



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held domestic securities in Treasury notes, bonds, and bills as of the most recent release available on or before the cutoff for this review. This account covers SOMA securities holdings only — total size, composition, and week-over-week change. It does not encompass repurchase or reverse repurchase operation results, for which no point-in-time-safe data source is currently available; the staff accordingly limited its report to the holdings figures above.

STAFF REVIEW OF THE ECONOMIC SITUATION

Economic activity continued to expand at a moderate pace over the intermeeting period. The Beige Book, prepared before June 6, reported that all twelve Districts saw business activity continue to grow from mid-April through May, with most Districts describing the expansion as moderate, solid, or well-sustained. A few Districts noted softer or uneven conditions — Philadelphia observed that growth had eased in May, and Boston and Cleveland cited unevenness across sectors. Retail activity was mixed: several Districts reported disappointing May sales and pointed to unseasonable weather as the main cause, while a few noted that high gasoline prices were weighing on consumer spending. Reports on other service industries were largely positive, residential real estate remained strong in most Districts, and several Districts saw improving commercial real estate conditions. Manufacturing generally continued to expand, though with varying conditions across industries. Labor markets improved in most Districts. Overall price pressures were characterized as moderate, though several reports flagged concern over high fuel, transportation, and building materials costs.

The incoming data were consistent with this picture. The unemployment rate stood at 5.1 percent, essentially at the estimated natural rate of 5.04 percent, and initial jobless claims of 321,000 pointed to a stable labor market. The Chicago Fed National Activity Index registered 0.41, indicating growth somewhat above trend. Core PCE inflation on a twelve-month basis was 1.44 percent, below the 2.0 percent objective. The federal funds rate stood at 3.0 percent.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions remained calm and broadly accommodative. The financial stress index was low at 0.1197, and the VIX, at 12.13, sat at a notably subdued level. The Baa corporate spread of 1.88 percentage points indicated tight, healthy credit conditions with no evident sign of borrowing-cost strain. The 10-year/2-year Treasury spread was positive at 0.33 percentage point, though flatter than in earlier periods, and did not signal an imminent inversion. The 3-month T-bill spread relative to the current funds rate was 0.0, suggesting that market participants were positioned for the policy rate to remain near its current setting or move only modestly.



STAFF ECONOMIC OUTLOOK

The forward-looking indicators available to the staff pointed to conditions that were near, rather than far from, balance. With the estimated neutral real rate (r^*) at 1.398 percent and core inflation running near 1.44 percent, the implied neutral nominal rate stood modestly below the current 3.0 percent funds rate, suggesting policy was at most only slightly restrictive. Momentum measures were small in magnitude: inflation momentum was mildly positive at 0.05 and unemployment momentum was slightly negative at -0.1, describing an economy that was drifting rather than deteriorating or accelerating sharply.

The reference rules diverged considerably in what they implied for the appropriate rate path. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to a sizeable easing of -75 basis points, reflecting the level gap between inflation and its 2.0 percent objective together with unemployment near its natural rate. The First-Difference rule, which responds to changes in inflation and unemployment rather than to level estimates, indicated a smaller -25 basis point adjustment. The reference rules were assessed as reliable in the current environment. Taking the loss function terms together, the framework's recommendation settled at -25 basis points — an outcome that gave weight to the soft inflation reading while discounting the more aggressive level-based signals in light of small momentum and near-balanced labor conditions.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, participants converged on the view that a 25 basis point increase in the target rate was the likely policy step. Several grounded this in the accommodative character of the current 3.0 percent stance relative to a solid, well-sustained expansion. One participant weighting inflation risk most heavily acknowledged that core PCE at 1.44 percent left headline inflation contained, but pointed to the Beige Book's recurring concern over fuel, transportation, and building materials costs, together with a labor market near full employment, as upside risks warranting continued removal of accommodation. A participant focused on employment observed that with unemployment essentially at the natural rate, jobless claims low and stable, and labor markets improving across most Districts, none of the conditions that would justify resisting further tightening — rising unemployment or slowing job growth — were present.

Participants attentive to financial conditions and to market signals reinforced this reading. One noted that the very low VIX and tight Baa spread suggested calm, even complacent, markets that afforded room to continue normalizing in an orderly way, and cautioned that failing to deliver a widely expected move could itself introduce volatility. Another emphasized that the 3-month T-bill spread of 0.0 indicated markets were already positioned for a continued measured pace, and that a positive though



flattening yield curve carried no recession alarm. The centrist participant framed the step as a consensus-consistent continuation of gradual normalization toward neutral, with no data supporting a pause, a cut, or an acceleration. The predictive discussion thus produced a unanimous expectation of a measured quarter-point increase.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points — a move opposite in sign to the predictive expectation — participants engaged directly with the divergence. Most agreed that the three level-based rules calling for -75 basis points overweighted fragile estimates of r^* and the natural rate and overstated the degree of slack in an economy that the Beige Book and the activity index showed expanding solidly. The First-Difference rule's gradualism drew the widest sympathy, precisely because it responded to the small observed momentum in inflation and unemployment rather than to a level gap. The employment-focused participant reasoned that with core inflation below target and no labor overheating, a modest cut would support employment preemptively without the overreaction implied by -75. The participant weighting inflation risk accepted the easing direction only reluctantly, noting that positive inflation momentum and building pipeline cost pressures, alongside strong residential real estate, argued for caution about easing at all.

A recurring theme was that policy appeared to sit close to neutral. Several participants derived a neutral nominal rate modestly below the current funds rate from r^* and current inflation, placing the 3.0 percent funds rate only modestly above it and supporting a small adjustment rather than a large one. The participant most attentive to market signals dissented from this arithmetic, arguing that a zero T-bill spread, a positive curve, and easy credit conditions implied that markets viewed neutral as sitting at or above the current rate — and that the economy was tolerating the present stance without distress. From that vantage, easing at all moved the wrong way relative to what market pricing implied, and a cut into already-easy, tight-credit conditions with strong housing risk fueling froth. The participant focused on financial stability shared part of this concern, weighing the froth risk of easing into calm markets against the observation that a flattening curve and soft core inflation made a small, reversible step defensible; that participant supported the direction while remaining wary of committing to the magnitude.

By the close of the discussion, participants broadly agreed that the data clustered around doing little and that the -75 basis point signals were outliers to be discounted. The disagreement that remained was over whether even a modest quarter-point ease was warranted given below-target inflation on one side and market-implied neutrality and housing-related risks on the other.

COMMITTEE POLICY ACTIONS



In the predictive vote on the likely policy action, all five participants anticipated a 25 basis point increase in the target federal funds rate, a unanimous tally of 5 to 0. On the separate question of the framework's loss-minimizing recommendation of -25 basis points, the Committee was divided. Two participants — the labor-market-focused member and the data-dependent centrist — endorsed the recommendation as-is. Two — the inflation-focused member and the financial-stability-focused member — agreed with the easing direction but not with committing to its magnitude or timing, registering partial support. One — the market-signal-focused member — declined to support the recommendation, judging that market pricing and easy financial conditions implied no need to ease. The resulting stance was 2 endorse, 2 partial, and 1 decline.