



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held a total of \$7,616.0 billion in domestic securities as of June 7, 2023. Treasury notes and bonds accounted for \$4,388.6 billion of the portfolio and Treasury bills for \$278.1 billion, with agency mortgage-backed securities making up the remaining \$2,549.8 billion. Total holdings were down \$2.9 billion from the prior release of May 31, a small net decline over the week. Staff noted that this review covers SOMA securities holdings only — total size, composition, and the week-over-week change — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation stood at 3.65 percent on a twelve-month basis, well above the Committee's 2 percent objective. Labor market conditions remained tight: the unemployment rate was 3.7 percent, below the estimated natural rate of 4.42 percent, and initial jobless claims were 232,000, still low with no clear sign of deterioration. The Employment Cost Index registered 157.4, and the M2 money supply stood at \$20,673.1 billion. The Chicago Fed National Activity Index was 0.07, consistent with growth near its historical trend. The current federal funds target range was 5.00 to 5.25 percent, and the Committee's most recent median projected rate was 5.1 percent, essentially at the current level.

The Beige Book characterized overall economic activity as having increased slightly since late May, with five Districts reporting slight or modest growth, five noting no change, and two reporting slight or modest declines. Reports on consumer spending were mixed, with growth generally observed in consumer services while some retailers noted shifts away from discretionary spending; tourism and travel activity was described as robust. Manufacturing activity edged up in half of the Districts and declined in the other half, and transportation activity was down or flat in most Districts reporting on it. Banking conditions were described as mostly subdued, with lending activity continuing to soften. Employment increased modestly, with labor demand remaining healthy even as hiring became more targeted and selective and labor availability improved in many Districts; contacts reported that unusually high turnover rates appeared to be returning to pre-pandemic norms. Wages continued to rise but more moderately, with contacts in multiple Districts noting wage increases returning to or nearing pre-pandemic levels. Prices increased at a modest pace overall, and several Districts noted some slowing in the pace of increase.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were calm across the indicators reviewed. The financial stress index stood at 0.2331, a low reading, and the VIX was 13.94, consistent with subdued market volatility. The Baa



corporate spread was 2.08, a moderate level that did not point to acute credit-market strain, though staff noted this stood alongside Beige Book reports of subdued banking conditions and softening lending. The 3-month Treasury bill spread versus the current policy rate was 0.055, essentially flat, suggesting market participants did not anticipate a near-term change in the target range. The 10-year/2-year Treasury spread remained deeply inverted at -0.77, a configuration historically associated with expectations of eventual easing and heightened recession risk.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available for this meeting. The estimated neutral rate (r^*) used in the reference-rule calculations was -0.5, a notably negative value that placed the current target range meaningfully above neutral on those rules' terms. Inflation momentum was positive at 0.13, indicating that price pressures were still building modestly rather than fully receding, while unemployment momentum was 0.0, consistent with a labor market that had neither tightened further nor begun to loosen over the recent window.

The reference rules delivered a wide dispersion. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 basis points, reflecting their sensitivity to the very negative r^* estimate and their reading that policy was already restrictive. The First-Difference rule, which adjusts from the current stance in response to the still-above-target inflation gap and positive momentum rather than recomputing a level, pointed in the opposite direction at +75 basis points. With the reference rules flagged as reliable, the loss-minimizing engine reconciled these opposing pulls into a recommended +25 basis points — a modest firming that leaned toward the inflation-responsive signal without adopting either extreme. Taken together, these figures imply a projected path in which policy remains near a restrictive-to-neutral setting, with the balance of risk tilted toward inflation persistence given positive momentum and a labor market still short of any softening.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, all five participants independently arrived at a hold at the current 5.00 to 5.25 percent range, though they reached that position from different starting points. The participant most focused on inflation risk emphasized that core PCE at 3.65 percent remained far above the 2 percent objective and that unemployment at 3.7 percent, below the 4.42 percent natural rate, pointed to a still-tight labor market. This participant noted an openness to a 25 basis point hike given inflation risk but judged that the current range was already restrictive, that the prior median projection of 5.1 percent sat essentially at the current level, and that banking-sector credit tightening was doing part of the restrictive work, so a hold preserved the restrictive stance while incoming data were assessed.



The participant most attentive to employment framed the question around labor-market risk and concluded that, with unemployment below the natural rate, claims low at 232,000, and job growth still modest per the Beige Book, the softening that would justify easing had not appeared. At the same time, this participant stressed that core PCE remained well above target and that easing could not be justified, while further hikes risked overtightening into a slowing economy — a concern reinforced by the deeply inverted 10-year/2-year spread. The participant weighing financial stability observed that stress indicators were contained — the stress index at 0.2331, the VIX at 13.94, and the Baa spread at 2.08 — but that subdued banking conditions and softening lending signaled credit tightening already underway, arguing against adding to it. The participant emphasizing market signals placed the heaviest weight on the flat 3-month T-bill spread of 0.055, reading it as a clear indication that markets did not expect a near-term move, while the participant taking the most literal data-dependent view noted the confluence of elevated inflation, a tight labor market, calm markets, and softening lending as supporting a pause to let prior firming propagate. In the rebuttal round, no participant was moved off the hold; the inflation-focused member consolidated around holding rather than pressing for a hike, and the others reaffirmed that the committee had converged on a hold as the risk-averse path.

Turning to the framework's optimal recommendation of +25 basis points, participants engaged closely with the divergence between that figure and their own predictive holds. Several found the First-Difference rule's logic the most persuasive of the reference set: because it adjusts from the current stance in response to still-above-target inflation and positive momentum of 0.13, rather than recomputing a level from an uncertain and very negative r^* of -0.5, it fit a data-dependent, lag-heavy environment better than the level rules that prescribed -75 basis points. Participants across perspectives rejected the deep-cut signals outright, judging that cutting 75 basis points into 3.65 percent core inflation and a labor market with unemployment below the natural rate would be premature and risk unanchoring expectations before disinflation proved durable.

There was broad agreement that the small gap between the members' +0 holds and the framework's +25 revealed that the current stance was near neutral-to-restrictive, with the debate now over a single marginal step rather than direction. The inflation-focused participant read the +25 as confirmation that current policy sat on the accommodative edge for this inflation, yet preferred to hold given that credit lags were already supplying restraint. The employment-focused participant judged that a hike posed negligible immediate job risk given 3.7 percent unemployment but was unnecessary if credit tightening would do the remaining work, and signaled readiness to pivot toward pausing or cutting should claims rise or job growth stall. The financial-stability participant accepted the firming direction as defensible while flagging that softening lending and still-building lagged credit effects gave pause on magnitude and timing. The market-signal participant reiterated that endorsing +25 would place policy ahead of



what the flat T-bill spread sanctioned, accepting the firming bias in principle but not the immediate step. The data-dependent participant likewise accepted that elevated inflation and a tight labor market justified a firming bias over cuts, while judging that flat market pricing and softening lending argued against adding a hike at this meeting.

Across both the predictive and optimal-framework discussions, participants generally judged that inflation, though still elevated and not yet conquered, was no longer accelerating, and that wages moderating toward pre-pandemic norms and prices slowing in several Districts supported patience. They weighed this against the recession signal embedded in the inverted yield curve and the possibility that banking-sector credit tightening was quietly amplifying restraint. The recurring theme was that current policy was close to appropriate, with the residual disagreement concerning whether one further measured step of firming was warranted now or better deferred while lagged effects continued to propagate.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported holding the target range at 5.00 to 5.25 percent, an outcome of 5 to 0 with no member favoring a change. On the deterministic policy engine's recommendation of +25 basis points, the Committee did not reach either full endorsement or outright rejection: all five members recorded a partial stance, agreeing with the firming direction implied by the recommendation given still-above-target inflation and a tight labor market, but not with taking the additional 25 basis point step at this meeting — citing flat near-term market pricing, softening lending, and the restraint already being supplied by banking-sector credit tightening. The recorded optimal-side tally was accordingly zero endorse, zero decline, and five partial.