



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that total System Open Market Account domestic securities holdings stood at \$7,739.9 billion as of April 26, 2023, the most recent release available before the point-in-time cutoff. Holdings were composed of \$4,492.0 billion in Treasury notes and bonds, \$281.0 billion in Treasury bills, and \$2,567.4 billion in agency mortgage-backed securities. Total holdings declined by \$17.2 billion from the prior release of April 19, a continued gradual reduction in the portfolio. Staff noted that this review covers SOMA securities holdings only — their total size, composition, and 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 currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that inflation remained well above the Committee's longer-run objective. Core PCE inflation was running at 3.89 percent over the prior twelve months, still nearly double the 2 percent target. The labor market remained tight by most measures: the unemployment rate stood at 3.5 percent, well below the estimated natural rate of 4.42 percent, and initial jobless claims registered 245,000. The Employment Cost Index reading of 155.5 was consistent with wage pressures that, while moderating at the margin, remained elevated. The Chicago Fed National Activity Index at -0.19 pointed to somewhat below-trend growth, and M2 money supply stood at \$20,818.1 billion.

The most recent Beige Book characterized overall economic activity as little changed in recent weeks, with nine Districts reporting no change or only slight change and three indicating modest growth. Consumer spending was generally flat to down slightly, auto sales were steady, and travel and tourism picked up across much of the country. Manufacturing activity was widely reported as flat or down even as supply chains continued to improve, and transportation and freight volumes were flat to down. Residential real estate sales and new construction softened modestly. Notably, lending volumes and loan demand generally declined across consumer and business loan types, and several Districts reported that banks tightened lending standards amid increased uncertainty and concerns about liquidity. On labor, employment growth moderated somewhat, a small number of firms — centered at a subset of the largest companies — reported mass layoffs, and contacts described the labor market as becoming less tight amid increases in labor supply. Wages showed some moderation but remained elevated. Overall price levels rose moderately, though the pace of increases appeared to be slowing, with contacts citing declines in nonlabor input prices and significantly lower freight costs.

STAFF REVIEW OF THE FINANCIAL SITUATION



Staff reported that financial conditions were on balance moderate rather than acutely stressed. The financial stress index stood at 0.2093, and the VIX at 18.84 pointed to relatively calm equity market conditions. Credit spreads were contained, with the Baa corporate spread at 2.09, suggesting no severe credit distress despite the tightening of bank lending standards noted in the Beige Book. The yield curve remained deeply inverted, with the 10-year/2-year spread at -0.47, a configuration commonly associated with elevated recession risk. Money market pricing was consistent with expectations of a modestly higher near-term policy rate: the 3-month Treasury bill spread relative to the current rate was +0.095, implying rates slightly above the current target range midpoint. Taken together, the readings suggested credit conditions that were tightening but orderly, with no acute market disruption evident.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities embedded in the policy framework. The estimated neutral rate (r^*) used in the analysis was -0.5, a notably low figure that, combined with the deeply inverted yield curve and below-trend activity index, would ordinarily bias level-based policy rules toward easing. Indeed, the Taylor rule, Balanced Approach rule, and ELB-adjusted rule each pointed to a 75 basis point reduction, while the First-Difference rule — which responds to the change in conditions rather than the level relative to a contested neutral estimate — pointed to a 75 basis point increase, reflecting inflation still well above target. Inflation momentum was estimated at 0.03 and unemployment momentum at -0.05, indicating price pressures that had not decisively reversed and a labor market that had not yet clearly loosened.

Reconciling these opposing signals, the framework's loss-minimizing recommendation was a 25 basis point increase. The projection implied by this configuration was of an economy near the top of its tightening cycle: with inflation momentum only marginally positive and unemployment momentum slightly negative, further large moves in either direction appeared unwarranted. The staff analysis flagged the reference rules as reliable, but the sharp divergence between the level rules and the change-based rule was itself informative — it suggested that a portion of the restraint on activity was being carried by tightening credit conditions rather than by the policy rate alone, so that a single modest firming step, rather than aggressive additional tightening, was consistent with returning inflation toward target over time.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants generally agreed that inflation remained too high to justify pausing or easing at this meeting. Several observed that core PCE at 3.89 percent stood nearly double the 2 percent objective, and that while the Beige Book pointed to slowing price increases and declines in nonlabor input and freight costs, wages and producer prices remained elevated.



Participants also noted that the labor market, though showing signs of cooling, remained tight: the unemployment rate at 3.5 percent sat well below the 4.42 percent estimated natural rate, and jobless claims at 245,000 were moderate rather than spiking. Against this backdrop, participants converged on the view that a further modest firming was appropriate, consistent with prior guidance that 'some additional policy firming may be appropriate' and with the last median projection of 5.1 percent, which implied roughly one more 25 basis point step from the current 4.75 to 5.00 percent range.

A participant focused most heavily on inflation risk argued that the persistence of core inflation near 4 percent was the dominant consideration and that the tight labor market left room for continued firming. This participant judged the level rules signaling cuts to be leaning too heavily on the contested negative neutral-rate estimate, and found the First-Difference logic — responding to inflation still above target — more persuasive, while accepting that emerging credit headwinds argued for a measured 25 basis point step rather than a larger move.

A participant most attentive to employment noted the building signs of labor softening — moderating employment growth, mass layoffs concentrated at a subset of the largest firms, rising labor supply, and a below-trend Chicago Fed activity index of -0.19. Even so, this participant judged that the thresholds warranting easing, namely a clearly rising unemployment rate or falling job growth, had not yet been met, and that cutting into inflation this elevated would risk re-anchoring expectations higher. This participant supported a final quarter-point step while expressing a strong preference to pause soon thereafter to protect employment as policy lags and tightening credit worked through, and emphasized retaining the optionality to pivot should claims and layoffs accelerate.

A participant emphasizing financial stability stressed that market-based stress signals were contained — the stress index at 0.2093, the VIX at 18.84, and the Baa spread at 2.09 all pointing to orderly rather than acute conditions — but that the Beige Book's reports of banks tightening lending standards amid liquidity concerns and broadly declining loan demand were doing meaningful restraining work in their own right. On this view, credit tightening substituted for part of the additional rate increases that might otherwise be required, arguing against a larger hike, while the absence of acute distress argued against a pause that might unanchor inflation expectations. A participant weighting market signals most heavily reinforced this reading, observing that the +0.095 3-month bill spread was consistent with markets pricing one more small step, while the -0.47 yield curve inversion warned against pushing restriction much further. A participant taking a data-dependent, centrist view characterized the 25 basis point step as the literal, consensus-consistent reading of the data: inflation not yet beaten, labor still firm, credit doing part of the work, and the current range sitting just below the 5.1 percent prior median.



When the discussion turned to the framework's loss-minimizing recommendation, participants noted the striking divergence among the reference rules — three level rules pointing to a 75 basis point cut driven by the -0.5 neutral-rate estimate, against the First-Difference rule pointing to a 75 basis point increase. Participants generally found the change-based logic more persuasive than the level rules, which they judged to rest on a deeply negative and uncertain neutral rate, and read the framework's reconciliation at +25 basis points as confirmation that current policy was near an appropriately restrictive stance with one small step remaining. In the rebuttal round, no participant was moved off the direction of the decision; the arguments about credit tightening reinforced the case for restraint at a modest step rather than either a larger hike or a pause, and participants reaffirmed their support for raising the range to 5.00 to 5.25 percent.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy decision, all five participants supported a 25 basis point increase, raising the target range to 5.00 to 5.25 percent (5 of 5 for +25 basis points). On the framework's loss-minimizing recommendation of a 25 basis point increase, the Committee was in full agreement: all five members endorsed the recommendation as-is, with none declining and none registering only partial agreement. The inflation-focused, employment-focused, financial-stability, data-dependent-centrist, and market-signal participants each endorsed the recommendation.