



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent data on the System Open Market Account. Staff noted that this account information covers SOMA holdings only — total size, composition, and the week-over-week change — and does not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to an economy expanding at a modest to moderate pace. The Chicago Fed National Activity Index registered 0.1, consistent with growth near trend. The Beige Book characterized activity in April through mid-May as increasing at a moderate pace in the San Francisco District and at a modest pace in a number of others, including Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, and Minneapolis. Chicago and Kansas City each reported that the pace of growth had slowed, Dallas described growth as marginal, and New York characterized activity as generally flat since the prior report. Several Districts noted generally optimistic outlooks among contacts, who expected growth to continue at its current pace or to pick up. Consumer spending was up modestly on balance in many Districts, though contacts in Boston, Cleveland, Minneapolis, and Dallas reported mixed or flat activity, and New York reported weakened retail sales in April and early May, with cool spring weather cited as a factor dampening sales in several eastern Districts.

On labor markets and prices, the unemployment rate stood at 4.7 percent, just below the estimated natural rate of 4.8 percent, and initial jobless claims were low at 267,000. The Beige Book reported that employment grew modestly since the prior report, that tight labor markets were widely noted, and that wages grew modestly while price pressure grew slightly in most Districts. The Employment Cost Index was reported at 126.0. Core PCE inflation was running at 1.33 percent on a twelve-month basis, well below the Committee's 2 percent objective. Overall loan demand was up moderately in all but one of the reporting Districts, and many Districts reported steady to good credit availability. The energy sector remained weak, and low commodity prices continued to pressure agricultural incomes even as crop conditions were described as promising in many Districts. M2 money supply was reported at \$12,651.4 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly calm over the intermeeting period. The financial stress index stood at 0.102, a very low reading, and the VIX was subdued at 14.08, indicating little market volatility priced in. The Baa corporate spread was 2.86, a moderate level that did not signal acute credit-market distress, though it remained somewhat elevated. The 10-year/2-year Treasury yield curve spread was positive at



0.93, showing no inversion and thus no recession signal from that measure. The 3-month T-bill spread relative to the current target rate was slightly negative at -0.095, indicating that bills were trading below the current target range midpoint and that markets were not pricing an imminent tightening. Consistent with the Beige Book, credit availability was reported as steady to good and loan demand up moderately across most reporting Districts.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on several quantities bearing on the likely path of policy-relevant conditions. The estimated neutral real rate (r^*) was -0.5, implying a deeply negative neutral setting against which the current target range of 1/4 to 1/2 percent, given core PCE inflation of 1.33 percent, leaves real policy modestly on the restrictive side. Inflation momentum was faintly positive at 0.025, and unemployment momentum was flat at 0.0, together suggesting little near-term pressure toward either an inflation overshoot or a further tightening of labor slack. On this reading, the inflation shortfall relative to the 2 percent objective was projected to persist absent additional accommodation, while labor markets were projected to remain near full employment rather than to overheat.

The staff also summarized the reference-rule outputs from the deterministic policy engine, which were judged reliable this meeting. The Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule all pointed to -25 basis points, and the loss-minimizing recommendation was likewise -25 basis points. The unanimity across rules of differing construction indicated that, on a mechanical basis, the persistent inflation undershoot combined with a closed unemployment gap and a negative neutral rate implied a policy setting somewhat below the current range. Staff cautioned that this projection reflects the rules' logic given current inputs and is distinct from participants' own judgments about the appropriate near-term stance.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, all five participants converged on holding the target range at 1/4 to 1/2 percent, though the reasoning behind that consensus varied and one member came close to favoring action. The participant most attentive to inflation risk observed that unemployment at 4.7 percent sat just below the 4.8 percent natural rate, that the Beige Book noted tight labor markets, modest wage growth, and slightly building price pressure, and that these firming conditions made a case for a preemptive 25 basis point increase. This participant nonetheless acknowledged that core PCE at 1.33 percent was a full percentage point below target and that the case for waiting was strong, ultimately describing the hike as defensible rather than compelling.



The other four participants each found the case for holding more persuasive. The participant focused on labor markets emphasized that low jobless claims and tight-but-modest employment growth showed no deterioration warranting a cut, while the inflation undershoot argued against a hike that might choke off the recovery. The financial-stability participant stressed that the low stress index, subdued VIX, and moderate credit spreads described benign rather than fragile conditions, so that no move was forced in either direction, and that acting against the negative 3-month T-bill spread would risk an avoidable surprise tightening. The data-dependent participant read the indicators at face value — soft inflation, near-trend activity, no recession signal — and judged tight labor the only hawkish signal, insufficient against the clear inflation shortfall. The market-focused participant weighted the negative T-bill spread most heavily as direct evidence that markets did not price a June move. In the second round, the inflation-focused participant explicitly revised toward holding, reasoning that current inflation risk was to the downside and that the slight price pressures did not yet constitute a genuine upside threat, while retaining a bias to tighten as the inflation case firmed.

When participants turned to the framework's loss-minimizing recommendation of -25 basis points, supported by all four reference rules, the discussion shifted notably. Several participants observed that the gap between their predicted hold and the framework's cut revealed the current stance to be modestly too tight relative to the rules' benchmark. The inflation-focused participant reconciled the divergence by noting that its usual caution against easing applies when inflation runs hot, whereas here inflation was undershooting by roughly two-thirds of a percentage point with only trivially positive momentum, so a cut would advance the 2 percent objective rather than endanger it. The labor-market participant found the Balanced Approach rule most persuasive, pointing to the wide inflation gap, the absence of labor overheating with unemployment momentum at zero, and Beige Book signs of slowing growth in Chicago and Kansas City as grounds for insuring the recovery. The financial-stability participant emphasized the negative neutral rate of -0.5 and the somewhat elevated Baa spread, arguing that a measured cut could relieve latent borrowing-cost stress while calm stress metrics posed no barrier.

The data-dependent participant stressed the unanimity of the reference rules as the strongest signal and judged the -25 basis point call correct on a literal reading of the data, with inflation persistently below target and no offsetting overheating. The market-focused participant agreed on direction, citing the negative T-bill spread and the flattening 10-year/2-year curve as evidence that markets already leaned toward a softer path, but registered reservations about magnitude: the T-bill spread was only modestly negative at -0.095, and Beige Book descriptions of moderate growth, tight labor, and optimistic firms suggested a gradual drift lower rather than a decisive full quarter-point step now. Across both the predictive and optimal discussions, participants generally agreed that financial



conditions were calm enough that a move in either direction carried little stability risk, and that the central tension lay between the persistent inflation undershoot and market-priced softness on one side and institutional caution against acting ahead of clearer data on the other.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate action at this meeting, all five participants supported maintaining the target range for the federal funds rate at 1/4 to 1/2 percent, a unanimous 5-0 outcome. On the separate question of the framework's loss-minimizing recommendation of -25 basis points, four participants — the inflation-focused member, the labor-market member, the financial-stability member, and the data-dependent member — endorsed the recommendation as stated, while the market-focused participant offered a partial endorsement, agreeing with the direction of easing but not with the full magnitude and immediate timing, favoring a more gradual adjustment consistent with modestly negative market-implied pricing. No participant declined the recommendation outright.