



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Manager reported on developments in the System Open Market Account. As of the June 16 release — the most recent available on or before the point-in-time cutoff — total SOMA domestic securities holdings stood at \$2,065.4 billion. Holdings were composed of \$712.0 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$1,127.6 billion in agency mortgage-backed securities, leaving the portfolio heavily weighted toward MBS. Total holdings rose \$13.4 billion from the prior release dated June 9. It was noted for the record that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not reflect repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to a continued but restrained recovery. Core PCE inflation was running at 0.91 percent on a year-over-year basis, well under half the 2 percent longer-run objective. The unemployment rate stood at 9.7 percent, far above the estimated natural rate of 5.03 percent, and initial jobless claims remained elevated at 456,000. The Chicago Fed National Activity Index registered -0.17, consistent with growth somewhat below its historical trend. The Employment Cost Index reading of 112.3 was consistent with the broader picture of subdued compensation pressures, and M2 stood at \$8,560.1 billion.

The Beige Book characterized economic activity as having continued to improve across all twelve Districts, though many described the pace as 'modest.' Consumer spending and tourism generally increased, with spending concentrated in necessities rather than discretionary big-ticket items and retail gains reported as uneven across April and May. Business spending rose on net, with employment and capital spending edging up but inventory investment slowing. Residential real estate activity in many Districts was buoyed by the April deadline for the homebuyer tax credit, while commercial real estate remained weak. On prices, the report was notably benign: prices of final goods and services were largely stable, higher input costs were not being passed along to customers, and wage pressures continued to be minimal. The staff also flagged the Gulf oil spill and Tennessee floods as sources of localized disruption — Atlanta reported some vacation lodging cancellations already, with the potential for a considerably greater impact.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as fragile but not acutely distressed. The financial stress index stood at 0.2922, a moderate reading, while the VIX at 25.92 indicated lingering market anxiety rather than calm. The Baa corporate spread of 3.07 percentage points pointed to continued credit stress for



lower-grade borrowers that had not fully healed. The Treasury yield curve remained steeply positive, with the 10-year/2-year spread at 2.52 percentage points, offering no imminent recession signal; the staff observed that the steepness in part reflected a front end anchored near the zero lower bound. The 3-month T-bill spread relative to the current target rate was slightly negative at -0.055, consistent with market pricing that embedded no near-term firming and, if anything, a modest easing bias.

STAFF ECONOMIC OUTLOOK

The staff projection pointed toward continued, gradual improvement with policy likely to remain pinned at the effective lower bound. The estimated neutral real rate (r^*) of 1.311 percent, set against core inflation running below 1 percent, implied that the prevailing nominal policy stance was only mildly accommodative rather than excessively loose. Inflation momentum was negative at -0.13, indicating that price pressures were decelerating rather than building, and unemployment momentum was likewise negative at -0.15, suggesting that labor-market slack would recede only slowly and persist for an extended stretch.

The reference rules were judged reliable this meeting and converged uniformly on a recommendation of 0 basis points — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule all returned the same prescription. Taken together, the negative momentum readings and the modest neutral-rate estimate implied that the loss-minimizing path was to maintain the current stance: with a large negative employment gap and below-target inflation, unconstrained rules would prescribe rates below zero, so the binding lower bound left holding as the projected optimal outcome rather than any near-term withdrawal of accommodation.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants generally judged that current conditions gave no basis for a change in the target range, and each arrived at that conclusion from a distinct analytical vantage point. The member most attentive to inflation risk emphasized that the usual hawkish trigger was simply absent: core PCE at 0.91 percent was less than half the objective, inflation momentum was decelerating, and the Beige Book confirmed that input costs were not being passed through and wage pressures remained minimal. He observed that he could not manufacture an inflation risk where the data showed none, and that with rates already at 0.0 to 0.25 percent, no meaningful easing was available in either case.

The member focused on the labor market stressed the enormous employment gap — unemployment at 9.7 percent against a 5.03 percent natural rate, claims still elevated at 456,000, and the Chicago Fed index below trend at -0.17. In this member's view, this was precisely the environment calling for maximal accommodation, but the zero lower bound foreclosed a further conventional cut. He argued



that the practical way to support hiring was to preserve the existing extended-period guidance rather than attempt an unavailable easing, and he cautioned against any premature signaling of firming that could threaten a still-weak recovery.

The participant weighing financial-stability considerations most heavily read the credit and volatility signals as fragile but not acute. The VIX near 26, the Baa spread of 3.07, and the moderate stress index all argued against tightening into shaky conditions — a move he characterized as risky and potentially destabilizing to credit markets. The member attentive to market signals reinforced this reading, noting that the slightly negative T-bill spread and the shape of the curve reflected market pricing of no hike and continued low short rates, so that firming would contradict what pricing had already aggregated. The data-dependent member offered the most literal synthesis: both mandate legs — too-low inflation and too-high unemployment — pointed the same direction, and the convergence across members reflected genuine agreement rather than a forced consensus.

A recurring theme in the discussion was the standing concern, echoing a prior dissent on the extended-period guidance, that prolonged accommodation could build financial imbalances over time. Participants took this concern seriously as a matter of ongoing vigilance, but they generally agreed it was not actionable at this meeting: current spreads and stress readings showed that imbalances were not yet acute, while disinflation and deep slack dominated the near-term calculus. Several observed that the steep yield curve offered some comfort against imminent recession, though one cautioned that the steepness reflected accommodation and a front end near the floor rather than underlying resilience.

In the optimal-framework discussion, participants noted that their predictive judgment and the framework's loss-minimizing recommendation coincided at 0 basis points, and that all four reference rules returned the same result. The ELB-adjusted rule resonated across lenses as the one that best captured the binding constraint — that the committee would prefer more support than it could conventionally deliver. Members read this agreement as evidence that the current stance was appropriately calibrated to conditions, with no divergence between forecast and optimum, while several reiterated that the downside risks flagged in the Beige Book, including the Gulf oil spill and slowing inventory investment, strengthened rather than weakened the case for maintaining support.

COMMITTEE POLICY ACTIONS

On the predictive vote, all five members supported maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous 5-0 outcome with no member favoring a change in either direction. On the framework's recommendation of 0 basis points, the committee was likewise in full



agreement: all five members — the inflation-focused member, the labor-market member, the financial-stability member, the data-dependent member, and the market-signal member — endorsed the recommendation as-is, with none declining and none registering only partial support. The predictive and optimal-side conclusions were thus fully aligned.