



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 of SOMA holdings, their composition across security types, or any change from the prior release. Members were advised that this gap pertains to the SOMA portfolio only; it does not reflect on repurchase or reverse repurchase operation results, for which no point-in-time-safe data source currently exists either. In the absence of these figures, this section is confined to noting the data limitation rather than characterizing open market operations over the intermeeting period.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 1.31 percent on a twelve-month basis, well below the 2 percent objective. The unemployment rate was 5.8 percent, above the estimated natural rate of 5.07 percent, and initial jobless claims remained elevated at roughly 396,000. The Chicago Fed National Activity Index registered a positive 0.29, consistent with activity expanding at or somewhat above trend, and the Employment Cost Index reading was 88.8. M2 stood at approximately 5,544 billion dollars. The current federal funds rate was 1.75 percent.

The most recent Beige Book, prepared before June 3, described overall economic activity as expanding at a moderate pace in late April and May, with a tone of modest but uneven growth. Some major sectors showed signs of improvement while others softened or remained weak. Retail sales were flat in most Districts and auto sales were mixed, with unseasonable weather cited as a drag in several regions. Activity in services and manufacturing improved overall but varied across regions and segments. Residential real estate markets generally remained robust while weakness persisted in most commercial markets. Districts noted few changes in lending markets, though contacts in a couple of Districts reported lost sales because potential buyers did not qualify for credit. Labor markets remained slack in most Districts, though several reported higher demand for temporary workers. Price pressures were in check for most goods and services, but many Districts noted rising steel prices along with continued increases in energy and insurance costs.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as broadly stable but marked by some lingering investor anxiety. The financial stress index was low at 0.1233, and the 10-year to 2-year Treasury spread was steeply positive at 1.95, offering no signal of imminent recession. At the same time, the VIX stood at an elevated 26.06, indicating meaningful market volatility, and the Baa corporate spread at 3.06 was somewhat wide, suggesting lenders were demanding a modest premium for credit risk. The 3-month



Treasury bill traded 7 basis points below the current funds rate, implying that markets were leaning toward a mild easing bias rather than any additional tightening. Taken together, the picture was one of contained systemic stress alongside residual caution in credit and volatility measures.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available to the Committee. The estimated neutral rate (r^*) used in the policy engine was 3.518 percent, notably above the current 1.75 percent funds rate, a gap that on its face would suggest policy is well below neutral. The level-based reference rules reflected this: the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points, consistent with an economy whose unemployment rate sits close to its natural rate and whose neutral rate is estimated high. Weighed against these, however, were the momentum signals — inflation momentum of negative 0.055 and unemployment momentum of negative 0.05 — both pointing to disinflation and a labor market that is, at best, only slowly closing its slack. The First-Difference rule, which keys off change rather than assumed equilibrium levels, prescribed negative 50 basis points.

The staff noted that the reference rules were flagged as reliable, but that their sharp divergence — from plus 75 to minus 50 — reflected genuine tension between a high estimated neutral rate and softening near-term dynamics. The loss-minimizing output, weighing these terms together, landed on negative 25 basis points: a modest easing that discounts the r^* -driven level prescriptions in light of below-target inflation and negative momentum, while stopping well short of the aggressive First-Difference cut. The implied path, then, is one in which conditions are projected to remain subdued in the near term, with disinflation the more salient risk than overheating, and with policy assessed as marginally too tight relative to that momentum rather than badly miscalibrated.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, all five participants arrived independently at holding the funds rate at 1.75 percent, though they reached that view from different vantage points. The participant most focused on inflation risk observed that core PCE at 1.31 percent was well below target and that the Beige Book confirmed price pressures were in check for most goods and services, leaving no elevated inflation risk demanding action. This participant flagged the narrow, sector-specific cost pressures in steel, energy, and insurance as worth monitoring for pass-through, but not as evidence of broad wage or price acceleration, and cautioned that hiking prematurely amid a VIX near 26 and elevated jobless claims would be risky.



The participant most attentive to employment described labor-market slack as the primary concern — unemployment at 5.8 percent above the 5.07 percent natural rate, claims near 396,000, and a Beige Book noting that labor markets 'remained slack in most Districts.' On these grounds this participant leaned toward wanting a cut, but acknowledged several counterweights: a steeply positive yield curve, a positive CFNAI, and a low financial stress index all pointed to an expansion underway rather than a contraction. The conclusion was that a cut, while justifiable on employment grounds, was likely to be outvoted, and that holding while remaining ready to ease was the more probable and prudent course. The participant focused on financial stability read the elevated VIX and somewhat wide Baa spread as reasons to avoid tightening, while the low stress index and contained credit spreads argued against easing as a signal of alarm. The data-dependent participant found that no indicator justified a cut and no inflation pressure justified a hike, favoring a literal consensus reading. The market-signal participant anchored on the 3-month bill trading 7 basis points below the current rate — a mild easing bias, but far short of pricing a 25 basis point cut — and on the steep, non-inverted curve, concluding that markets were pricing the status quo. On rebuttal, no participant was moved off hold; several noted that the convergence of the group reinforced their own reading.

The discussion took on a different character once participants turned to the framework's loss-minimizing recommendation of negative 25 basis points, which diverged from their unanimous predictive hold. A recurring theme was skepticism toward the level rules' call for 75 basis points of tightening. Participants generally judged that those prescriptions rested on an estimated neutral rate of 3.518 percent that sat uneasily against soft activity, negative inflation momentum, and a Beige Book tone of modest, uneven growth. Several found the First-Difference rule's logic — responding to change and momentum rather than an assumed equilibrium — the most persuasive fit for the softening they saw, even as they viewed its full negative 50 basis point prescription as an overreaction.

Notably, the inflation-focused participant reasoned that because inflation was running cool and momentum was negative, the usual objection to cutting was muted; a measured 25 basis point step could be accepted as insurance without fear of igniting price pressures, though this participant resisted going larger. The employment-focused participant read the divergence between the hold vote and the framework's cut as evidence that current policy was likely too tight for the slack on hand, and endorsed the modest easing as cushioning a fragile labor recovery. The financial-stability participant emphasized concrete credit-tightness signals — the wide Baa spread, elevated VIX, and Beige Book reports of buyers failing to qualify for credit — and concluded that if forced to move, easing beat tightening, with a 25 basis point step cushioning stress without overreacting to contained conditions.



Two participants, while agreeing on direction, were less persuaded on magnitude. The data-dependent participant noted that the gap between hold and negative 25 was a single increment, that the stress index was low and the curve not inverted, and that the literal data did not compel even a small cut now — leaning toward easing as the correct direction but judging an immediate 25 basis point move as more than the data required. The market-signal participant made a parallel argument grounded in pricing: the front end implied only about 7 basis points of easing, and a steep curve with contained stress suggested markets were pricing something smaller than a full 25, so the direction was right but the magnitude overshot the mild market signal.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported holding the target federal funds rate at 1.75 percent, an outcome of 0 basis points by a vote of 5 to 0. On the separate question of the framework's loss-minimizing recommendation of negative 25 basis points, three participants — those focused on inflation risk, on employment, and on financial stability — endorsed the recommendation as-is, while the remaining two — the data-dependent participant and the market-signal participant — registered partial agreement, concurring that the appropriate direction of any move was easing rather than tightening but judging an immediate 25 basis point cut larger than the data or market pricing compelled. No participant declined the recommendation's direction outright.