



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent data on the System Open Market Account. As of June 13, 2012, total SOMA domestic securities holdings stood at \$2,611.8 billion, up \$12.2 billion from the prior release on June 6. The composition remained concentrated in Treasury securities: \$1,565.6 billion in Treasury notes and bonds and \$18.4 billion in Treasury bills, alongside \$867.9 billion in agency mortgage-backed securities. It was noted for the record that these figures cover SOMA holdings only — total size, composition, and the 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 reported changes should therefore be read as a snapshot of the portfolio's securities position rather than a full accounting of open market operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation stood at 1.46 percent on a twelve-month basis, below the Committee's 2 percent objective. The prior pickup in headline prices had been characterized as temporary and largely gasoline-driven, and the qualitative price evidence was consistent with subdued pressure: Beige Book contacts 'rarely mention prices or pricing,' and fears about higher gasoline prices hurting spending in other categories had moderated. The Employment Cost Index reading of 116.8 showed no acceleration in labor compensation. On the labor market, the unemployment rate was 8.2 percent, well above the estimated 5.5 percent natural rate, indicating substantial slack. Initial jobless claims were 377,000. The Chicago Fed National Activity Index at 0.11 was consistent with growth at roughly trend. M2 money supply was reported at \$9,842.2 billion.

The Beige Book pointed to steady but modest expansion. Activity in the First District continued to grow, with commercial real estate showing slight improvement and residential real estate contacts finally mentioning recovery, described as fragile. Retail contacts reported good business and improving consumer sentiment, with recent year-over-year sales ranging from near zero to gains of 2 to 5 percent, and one firm raising its 2012 sales forecast from 2.5 percent to 4.5 percent. Travel and tourism reported strong results, with the industry expecting a 9.5 percent increase over 2011. Hiring, however, was limited — outside software and IT services, 'few firms are doing substantial hiring.' The manufacturing outlook was described as guarded, perhaps slightly more so than in recent months; thirteen of sixteen responding firms reported growing sales versus a year earlier, but a couple of manufacturers were making contingency plans for a potential slowdown, and some contacts cited European conditions and domestic political tensions as risks to growth.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were mixed but did not signal acute stress. The financial stress index at 0.177 was low-to-moderate. The VIX at 24.27 was elevated relative to tranquil levels, a reading generally attributed to anxiety over potential European spillovers rather than domestic funding strain. The Baa corporate spread of 3.43 percentage points indicated a meaningful but non-crisis credit-risk premium. The Treasury yield curve remained positively sloped, with the 10-year/2-year spread at 1.31, showing no inversion or recession signal from the term structure. The 3-month T-bill spread of -0.025 relative to the current rate sat just below the target, consistent with cautious money markets, mild safe-haven demand, and no near-term expectation of tightening.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff pointed to a continuation of accommodative conditions with no near-term impetus for a change in the policy rate. The estimated neutral real rate (r^*) was -0.126, implying that the neutral setting was essentially at or below zero and that the current target range of 0.0 to 0.25 percent was already accommodative rather than restrictive. Inflation momentum was mildly positive at 0.075, small enough to suggest no meaningful acceleration toward or beyond the 2 percent objective over the projection horizon. Unemployment momentum was -0.15, consistent with gradual labor market improvement rather than either rapid healing or fresh deterioration.

All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — returned 0 bps and were judged reliable this meeting. With wide, negatively signed inflation and unemployment gaps, the unconstrained rule prescriptions implied a policy rate below zero; because the funds rate cannot fall below the effective lower bound, the rules resolved to holding at the current range as the tightest feasible stance the arithmetic endorses. Taken together, these figures projected an economy improving only gradually, with inflation contained and downside risks — particularly European spillovers and a guarded manufacturing outlook — weighing against any near-term withdrawal of accommodation.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants broadly agreed that the current 0.0 to 0.25 percent target range remained appropriate, though they arrived at that conclusion from distinct starting points. The member most attentive to inflation risk observed that core PCE at 1.46 percent was meaningfully below the 2 percent objective, which removed the primary trigger for tightening in that framework. This participant noted that the earlier gasoline-driven pickup had been characterized as temporary, that Beige Book contacts 'rarely mention prices or pricing,' and that the ECI showed no wage acceleration. The one lingering reservation concerned prior discussion of upside inflation risk from a highly accommodative stance; this



consideration argued against adding accommodation, but was judged insufficient to justify a hike given below-target inflation and substantial labor slack. Importantly, this reservation was described as pertaining to the duration of forward guidance rather than to the rate level itself.

The participant most focused on labor market weakness emphasized that unemployment at 8.2 percent remained far above the 5.5 percent natural rate, that initial claims at 377,000 were elevated and not improving decisively, and that the Beige Book confirmed 'few firms are doing substantial hiring' with some manufacturers making contingency plans for a slowdown. In the first round this member favored easing to support employment, noting that below-target inflation left ample room. Over the course of the discussion, however, this participant confronted the binding constraint that every other member had raised: with the target range already at the effective lower bound, a conventional cut of 25 basis points would push into or below zero, and none of the data pointed to a coordinated case for such a move. The absence of an acute crisis — moderate financial stress, a positively sloped curve, functioning credit markets — was decisive in that revision. This member ultimately supported holding while stressing that an easing bias and the existing accommodative stance should be preserved given labor market fragility.

The participant attentive to financial stability grounded the discussion in the stress and spread indicators, judging conditions mixed but non-crisis. VIX at 24.27 was read as European-driven anxiety rather than a domestic funding seizure, the Baa spread of 3.43 as a meaningful but not alarming risk premium, and the yield curve at 1.31 as free of recession signal. This member argued that a cut from the current range would offer negligible loosening of credit conditions while risking a signal of alarm that could itself destabilize anxious markets, and that there was likewise no case to tighten into fragile credit conditions and European tail risk. The data-dependent centrist reinforced this reading from a literal-mandate perspective: both mandate legs — below-target inflation and a wide employment gap — pointed the same direction, toward maintaining the floor, and the data had not materially shifted since the prior meeting, which had held rates with dovish guidance. The market signal realist added that the 3-month T-bill spread of -0.025 and the steady term structure indicated markets were pricing neither a hike nor a cut, giving no signal-based basis to break from consensus.

In the optimal-framework discussion, participants engaged directly with the reference rules and the estimated neutral rate. There was wide agreement that r^* at -0.126 implied a neutral setting at or below zero, so that the current range was already accommodative. Several members found the ELB-adjusted rule most resonant given that policy was pinned at the floor; the inflation-focused and centrist members were most persuaded by the Taylor rule, whose wide negative gaps mechanically implied a below-zero rate floored at the effective lower bound. The convergence of all four rules on 0 bps, judged



reliable this meeting, was read as confirmation that the stance was appropriately calibrated — accommodative enough for a fragile recovery and fragile credit, without stoking the upside inflation risks some had flagged. Inflation momentum near zero and negative unemployment momentum were seen as consistent with slow improvement rather than overheating.

In sum, participants generally judged that the rate level was not the active margin this meeting. The labor market member's preference to ease was constrained by the lower bound rather than by disagreement over holding, and framed its residual dovish energy as belonging to guidance. The inflation-focused member's residual concern likewise attached to guidance duration, not the rate. A couple of participants noted that whatever additional accommodation might be desired resided in existing guidance and the maturity-extension program rather than in the funds rate itself. With inflation contained, substantial slack, a fragile-but-positive growth picture, European risk as the principal tail, and no acute financial or recession signal, participants converged on maintaining the target range at 0.0 to 0.25 percent.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported no change to the target range, a unanimous +0 bps outcome ($\{0: 5\}$). The Committee then considered the deterministic policy engine's recommendation of 0 bps, which was supported by all four reference rules — Taylor, Balanced Approach, First-Difference, and ELB-adjusted — judged reliable this meeting, with an estimated r^* of -0.126 , inflation momentum of 0.075 , and unemployment momentum of -0.15 . On the optimal-side stance, the outcome was full agreement: all five members endorsed the recommendation as-is, with none declining and none registering partial support. Accordingly, the Committee agreed to maintain the federal funds target range at 0.0 to 0.25 percent.