



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that total System Open Market Account holdings of domestic securities stood at \$4,227.4 billion as of April 26, 2017, comprising \$2,330.2 billion in Treasury notes and bonds and \$1,769.0 billion in agency mortgage-backed securities. Relative to the prior release of April 19, total holdings declined by \$7.9 billion. Members were reminded that this accounting reflects SOMA securities holdings only — their total size, composition, and week-over-week change — and does not encompass repurchase or reverse repurchase operation results, for which no point-in-time-safe data source currently exists; accordingly, no summary of those operations was presented.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data suggesting an economy expanding at a steady, if unspectacular, pace. Core PCE inflation stood at 1.48 percent on a twelve-month basis, remaining below the Committee's 2 percent objective. Labor market indicators pointed to continued tightness: the unemployment rate was 4.5 percent, below the estimated natural rate of 4.74 percent, and initial jobless claims were low at 244,000. The Chicago Fed National Activity Index registered 0.08, consistent with growth near its longer-run trend rather than an economy running hot. The Employment Cost Index reading was 128.0, and M2 stood at \$13,380 billion.

The Beige Book, covering mid-February through the end of March, reported that activity increased in all twelve Districts, with the pace split evenly between modest and moderate. Manufacturing continued to expand at a modest to moderate pace, though growth in freight shipments slowed slightly. Consumer spending was mixed, with stronger light vehicle sales alongside softer non-auto retail readings. Labor markets remained tight; employers in most Districts reported more difficulty filling low-skilled positions, and a couple of Districts noted that worker shortages and rising labor costs were restraining growth in sectors such as manufacturing, transportation, and construction. Modest wage increases broadened, with larger gains for workers whose skills were in short supply, and more firms cited higher turnover and difficulty retaining staff. On prices, the report noted that they 'rose modestly' since the prior period, with input prices generally outpacing selling prices, which rose 'only slightly.' Increases were noted for some building materials such as lumber and concrete, while metal prices were fairly stable and energy prices were flat to slightly lower.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as notably calm and accommodative. The financial stress index stood at 0.069, a very low reading, and the VIX at 10.85 pointed to unusually subdued volatility. Credit markets showed no sign of strain: the Baa corporate spread was 2.26, a moderate level with no



evidence of widening. The Treasury yield curve remained positively sloped, with the 10-year/2-year spread at 1.04, offering no recession signal. The 3-month T-bill spread relative to the current policy rate was slightly negative at -0.065, an indication that front-end markets were not pricing an imminent policy move at this meeting.

STAFF ECONOMIC OUTLOOK

The staff projection took as its point of departure the estimate that the neutral real rate (r^*) was around -0.5 percent, implying a very low neutral level and raising the possibility that the current 0.75 to 1.00 percent target range sits modestly above neutral once the below-target inflation reading is netted out. Inflation momentum was slightly negative at -0.03, suggesting that core PCE was drifting away from rather than toward the 2 percent objective in the near term. Unemployment momentum was mildly positive at 0.1, a tentative hint that the pace of labor-market tightening may be leveling off rather than intensifying.

The staff noted that the reference rules pointed uniformly toward easier policy, though they differed in magnitude. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed -75 basis points, reflecting heavy weight on the inflation shortfall and the low estimate of r^* . The First-Difference rule, which adjusts incrementally from the current stance rather than solving to an absolute level, prescribed -25 basis points. With the reference rules assessed as reliable in the current environment, the loss-minimizing framework recommendation settled at -25 basis points — a measured step consistent with the First-Difference logic and tempering the more aggressive level-based prescriptions. Taken together, these quantities implied that conditions were unlikely to generate near-term inflationary pressure and that the prevailing stance had drifted marginally restrictive.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their assessment of current conditions, participants converged on a common reading of the data even as they arrived at it through different lenses. All emphasized that core PCE at 1.48 percent remained meaningfully below the 2 percent target, removing any sense of inflation emergency. At the same time, all acknowledged that the labor market was genuinely tight — unemployment below the natural rate, low jobless claims, and Beige Book reports of worker shortages, broadening wage increases, and higher turnover. The participant most attentive to inflation risk framed this tension directly: current realized price pressure was muted, with selling prices rising 'only slightly,' but the wage dynamics constituted a latent forward risk of pass-through that warranted vigilance rather than either preemptive easing or an immediate further move.



On the question of what the Committee was likely to do at this meeting, participants were unanimous in favoring no change to the target range. Several stressed that the prior meeting had just raised the range to 0.75 to 1.00 percent under guidance emphasizing gradual, data-dependent increases, and that a back-to-back move would sit uneasily with that stated trajectory. The participant focused on financial stability observed that markets were extraordinarily calm — the stress index near zero, the VIX at 10.85 signaling complacency — and cautioned that a hike unanticipated by a placid market, as suggested by the slightly negative 3-month T-bill spread, could invite an abrupt and unnecessary repricing. The participant weighing market signals most heavily read that same spread as the strongest available indication that no near-term move was priced. The participant attentive to employment saw no deterioration that would justify a cut and no inflation surge forcing a hike, and thus no cost to a pause. The centrist member read the data literally to the same conclusion: consecutive hikes are typically spaced out, and below-target inflation reduced any urgency to move again immediately.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, participants engaged seriously with the gap between that call and their expectation of a hold. Most found the First-Difference rule the most persuasive of the reference rules, precisely because it adjusts incrementally from the current stance rather than solving to an absolute level and therefore avoids over-reliance on the uncertain r^* estimate that drove the -75 basis point readings from the other rules. Several participants judged that with r^* near -0.5 percent and inflation momentum slightly negative, the prevailing stance had likely crept modestly restrictive, and that a measured 25 basis point reduction would relieve that mild tightness — protecting labor-market gains, in the view of the employment-focused member, and moving toward a low neutral without lurching, in the view of the stability-focused member. Each of these participants was careful to reject the -75 basis point prescriptions as too abrupt given tight labor conditions, calm markets, and the absence of any recession signal from the positively sloped yield curve.

The participant most focused on inflation risk dissented from this reading of the optimal case. While accepting that inflation was below target and its momentum barely negative, this participant weighted the broadening wage increases and worker shortages heavily as a source of future inflation, and judged that easing into a strong, tight labor market risked unanchoring inflation just as it approached the target. In this participant's view the barely negative momentum did not constitute a decisive downtrend, and the uncertain r^* estimate did not warrant preemptive accommodation; tolerating a slight restrictiveness was preferable to cutting before inflation firmed. The other participants did not find this argument sufficient to abandon the measured easing case, but all agreed that the narrow 25 basis point gap between a hold and the framework's recommendation indicated the current stance was close to appropriate — neither clearly too tight nor too loose.

**COMMITTEE POLICY ACTIONS**

In the predictive vote on the policy action at this meeting, all five participants supported maintaining the target range for the federal funds rate at 0.75 to 1.00 percent, a unanimous 5-0 outcome. On the separate question of the framework's loss-minimizing recommendation of a 25 basis point reduction, the Committee did not reach full agreement: four participants — the labor-market-focused member, the financial-stability-focused member, the data-dependent centrist, and the market-signal-focused member — endorsed the -25 basis point recommendation as the mandate-optimal action, while the inflation-focused participant declined to support it, citing latent wage-driven inflation risk as grounds to tolerate a modestly restrictive stance rather than ease. No participant took a partial position.