



## DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$3,644.6 billion in domestic securities as of June 12, 2019, unchanged from the prior release on June 5. The composition consisted of \$1,955.5 billion in Treasury notes and bonds, a negligible \$0.1 billion in Treasury bills, and \$1,555.4 billion in agency mortgage-backed securities. The manager noted that these figures reflect SOMA holdings only — total size, composition, and the week-over-week change — and do not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available; nothing in this review should be read as characterizing those operations.

## STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation stood at 1.23 percent on a twelve-month basis, notably below the Committee's 2 percent objective. The unemployment rate was 3.6 percent, a full point beneath the estimated natural rate of 4.6 percent, and initial jobless claims were low at 218,000. Against this evidence of labor-market tightness, the Chicago Fed National Activity Index registered -0.45, consistent with growth running below its longer-run trend. The Employment Cost Index reading was 136.2 and M2 stood at \$14,513.8 billion.

The Beige Book described economic activity expanding at a modest pace from April through mid-May, a slight improvement over the prior period, with almost all Districts reporting some growth. Manufacturing reports were generally positive, though some Districts noted signs of slowing activity and a more uncertain outlook among contacts. Residential construction and real estate grew overall but with wide variation in sentiment across Districts, consumer spending reports were 'generally positive but tempered,' tourism was stronger while vehicle sales were lower, and agricultural conditions remained weak overall. Employment continued to increase nationwide, with most Districts reporting modest or moderate job growth, though stronger gains were constrained by shortages of both high- and low-skill workers. Competition for workers applied some wage pressure and prompted improvements in benefits, but overall wage pressures 'remained relatively subdued given low unemployment rates.' Prices rose at a modest pace; several Districts cited faster growth in input than in final selling prices, while steel, other metals, and lumber prices eased in a number of Districts.

## STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly calm. The financial stress index stood at 0.3 and the VIX at 15.91, both consistent with unstressed markets, and the Baa corporate spread of 2.38 pointed to moderate rather than elevated credit conditions. The 10-year/2-year Treasury spread was thin at 0.25, flat but not inverted. Notably, the 3-month Treasury bill traded 0.155 below the current funds-rate range, an



indication that short-term markets were leaning toward expectations of easing ahead. The staff observed that this negative spread fell short of a full 25 basis points, suggesting markets saw a policy move as coming soon rather than being fully priced for the current meeting.

### **STAFF ECONOMIC OUTLOOK**

The staff projection centered on the observation that the current 2.25 to 2.50 percent target range appeared meaningfully restrictive relative to a low estimated neutral rate. With the neutral real rate ( $r^*$ ) placed near  $-0.474$ , a nominal range near 2.375 percent alongside inflation running about 1.2 percent implied a real policy rate well above neutral. Both inflation and unemployment momentum were negative — inflation momentum at  $-0.11$  and unemployment momentum at  $-0.05$  — signaling that conditions were drifting away from the Committee's objectives rather than toward them, with disinflation ongoing rather than a one-off dip.

The reference rules corroborated this reading. The Taylor rule, Balanced Approach rule, and ELB-adjusted rule each pointed to  $-75$  basis points, while the First-Difference rule indicated  $-50$  basis points; the reference rules were judged reliable this meeting. The loss-minimizing recommendation settled at  $-50$  basis points, splitting the more aggressive rule cluster against a benign financial backdrop. The staff analysis implied that, absent a pickup in inflation or a firming of activity indicators such as the CFNAI, continued restriction would tend to push inflation further below target and leave the yield curve flat, whereas a measured move toward neutral would ease that pressure without overshooting into stimulative territory given the absence of acute financial stress.

### **PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK**

Participants entered the discussion with a shared reading of the underlying data even as they weighed it differently. All noted that core PCE at 1.23 percent sat well below the 2 percent objective and that the prior meeting had flagged downside risks to inflation and concern that longer-term expectations could slip below target. At the same time, participants generally judged the labor market to be strong, citing unemployment at 3.6 percent against a 4.6 percent natural rate and low jobless claims of 218,000, with the Beige Book reporting continued modest-to-moderate job growth and worker shortages across Districts. The recurring tension was that the inflation leg of the mandate was clearly deficient while the employment leg showed no deterioration.

In the predictive phase, a strong center of gravity formed around holding the target range at 2.25 to 2.50 percent. The member most attentive to inflation risk observed that low inflation removed any case for a hike but that a still-solid economy and contained wage pressures argued against cutting preemptively. The employment-focused member expressed a genuine easing bias, pointing to the



CFNAI reading of  $-0.45$  and the negative T-bill spread as warning signs, but concluded that with no rise in unemployment and no clear slowing in hiring, a cut this meeting would be premature. One participant, reasoning from a financial-stability lens, initially favored a 25 basis point insurance cut to hedge downside risks in line with market pricing. On reflection, that member revised to hold, noting that the very calm conditions on which stability is judged — VIX at 15.91, a stress index of 0.3, and a moderate Baa spread — removed any urgent rationale, and that front-running a market that had priced easing 'soon, not necessarily now' risked signaling alarm the data did not support.

The market-focused participant weighed the  $-0.155$  T-bill spread most heavily, emphasizing that it fell short of a full 25 basis points and therefore implied easing was priced slightly ahead of, rather than at, this meeting; with the 10-year/2-year spread flat but not inverted and no acute credit stress, this member saw a defensible but not demanded case for a cut, and leaned to hold. The data-dependent centrist reached the same conclusion by a literal reading of mixed data — soft inflation and below-trend activity on one side, strong labor and calm financial conditions on the other — finding nothing that constituted acute deterioration requiring immediate action. The predictive discussion thus converged on a patient hold, with several participants stressing readiness to ease promptly should activity indicators worsen or claims begin to rise.

The optimal-framework discussion sharpened the analysis and moved participants notably further. Confronted with a loss-minimizing recommendation of  $-50$  basis points and reference rules clustered at  $-50$  to  $-75$ , participants engaged directly with the estimate of a neutral real rate near  $-0.474$ , which implied the current range was meaningfully restrictive, and with negative inflation momentum of  $-0.11$  that indicated active disinflation. The inflation-focused member framed the case in his own terms: with inflation a full 0.77 percentage point below target and decelerating, excessive restriction risked entrenching a below-target regime and eroding target symmetry, and he acknowledged that his predictive hold reflected a hiking bias no longer justified by the data. The employment-focused and centrist members leaned toward the Balanced Approach logic, which weights the mandate leg they viewed as deficient, while resisting the full  $-75$  magnitude.

Across Rounds 3 and 4, participants coalesced on  $-50$  basis points as the disciplined middle course. The stability-focused member argued that a flat 0.25 curve foreshadowed compressed bank margins and tightening credit ahead, favoring a gradual First-Difference-style adjustment over a jolting  $-75$  that could widen spreads and signal alarm. The market-focused member found the  $-50$  move consistent with curve-implied easing without overshooting the moderate degree of easing markets had priced. Participants generally judged that the calm financial backdrop — low stress readings, an uninverted curve, and low claims — was precisely why  $-50$  rather than  $-75$  was the loss-minimizing choice: it eased



restrictiveness toward neutral while leaving the range near, not below, neutral. Several observed that the gap between the predictive hold and the -50 optimum revealed a stance more restrictive than the inflation and neutral-rate data warranted, reflecting institutional caution clashing with what the rules indicated.

### **COMMITTEE POLICY ACTIONS**

In the predictive vote, all five participants supported maintaining the target range for the federal funds rate at 2.25 to 2.50 percent, a unanimous outcome of 5 to 0, consistent with the prior meeting's patient stance while acknowledging an easing tilt in market signals. On the framework's loss-minimizing recommendation of a 50 basis point cut, the Committee's recorded stances showed full agreement: all five members — the inflation hawk, the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist — endorsed the -50 basis point recommendation as-is, with none declining and none registering a partial view on magnitude or timing.