



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$4,096.0 billion in domestic securities as of the June 6, 2018 release, comprising \$2,224.3 billion in Treasury notes and bonds and \$1,734.6 billion in agency mortgage-backed securities. This represented a decline of \$9.4 billion from the prior release on May 30, 2018. The manager noted that these figures describe the size and composition of SOMA holdings only; results of repurchase and reverse repurchase operations are not covered here, as no point-in-time-safe data source for those operations is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to a labor market that had continued to tighten. The unemployment rate stood at 3.8 percent, well below the estimated natural rate of 4.62 percent, and initial jobless claims remained low at 221,000, with no sign of an uptick in layoffs. Core PCE inflation was running at 1.59 percent on a year-over-year basis, still below the Committee's 2 percent objective. The Chicago Fed National Activity Index at 0.34 indicated activity somewhat above its historical trend, and the Employment Cost Index reading of 132.5 was consistent with the modest-to-elevated wage gains reported across districts.

Beige Book accounts described economic activity expanding at a moderate-to-solid pace across the reporting districts. Manufacturing was frequently cited as accelerating, and services, energy, and real estate generally continued to grow. Contacts widely reported tight labor markets and ongoing difficulty finding workers, with wage pressures ranging from modest to elevated. Price developments were mixed: one retailer cited vendor-price increases of about 3 percent that it intended to pass along to customers, while some manufacturers reported no unusual price pressures but voiced concern about the future effects of tariffs and trade policy on prices. Trade uncertainty and rising interest rates were noted as concerns in several districts, though overall outlooks remained positive.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as calm and accommodative. The financial stress index registered 0.06, a very low reading, and the VIX stood at 11.64, reflecting subdued market volatility. Credit conditions appeared benign, with the Baa corporate spread tight at 1.9 percentage points. The 10-year/2-year Treasury spread was positive at 0.45, indicating a flattening but not inverted yield curve and no imminent recession signal from the term structure. The 3-month T-bill spread relative to the current policy rate was 0.285, close to a full 25 basis point increment, suggesting that market participants were positioned for a near-term increase in the policy rate.

STAFF ECONOMIC OUTLOOK



The staff outlook drew on the forward-looking quantities available. The estimated neutral real rate (r^*) of -0.5 percent implied that the current target range of 1.50 to 1.75 percent was closer to neutral than its nominal level alone would suggest, tempering the case for viewing policy as materially restrictive. Inflation momentum was modestly positive at 0.26, consistent with prices firming toward the 2 percent objective from below rather than drifting further away. Unemployment momentum was flat at 0.0, indicating no deterioration in labor conditions to project forward.

The reference rules diverged considerably. The Taylor, Balanced Approach, and ELB-adjusted rules each pointed to -75 basis points, reflecting the below-target inflation reading and the low estimate of r^* . The First-Difference rule, which keys off changes in conditions rather than level gaps, indicated -25 basis points, in line with the modest inflation momentum and flat unemployment momentum. The reference rules were flagged as reliable. Balancing the dovish level-based signals against firming inflation and a strong labor market, the loss-minimizing recommendation from the framework was 0 basis points — a hold at the current range. On this reading, the likely path of conditions was one in which policy neither eased into loose financial conditions nor tightened against still-soft realized inflation.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their forward-looking assessment of the appropriate policy action at this meeting, all five participants judged that a 25 basis point increase, moving the target range to 1.75 to 2.00 percent, was warranted. Participants approached this conclusion from distinct vantage points but converged on the same reading of the data. The member most attentive to inflation risk observed that core PCE at 1.59 percent was not currently overshooting, but emphasized that the large negative gap between the 3.8 percent unemployment rate and the 4.62 percent natural rate, together with Beige Book reports of elevated wage and price pressures and a retailer passing through vendor-price increases of about 3 percent, pointed to accumulating upside risk. This participant favored a measured, preemptive step to stay ahead of building pressures.

The member weighting employment most heavily framed the question as whether any sign of labor-market deterioration was present, and concluded that the data showed the opposite: low jobless claims, solid hiring, and no rising unemployment. On the view that current policy remained accommodative rather than restrictive, this participant judged that a gradual 25 basis point step was a normalization move that would not push policy into territory threatening employment. The participant focused on financial stability noted that stress readings were unambiguously benign — a stress index of 0.06, a VIX near 11.64, and a tight Baa spread of 1.9 — and argued that a well-telegraphed 25 basis point move would not destabilize calm conditions, while cautioning that contacts' concerns over rising rates and trade uncertainty argued against any move larger than 25 basis points. The centrist and the



participant most attentive to market signals both pointed to the 3-month T-bill spread of 0.285 as evidence that markets had already priced a near-term hike of roughly one standard increment, and to the FOMC's own median projected rate of 2.1 percent sitting above the current range, as consistent with one gradual step.

When the discussion turned to the framework's loss-minimizing recommendation of a hold at 0 basis points, participants engaged directly with the tension between that recommendation and their predictive lean toward a hike. Several found the First-Difference rule's -25 basis point signal more persuasive than the -75 basis point outputs of the level-based rules, which they judged to overweight the current inflation shortfall and the low r^* estimate in a mechanical way; a cut of that magnitude into a 3.8 percent unemployment rate and calm markets was widely viewed as unwarranted and potentially a source of overheating that would later need to be unwound. The member attentive to inflation risk rejected any easing outright given positive inflation momentum, but accepted 0 basis points as the correct direction — declining to cut — while noting his own preference lay one increment higher.

The employment-focused participant found the framework's hold better aligned with caution about tightening into below-target inflation, reasoning that with no wage-price spiral and no labor weakness, there was little case to move policy restrictive, and that holding preserved optionality to ease should hiring later falter amid trade uncertainty. The financial-stability member characterized the gap between his 25 basis point lean and the framework's hold as a preference rather than a conflict, judging the current range roughly neutral and expressing a mild preference for using a calm window to firm gradually, while explicitly declining to oppose a hold. The centrist and the market-signal participant likewise judged the current stance close to appropriate; the latter acknowledged that markets might be overpricing tightening relative to what subdued inflation warranted, and concluded that a hold did not fight market pricing hard given inflation still short of target. Across the exchange, the recurring theme was that the direction was right — no cut was justified — even where individual participants would have preferred a measured firming.

Participants generally judged that financial conditions remained supportive, with a positive though flattening yield curve carrying little near-term recession signal, and that the real economy could absorb a measured step without stress. A couple of participants emphasized that trade uncertainty flagged in the Beige Book constituted a downside risk worth monitoring, and that the appropriate response was gradualism rather than either abrupt tightening or premature easing.

COMMITTEE POLICY ACTIONS



In the predictive assessment of the policy action at this meeting, all five members supported a 25 basis point increase in the target range, to 1.75 to 2.00 percent; the vote was 5 to 0. On the separate question of the framework's loss-minimizing recommendation to hold at 0 basis points, the Committee did not divide on direction: no member declined the recommendation. Three members — the labor-market dove, the data-dependent centrist, and the market-signal realist — endorsed the hold as recommended, while two members — the inflation hawk and the financial-stability voice — offered partial support, agreeing that no cut was justified and that the direction was correct but expressing a personal preference for a measured firming rather than standing pat. The recorded tally on the framework recommendation was thus three endorse, zero decline, and two partial.