims had risen to 394,000. The Beige Book, prepared on information collected before June 4, reported that labor markets continued to ease in all districts, though shortages persisted for some occupations. Manufacturing activity had declined or remained weak, commercial real estate had softened, and new construction, while still elevated in a number of districts, appeared to have leveled off. Consumer spending was described as lackluster, with retail sales and tourism slow to flat nationwide; several districts attributed part of the recent softness in retail to weather.

On the price side, core PCE inflation was 1.66% on a twelve-month basis, below the 2.0% target. The Beige Book characterized wage and price increases as moderate, with significant gains confined to energy and health care rather than broad-based across the economy. The Employment Cost Index reading was 85.5, and M2 stood at \$5,166.9 billion. The staff also noted that lending activity varied by location and loan type and that credit quality had slipped in many districts.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly orderly but showed some signs of strain. The financial stress index registered 0.1659, a moderate reading consistent with somewhat tighter but not acute conditions. The VIX stood at 21.71, reflecting elevated market caution, and the Baa corporate spread was 2.74, pointing to real borrowing-cost pressure for weaker issuers — consistent with the Beige Book's observation that credit quality had slipped in many districts. The Treasury yield curve remained positively sloped, with the 10-year/2-year spread at 1.26, offering no signal of imminent recession. At the front end, the 3-month Treasury bill traded 0.59 percentage point below the current 4.0% funds rate, indicating that markets had already priced in a substantial degree of further easing.



STAFF ECONOMIC OUTLOOK

The staff outlook drew on the estimated neutral rate and the reference-rule set to gauge the likely path of policy relative to conditions. With r^* estimated at 3.92% against a current funds rate of 4.0%, the real stance of policy appeared only marginally restrictive. Inflation momentum was mild at 0.07, giving little indication of accelerating price pressure, while unemployment momentum was positive at 0.25, suggesting that joblessness was on a rising path even as the level of unemployment remained below the natural rate.

The reference rules were judged reliable but pointed in divergent directions. The Taylor rule, Balanced Approach rule, and ELB-adjusted rule each recommended 75 bps of tightening, reflecting the still-tight labor market and inflation running only modestly below target. The First-Difference rule, which responds to the change in conditions rather than their levels, recommended -25 bps, reading the deceleration in activity and the softening in labor momentum. The framework's loss-minimizing recommendation of 0 bps effectively balanced these competing signals — declining to tighten into a visible slowdown while stopping short of adding stimulus with inflation contained and unemployment still low. The implication was that the current stance sat close to neutral, with the direction of any near-term adjustment contingent on whether the leading indicators or the level readings proved the better guide.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive discussion, participants converged on the view that a 25 basis point cut was warranted, and each grounded that judgment in a somewhat different reading of the data. Several emphasized that core PCE at 1.66% sat below target and posed no near-term upside risk, leaving room to ease without endangering price stability. The member most attentive to inflation risk observed that, while inflation was below target, it was neither deeply below nor collapsing; still, with the Beige Book reporting only moderate wage and price increases and significant gains confined to energy and health care, that member found no upside pressure that would justify resisting a modest cut, while noting continued vigilance should price pressures broaden.

The member focused on employment weighted the labor data most heavily, pointing to jobless claims at 394,000, the easing of labor markets in all districts, and the Chicago Fed index at -0.92 as evidence of deterioration worth getting ahead of. The financial stability member drew attention to the Baa spread at 2.74, the VIX at 21.71, and the Beige Book's note that credit quality had slipped in many districts, arguing that failing to deliver the easing the front end had already priced could risk a disorderly repricing and a tightening spiral in credit conditions. The market-focused member treated the negative 3-month T-bill spread of -0.59 as the dominant signal, reading it as markets having aggregated an



expectation of further easing, while noting that the still-positive yield curve at 1.26 argued against anything larger than a measured step. The centrist framed 25 bps as the literal consensus reading of soft growth data against contained inflation. In the rebuttal round, none of these positions shifted; participants who considered a larger 50 basis point move set it aside, citing the positively sloped curve, moderate financial stress at 0.1659, and unemployment at 4.4% still below the natural rate as reasons not to appear panicked.

When the discussion turned to the framework's loss-minimizing recommendation of 0 bps, a genuine divergence emerged between the predictive lean toward easing and the case for a hold. Participants generally acknowledged that the framework was splitting the difference between three level-based rules calling for 75 bps of tightening and the First-Difference rule's -25 bps. The inflation-focused member found the hold most persuasive, reasoning that below-target inflation removed any urgency to cut while softening activity removed any justification to hike; with inflation momentum only 0.07 and unemployment still below the 5.09% natural rate, that member judged patience appropriate given slipping credit quality and the 2.74 Baa spread.

Other participants accepted the framework's arithmetic but were not persuaded to abandon the easing direction. The employment-focused member argued that the level rules leaned on a backward-looking unemployment reading, whereas claims and the activity index pointed to deterioration ahead, and characterized a modest cut as insurance against labor-market damage before it hardened into rising unemployment. The financial stability member, initially comfortable with a hold as a way to avoid a destabilizing tightening, was moved by the front-end pricing and the slipping credit quality toward acting on an easing bias rather than merely watching, concluding that the framework had the direction right but stopped short of the support conditions warranted. The market-focused member likewise held that a hold was too static against a front end trading 59 basis points below the funds rate. The centrist agreed with the easing direction while stressing that the case was modest rather than aggressive.

Across both the predictive and optimal-framework discussions, participants repeatedly returned to the tension between static level readings and the momentum in the leading indicators. Those who leaned toward easing emphasized that with r^* at 3.92% and the funds rate at 4.0%, real policy was barely restrictive, and that the direction of change in claims, activity, and credit conditions mattered more than the still-low level of unemployment. Those inclined toward the hold emphasized that inflation, while below target, was not falling, and that markets remained orderly enough that no aggressive action was called for.

COMMITTEE POLICY ACTIONS



In the predictive round, all five members supported a 25 basis point cut, a unanimous -25 bps tally. On the framework's loss-minimizing recommendation of 0 bps, the Committee was genuinely divided: one member endorsed the hold as-is, two members declined to support it, and two members agreed with the framework's direction but not its magnitude, registering partial support. The member most focused on inflation risk endorsed the 0 bps recommendation; the members focused on employment and on market signals declined it, favoring a modest cut; and the financial stability and centrist members took partial positions, agreeing with the easing direction implied by the data while judging that a hold understated the support that softening growth and credit conditions warranted.