



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$786.1 billion in domestic securities as of the June 20 release, split between \$474.7 billion in Treasury notes and bonds and \$277.0 billion in Treasury bills. The account was unchanged from the prior release of June 13, showing no net change over the week. It should be emphasized that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available; the account discussion here is accordingly limited to the outright holdings just described.

STAFF REVIEW OF THE ECONOMIC SITUATION

Incoming data pointed to continued expansion at a pace close to trend. The Chicago Fed National Activity Index stood at -0.02, essentially consistent with growth around its historical average. Core PCE inflation on a twelve-month basis was 1.59 percent, below the 2.0 percent level the Committee has generally treated as its objective. The unemployment rate was 4.5 percent, below the estimated natural rate of 5.05 percent, indicating that resource utilization in the labor market remained elevated. Initial claims for unemployment insurance were 320,000, a moderate reading that showed no clear upward trend suggestive of labor-market deterioration. The Employment Cost Index was reported at 105.1 and M2 at \$7,242.3 billion.

The Beige Book, prepared by the Federal Reserve Bank of Philadelphia on information collected before June 4, reported that economic activity continued to expand from mid-April through May. Seven Districts described growth as modest or moderate, Dallas characterized growth as moderately strong, Minneapolis said its economy edged up, and Philadelphia and Richmond reported some pickup, while Boston described its contacts' reports as generally positive. Consumer spending and retail sales were generally up, with several Districts noting that luxury items were outselling lower-end merchandise, and travel and tourism remained healthy despite higher gasoline prices. Manufacturing was up in a majority of Districts, with weakness concentrated among producers tied to residential construction and strength among machinery and equipment makers. Residential real estate and construction remained weak, but commercial real estate strengthened. Half the Districts reported little change in overall loan demand, with commercial lending firm and residential mortgage and consumer lending soft, and the trucking industry was a notable area of widely reported decline among the service industries.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were calm across the indicators reviewed. The financial stress index stood at 0.1383, a low level, and the VIX at 14.21 pointed to subdued equity-market volatility. Credit conditions



appeared healthy, with the Baa corporate spread at 1.6 showing no sign of acute distress. The Treasury yield curve was modestly positively sloped, with the 10-year/2-year spread at 0.18, tempering any recession signal from the curve while remaining quite flat. The 3-month Treasury bill yielded 0.73 percentage point below the current 5.25 percent federal funds rate, a configuration consistent with market participants pricing some easing of the funds rate over the near-to-medium term rather than an imminent move.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff pointed to a policy stance that is meaningfully restrictive relative to neutral. With the estimated neutral real rate (r^*) at 1.28 percent and core inflation running near 1.6 percent, a neutral nominal rate would be in the vicinity of 2.9 percent, well below the current 5.25 percent funds rate. That gap is reflected in the reference rules: the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed -75 basis points, driven principally by below-target inflation and the sizable distance to neutral. The First-Difference rule, which adjusts incrementally from the current setting rather than closing the full level gap, prescribed -25 basis points.

Momentum readings suggested that the underlying dynamics were only slightly negative rather than sharply deteriorating: inflation momentum was -0.11, indicating gradual disinflation, and unemployment momentum was -0.05, near flat. Taken together, these figures imply that conditions are drifting modestly rather than turning abruptly. Under the loss function, with the reference rules judged reliable, the recommended path was -25 basis points — a step that removes some of the excess restriction implied by the r^* gap while stopping short of the aggressive one-step adjustment to neutral that the level-based rules would prescribe.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive round, all five participants independently favored leaving the federal funds rate unchanged at 5.25 percent. Participants generally observed that core PCE inflation at 1.59 percent sat below the 2.0 percent objective and appeared to be moderating — a development that, as several noted, spoke directly against the prior meeting's central concern that inflation might fail to moderate. At the same time, the participant most attentive to inflation risk cautioned against reading too much into a single below-target print and pointed to the unemployment rate at 4.5 percent, below the 5.05 percent natural rate, as evidence of a tight labor market capable of sustaining price pressures. This tension — moderating inflation set against elevated resource utilization — framed much of the discussion and, in participants' predictive read, argued for neither a hike nor a cut.



The participant most focused on employment emphasized that a cut on his terms would require material labor-market softening, and that neither rising unemployment nor a clear slowing in job growth was yet evident; initial claims at 320,000 were moderate and showed no upward trend. The participant attentive to financial stability found no systemic strain to act against, citing the low stress index, subdued VIX, and contained Baa spread, and expressed reluctance to disturb calm, even complacent, markets with a surprise move in either direction. The participant reading market signals highlighted the 3-month T-bill yield 0.73 percentage point below the funds rate as an eventual easing bias priced by markets, but stressed that no imminent move was being priced, while the modestly positive 10-year/2-year spread removed any acute recession alarm. The data-dependent participant summarized the literal, consensus reading: inflation below target removed hike pressure, while tight labor and calm financial conditions removed cut pressure. The predictive rebuttal round did not shift any participant, and the group's convergence on a hold was reaffirmed.

Turning to the loss-minimizing framework, which recommended -25 basis points, participants engaged with a case for easing that diverged from their predictive instinct to hold. Several found the divergence itself informative — a signal that the current stance may be more restrictive than conditions warrant. With r^* at 1.28 percent and core inflation near 1.6 percent, participants noted that a neutral nominal rate near 2.9 percent left 5.25 percent looking meaningfully tight, and that the three level-based reference rules pointing to -75 basis points reinforced that reading. Across their remarks, participants gravitated toward the First-Difference rule's prescription of -25 basis points as the more disciplined path, reasoning that inflation momentum at -0.11 and unemployment momentum at -0.05 were only slightly negative and therefore favored an incremental adjustment over a full one-step move to neutral.

The participant most concerned with inflation acknowledged that the sub-target core reading and negative inflation momentum genuinely undercut his above-target worry, and characterized a single quarter-point cut as removing unnecessary restriction while preserving optionality to pause should wage pressures or inflation reaccelerate given the still-tight labor market. The employment-focused participant read the Beige Book's weakness in residential real estate, construction, trucking, and consumer lending, together with growth slipping toward trend, as early cracks warranting a measured, preemptive step toward neutral. The financial-stability participant argued that a -75 basis point move in one step could itself signal alarm and destabilize calm markets, and that gradualism was precisely what preserved stability — a -25 basis point cut easing restrictiveness gently without shocking credit. The market-signal participant found -25 basis points consistent with both the First-Difference rule and the orderly, non-crisis easing embedded in the T-bill spread. The data-dependent participant characterized -25 basis points as the disciplined middle path between the aggressive level rules and



gradualist First-Difference logic. In the final rebuttal round, no participant was moved toward a hold, toward declining the recommendation, or toward the larger -75 basis point step.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported leaving the federal funds rate unchanged at 5.25 percent, a unanimous 5-0 outcome. On the separate question of the loss-minimizing framework's recommendation of a 25 basis point reduction, all five participants endorsed the recommendation as-is — the inflation-focused, employment-focused, financial-stability, data-dependent, and market-signal participants each recording an endorsement — for a tally of five endorse, zero decline, and zero partial. There was thus full agreement on the optimal-side recommendation, with no dissent as to direction or magnitude.