



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available on or before the cutoff for this meeting. As a result, the Committee is unable to report a total portfolio size, its composition across security types, or any change from a prior release. Members were reminded that this section covers SOMA holdings only and does not encompass the results of temporary open market operations, including repurchase and reverse repurchase transactions, for which no point-in-time-safe data source currently exists. The staff noted this gap and indicated that future reports would incorporate holdings data as it becomes available on a reliable point-in-time basis.

STAFF REVIEW OF THE ECONOMIC SITUATION

The economy continued to expand at a solid pace across most parts of the country. The Chicago Fed National Activity Index stood at 0.82, a reading consistent with growth above its longer-run trend. Core PCE inflation on a year-over-year basis was 2.19 percent, modestly above the 2.0 percent objective. The unemployment rate was 6.1 percent, above the estimated natural rate of 5.43 percent, indicating that some slack remained in the labor market. Initial claims for unemployment insurance were 338,000, a level the staff characterized as moderate and not indicative of any deterioration in labor conditions. M2 stood at \$3,582.1 billion.

The most recent Beige Book reported that business activity in most areas was continuing to expand at a solid pace, though a number of Districts noted scattered indications of some slowing or slight declines. Retail activity, which had moderated during the spring, appeared to have picked up recently, with most Districts reporting improved sales of autos, building materials, and apparel since the June report. Several Districts described a tightening in labor markets that in some cases had produced faster wage growth, though labor shortages appeared concentrated in a few skilled occupations. The range of commodities registering price increases had broadened somewhat. At the same time, a majority of Districts reported that retailers were holding the line on price increases, with profit margins narrowing in an environment that continued to be characterized as competitive.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly benign. The financial stress index registered 0.0639, a very low reading indicating calm and orderly markets with no evident systemic strain. The VIX stood at 12.54, signaling subdued volatility. The Baa corporate spread over Treasuries was 1.46, a tight level pointing to healthy credit availability and low borrowing-cost stress. The 10-year/2-year Treasury yield curve spread was positive at 1.07, showing no inversion and no recession warning from the curve. The 3-month Treasury bill traded roughly 0.2 percentage point above the current federal funds rate of 4.25



percent, a spread consistent with market expectations of modest near-term firming in policy.

STAFF ECONOMIC OUTLOOK

The staff's projection drew on the forward-looking quantities available. The estimated neutral real rate (r^*) was 1.288 percent, which together with inflation running slightly above 2 percent implied a neutral nominal rate in the neighborhood of 3.5 percent. With the current funds rate at 4.25 percent, the real funds rate stood modestly above the neutral estimate, suggesting a policy stance that was roughly neutral to only mildly firm rather than clearly restrictive. Inflation momentum was essentially flat at 0.01, pointing to little near-term acceleration in prices, while unemployment momentum was negative at -0.25, consistent with labor market slack that was shrinking rather than widening.

The reference rules spanned an unusually wide range. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 basis points, driven largely by the sizable unemployment gap relative to the small inflation overshoot. The First-Difference rule, which emphasizes changes rather than gap levels, pointed to +25 basis points, reflecting firming momentum. The loss-minimizing output of the framework, taking the reference rules as reliable and balancing these opposing signals, was 0 basis points. Taken together, these figures projected an economy in which slack continues to close gradually, inflation holds modestly above target without accelerating, and financial conditions remain calm — a configuration in which policy near current levels would keep conditions on a broadly stable path absent a clear shift in momentum.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening assessments, participants agreed that the economy was expanding solidly and that financial conditions were calm enough to accommodate a policy move, but they divided on magnitude. Several participants favored a 50 basis point increase. One emphasized that core PCE at 2.19 percent stood above the 2.0 percent objective and that the Beige Book documented broadening price increases, tightening labor markets, and faster wage growth in some Districts — conditions that in this participant's view called for firm preemptive action while calm markets could absorb it. Another, focused on financial stability, reasoned that with the stress index at 0.0639, the VIX at 12.54, and Baa spreads tight, markets had ample cushion to absorb a firm move without destabilization, and that acting decisively now would reduce the risk of sharper corrections later. A third participant, weighing the data at face value, initially reached the same conclusion, citing above-trend growth on the Chicago Fed index and the broadening of price pressures.

Other participants favored a 25 basis point increase. One who weights market pricing most heavily stressed that the 3-month Treasury bill sat only about 20 basis points above the current funds rate, a



spread consistent with a quarter-point move and not a half-point move; in this participant's framework, resilience to a larger move was not the same as the market having priced one, and overshooting the priced path risked an unnecessary repricing shock even from a calm base. A participant focused on the labor market observed that unemployment at 6.1 percent remained above the 5.43 percent natural rate, implying residual slack, and cautioned that an aggressive move risked over-tightening onto a labor market that had not fully recovered — while acknowledging that with no employment weakness visible, a measured hike was defensible.

In the course of the discussion one participant weighing the data literally was persuaded to revise down from 50 to 25 basis points, finding the T-bill spread the most concrete market-implied measure of magnitude available and judging that the case for a larger step rested more on qualitative Beige Book language and on the general observation of 'room to move' than on data compelling it. The participant favoring the larger move was not persuaded to soften, holding that market pricing did not bind a judgment centered on inflation risk. This left a lean toward a quarter-point move as the balance of predictive opinion.

Turning to the framework's loss-minimizing recommendation of no change, participants engaged directly with the wide dispersion among the reference rules. There was broad agreement in rejecting the deep cuts implied by the Taylor, Balanced Approach, and ELB-adjusted rules; participants viewed those level-based rules as overweighting the unemployment gap while ignoring above-target inflation, above-trend growth, and the fact that unemployment momentum was already negative. The participant focused on employment noted that the very gap those rules chased was closing on its own, and that cutting deeply into an improving labor market with inflation at 2.19 percent risked overheating and later forced tightening that would itself hurt jobs. The stability-focused participant added that easing 75 basis points into calm markets and tight spreads could fuel excessive risk-taking and credit froth, and saw no stress signal that would provide any basis for a cut.

Several participants found the First-Difference rule's logic most persuasive, since it emphasized the direction of travel — firming momentum that markets were also pricing — without over-relying on the noisy neutral-rate estimate. With inflation momentum essentially flat at 0.01, however, participants generally judged that there was no urgency demanding an immediate move in either direction. A couple of participants read the small gap between the framework's hold and their own preference for a modest firming step as itself informative: the shared rejection of easing revealed that current policy near 4.25 percent was roughly neutral rather than restrictive, given a neutral nominal rate estimated near 3.5 percent. Those participants leaning firmer maintained that the market's forward tilt and above-target inflation argued for a small step now, while those endorsing the hold emphasized residual



slack, narrowing retail margins, and the option value of waiting for clearer inflation momentum in calm markets.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action, the Committee's vote favored a 25 basis point increase, with three members supporting a quarter-point move and two members supporting a half-point move. On the framework's loss-minimizing recommendation of no change (0 basis points), the Committee recorded three members endorsing the recommendation as-is — the participant focused on the labor market, the participant focused on financial stability, and the data-dependent participant — and two members registering partial agreement, the inflation-focused participant and the market-signal participant, each concurring with the direction of no easing but preferring a modest firming step rather than a full hold. No member declined to support the recommendation's direction.