



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 so the Committee had no report on the total size, composition, or change from a prior release of the SOMA portfolio to review. This section therefore describes only what is absent: with no SOMA figures in hand, staff were unable to characterize the outright holdings of Treasury or other securities or any month-over-month change in them. Members should note that this discussion covers 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; nothing here should be read as a statement about the scale or direction of temporary open market operations over the intermeeting period.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review pointed to a broadening but still uneven recovery. Core PCE inflation stood at 1.05 percent on a twelve-month basis, well below the 2 percent objective, and the Beige Book reported that wage and price pressures generally stayed in check. The unemployment rate was 5.7 percent, above the estimated natural rate of 5.07 percent, and initial jobless claims remained elevated at 414,000. The Chicago Fed National Activity Index, at 0.16, was consistent with growth only modestly above trend. The Beige Book, prepared on information collected before mid-April, found that almost all Federal Reserve Districts reported signs of improvement or actual increases in activity, with Boston the sole exception in describing conditions as mixed.

Beneath the generally positive tone, several qualifications stood out. Cleveland noted that the pace of improvement had slowed considerably from earlier in the year, while Kansas City and Dallas described their economies as still weak despite recent signs of firming. Retail sales held steady or increased in most Districts, and all Districts reported stable or improved manufacturing conditions, though manufacturers' capital spending plans remained limited. Residential real estate was strong in most areas as home sales and construction rose, while commercial real estate remained generally weak. Labor markets stayed slack, with reports of shortages confined largely to skilled health care workers, and those Districts mentioning wage pressures described them as minimal. Retail prices were generally flat; steel producers sharply boosted prices, but most other manufacturers held prices steady.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly calm and accommodative. The financial stress index was low at 0.1266, and the VIX, at 21.91, was elevated but not at levels signaling acute market fear. The Baa corporate spread of 2.84 indicated some caution in credit markets but no acute distress. The



10-year/2-year Treasury spread was steeply positive at 1.87, showing no inversion and, by that measure, a low market-implied probability of recession. The 3-month T-bill spread against the current federal funds rate was essentially flat at minus 0.01, indicating that markets were pricing in no near-term move in the policy rate. Taken together, these readings described orderly markets with contained credit stress and no signal of imminent policy action.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff pointed in conflicting directions, which is worth setting out plainly rather than resolving prematurely. The estimated neutral rate (r^*) of 3.58 percent sits well above the current 1.75 percent federal funds rate, which on a level basis implies that policy is already accommodative relative to fundamentals. Consistent with that reading, the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points above the current setting. The reference rules were judged reliable in this instance.

The momentum figures, however, cut the other way. Inflation momentum was negative at minus 0.255, indicating that core inflation was drifting further below target rather than stabilizing, while unemployment momentum was slightly positive at 0.05, suggesting that labor-market slack was not yet closing. The First-Difference rule, which responds to the direction of change rather than to the level relative to r^* , prescribed minus 25 basis points. Weighing the persistent inflation shortfall and residual slack against the level-based signals, the loss-minimizing engine recommended minus 50 basis points. The projection that emerges is thus one of a recovery that is real and broadening but accompanied by disinflation that, if it continued, would widen the gap to target and raise the cost of delay in acting to support both mandates.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants converged on holding the federal funds rate at 1.75 percent, though they arrived there from different starting points. The member weighting inflation risk most heavily observed that core PCE at 1.05 percent left little immediate inflation threat and that the Beige Book confirmed slack labor markets and minimal wage pressure; even so, this participant saw no case for a hike given the fragile and uneven recovery, and firmly opposed any cut on the grounds that policy at 1.75 percent was already accommodative and further easing risked stoking inflation once slack was absorbed. The member most focused on employment emphasized that unemployment at 5.7 percent exceeded the 5.07 percent natural rate and that claims at 414,000 signaled fragile labor demand, but judged that broad improvement across Districts described a recovery rather than a deteriorating labor market demanding an emergency cut. The financial-stability voice and the market-signal member both pointed to low stress, a steep and non-inverted curve, and a flat short-end



spread as evidence that markets were pricing no move and that neither easing nor tightening was warranted. The data-dependent centrist read the indicators at face value and reached the same conclusion: subdued inflation removed any case to tighten, while broad-based recovery removed any case to ease further.

The rebuttal round largely reinforced this consensus. The inflation-focused member flagged the sharp steel price increase as the one inflation signal worth watching but judged it isolated, with most manufacturers holding prices steady and retail prices flat. The employment-focused member acknowledged that the convergence on low financial stress and broad recovery had persuaded her that holding was prudent, while reserving the option to cut if labor data deteriorated or claims climbed further. No participant was moved off a hold; the group read the flat 3-month T-bill spread and the steep yield curve as confirmation that markets expected recovery, not distress.

The tenor of the discussion shifted markedly once participants turned to the framework's minus 50 basis point recommendation. Here genuine disagreement emerged. The employment-focused member found the easing logic persuasive and endorsed the direction: with inflation momentum negative at minus 0.255, slack not yet closing, and prices contained nearly a point below target, this participant argued that easing costs least precisely when the labor market is soft and that a hold would leave employment under-supported. Several participants credited the momentum case as the strongest challenge to a static hold. The centrist, the financial-stability voice, and the market-signal member all came to accept that the direction of easing was defensible given the deepening disinflation, even as their predictive votes had been for a hold.

But the same participants balked at the magnitude. The financial-stability voice endorsed insurance easing in principle yet judged that a 50 basis point cut into low-stress, broadly-improving conditions risked overstimulation and a destabilizing signal, preferring a measured step consistent with the First-Difference rule's minus 25 basis points. The centrist made a parallel argument: disinflation and elevated claims justified the direction, but almost all Districts reported improvement, three level rules pointed up toward 75 basis points, and a half-point move overshot what the mixed data supported. The market-signal member stressed that a flat short-end spread meant markets were pricing no move at all, so a full 50 basis points would surprise and overshoot; a modest step at most was consistent with the efficient market read. The inflation-focused member went further and declined the recommendation outright, noting that easing 50 basis points against three level rules calling for a hike, into a recovery the Beige Book described as broadening, was excessive; at most, elevated claims justified a small easing bias, not a half-point cut.



The discussion thus resolved into a shared recognition that the level rules and the momentum rules told different stories. Participants generally agreed that with r^* estimated at 3.58 percent, real rates at 1.75 percent nominal were not restrictive on a level basis; yet most also credited the framework's point that persistent disinflation argued for at least some insurance easing that current policy was not actively providing. The gap between the unanimous predictive hold and the framework's minus 50 basis points was read by several as evidence that the current stance was passively too tight relative to the mandate gaps, even where members were unwilling to act aggressively against firming activity and calm markets.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action at this meeting, the Committee voted unanimously to hold the federal funds rate at 1.75 percent, with all five members in agreement (5 votes for no change). On the separate question of the deterministic framework's minus 50 basis point recommendation, the Committee did not reach agreement. Of the five members, one endorsed the recommendation as-is (the employment-focused member), one declined it (the inflation-focused member), and three agreed with the easing direction but not the magnitude or timing (the financial-stability voice, the data-dependent centrist, and the market-signal member), preferring a smaller step consistent with the First-Difference rule. The recorded optimal-side tally was thus one endorse, one decline, and three partial.