



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, and the Committee accordingly had no current figures on the total size, composition, or period-over-period change of the portfolio before it. The desk's account of open market operations therefore could not be reconciled against a reported SOMA balance. Members were reminded that this limitation pertains specifically to SOMA holdings; it does not extend to, nor substitute for, the results of repurchase and reverse repurchase operations, for which no point-in-time-safe data source currently exists. The discussion of financial-market developments in this document rests instead on the market-conditions indicators summarized in the staff's financial review.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that incoming data described an economy expanding at a pace close to trend, with no clear evidence of either overheating or slowing. Core PCE inflation stood at 1.73 percent on a year-over-year basis, below the 2.0 percent target. The unemployment rate was 5.4 percent, only slightly above the estimated natural rate of 5.29 percent, leaving the labor market roughly in balance. Initial jobless claims of 331,000 were moderate and did not indicate a sharp deterioration in hiring. The Chicago Fed National Activity Index at 0.22 pointed to growth modestly above trend. The current federal funds rate was 5.25 percent, and M2 stood at 3,747.8 billion dollars.

The Beige Book summary of commentary compiled across the twelve Districts was available in the July compilation but did not, in the material before the Committee, furnish a distinct signal of either general overheating or broad slowing beyond what the aggregate indicators already showed. Taken together, the staff characterized the situation as one of steady, near-trend activity with inflation running somewhat under target and labor-market conditions close to their estimated normal state.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were described as calm and broadly accommodative. The financial stress index at 0.0804 was low, and the VIX at 16.41 indicated subdued equity-market volatility with no evident spike in risk aversion. The Baa corporate spread of 1.52 percentage points was tight, consistent with credit markets that showed no elevation in borrowing costs or signs of stress. The 10-year/2-year Treasury spread was positively sloped at 0.6, carrying no recession signal from an inverted curve. The 3-month T-bill traded 0.22 percentage point below the current funds rate, a mild indication that markets anticipated steady policy with a slight tilt toward easing rather than any near-term tightening.

STAFF ECONOMIC OUTLOOK



The staff's forward-looking assessment drew on the estimated neutral rate and the momentum readings embedded in the data. With r^* estimated at 2.84 percent and core inflation near 1.73 percent, the implied neutral nominal rate sat well below the prevailing 5.25 percent funds rate, indicating that the current stance was somewhat restrictive. Inflation momentum was negative at -0.055, suggesting continued easing rather than building price pressures, while unemployment momentum was slightly positive at 0.05, consistent with a labor market drifting marginally toward more slack. On the strength of these readings the reference rules were judged reliable.

The reference rules diverged in magnitude while agreeing in direction. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 basis points, reflecting sub-target inflation together with a small measure of labor slack. The First-Difference rule, which adjusts incrementally from the current setting and relies on momentum rather than level estimates, indicated a more modest -25 basis points. Reconciling the level-based and momentum-based approaches, the deterministic policy engine's loss-minimizing recommendation was -25 basis points. The projection these figures collectively support is one of gradual normalization toward a less restrictive stance, with the pace of any adjustment tempered by above-trend activity and calm financial conditions that argue against an abrupt move.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants uniformly judged that current conditions warranted no change in the policy rate. The member most attentive to inflation risk observed that core PCE at 1.73 percent was below target and thus removed any immediate case for a hike, while the tight labor market and steady growth ruled out a cut; holding, in this view, preserved optionality to tighten later should price pressures re-emerge, particularly given that unemployment near the natural rate combined with above-trend growth is a configuration in which inflation can re-accelerate. The member focused on employment reached the same conclusion from the opposite mandate priority, noting that unemployment at 5.4 percent sat only marginally above the 5.29 percent natural rate and that jobless claims of 331,000 and the absence of any sign of employment weakness in the Beige Book gave no trigger for a preemptive easing.

The member weighing financial stability emphasized that the low stress index, subdued VIX, tight Baa spread, and positively sloped yield curve showed neither systemic tension nor recession signal, so that no defensive move was required in either direction; a hike would risk tightening calm conditions unnecessarily, and a cut was unwarranted with growth on trend. The centrist read the numbers as describing a balanced economy near its targets, and the market-signal member pointed to the slightly negative T-bill spread as evidence that markets expected steady policy with a mild easing tilt but no



imminent action. This reasoning produced a unanimous predictive lean toward holding.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, participants confronted the gap between their hold forecast and a modest easing. Several found the divergence informative rather than contradictory: with the funds rate at 5.25 percent against an r^* of 2.84 percent and core inflation near 1.7 percent, real policy was mildly restrictive, and a single 25 basis point step would normalize the stance without abandoning discipline. Participants generally distrusted the -75 basis point prescriptions of the Taylor, Balanced Approach, and ELB-adjusted rules, judging that those rules overstated the case by overreacting to a small inflation gap and to minimal labor slack while ignoring above-trend growth as measured by the CFNAI at 0.22. The First-Difference rule's -25 basis points, adjusting gradually from the current setting and depending on momentum rather than uncertain level estimates, was the rule most participants found persuasive.

The employment-focused member made the strongest affirmative case for acting, arguing that positive unemployment momentum and elevated-at-the-margin claims signaled firming joblessness and that leaving restrictive policy in place risked letting slack widen before the Committee responded; a measured, reversible -25 basis points was framed as an insurance-style easing consistent with the reliable rules. The financial-stability and market-signal members added that a small cut would validate rather than shock expectations, given that the T-bill was already trading about 22 basis points below the funds rate, and that a larger lurch into calm markets risked fueling excess risk-taking. The centrist characterized -25 basis points as the literal middle reading of the numbers—proportionate and reversible. The inflation-focused member accepted that negative inflation momentum made the easing direction defensible but resisted committing to the full step now, preferring to wait until the below-target reading confirmed as durable rather than transient, and worrying that cutting into above-trend growth could reignite price pressures.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported no change to the federal funds rate, a unanimous 0 basis point outcome. On the deterministic framework's recommendation of -25 basis points, four members endorsed the recommendation as-is: the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist. The inflation hawk registered a partial position, agreeing with the easing direction implied by below-target inflation and negative inflation momentum but declining to commit to the full magnitude at this time, preferring to confirm the durability of the sub-target inflation reading before taking the step. No member declined the recommendation outright.