



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data was available on or before the point-in-time-safe cutoff for this meeting, and so the Committee had no current figures on the total size, composition, or period-over-period change in SOMA holdings to review. This section accordingly reports only on SOMA holdings, and no such holdings data could be presented; it does not cover the results of temporary repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists. Members were advised that this gap reflects data availability rather than any change in the conduct of open market operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity generally expanded at a moderate rate across many districts in June and July, with several districts describing growth as more brisk. Consumer spending picked up noticeably since the prior report, aided in part by improved weather; most districts reported stronger retail sales, with only one district noting weaker activity. Apparel demand appeared stronger in many districts, and purchases of some big-ticket and luxury items rose in several. Automobile sales were a partial exception, edging slightly softer, though light trucks and sport utility vehicles continued to sell well. Manufacturing remained at a high level or expanded further across most industries, particularly for nonautomotive durables, and manufacturers' inventories were generally reported at desirable levels. Commercial real estate activity strengthened across much of the country as vacancy rates declined and rents rose, while home sales and construction increased modestly but remained slightly below year-ago levels.

On the labor side, the staff noted that markets tightened further, but only scattered wage pressures were reported. The unemployment rate stood at 4.8%, below the estimated natural rate of 5.23%, and initial jobless claims were 329,000, a level the staff characterized as moderate with no sign of deterioration. Price data were contained: core PCE inflation was 1.72% on a year-over-year basis, below the 2.0% objective, and the Beige Book indicated that prices for most goods were stable, with increases limited mainly to lumber and some agricultural products. Recent rains in some districts brought relief to crops earlier damaged by heat and sparse rainfall. The Chicago Fed National Activity Index at 0.29 was consistent with the picture of moderate-to-firm growth, and M2 stood at \$3,919.8 billion. Several districts reported that commercial lending strengthened, while reports on consumer lending were more mixed.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff reported that financial conditions remained calm and broadly benign. The financial stress index stood at 0.1026, a low reading indicating little strain in overall conditions. Credit spreads were narrow, with the Baa corporate spread at 1.48, pointing to no meaningful borrowing-cost stress. The Treasury yield curve was positively sloped, with the 10-year/2-year spread at 0.39 — flat but not inverted, and thus carrying no recession signal. The VIX at 23.75 was moderately elevated, reflecting some market uncertainty but well short of distressed levels. The 3-month T-bill spread relative to the current federal funds rate was -0.33, indicating that the front end of the market was pricing rates slightly below the prevailing 5.5%, consistent with a mild easing bias in market expectations. Reports from districts of strengthening commercial lending and healthy credit availability corroborated the picture of orderly credit markets.

STAFF ECONOMIC OUTLOOK

The staff outlook, drawing on the forward-looking quantities available, suggested that the current policy stance was modestly restrictive relative to a neutral setting. With the estimated neutral real rate (r^*) at roughly 3.0% and core inflation near 1.72%, a neutral nominal rate would be in the vicinity of 4.7%, leaving the current 5.5% funds rate meaningfully above that estimate. The real funds rate of approximately 3.78% likewise exceeded r^* by a meaningful margin. Inflation momentum was slight at 0.015, indicating no accelerating price pressure, while unemployment momentum at -0.25 implied labor markets were still tightening rather than softening.

The reference rules gave a divided reading of the appropriate response to these conditions. The Taylor rule prescribed -50 basis points, reflecting inflation below target and a real rate above neutral, while the Balanced Approach, First-Difference, and ELB-adjusted rules each indicated no change. The reference rules were judged reliable in the current environment. Weighing the below-target inflation and restrictive real rate against still-firm activity and a tightening labor market, the framework's loss-minimizing recommendation settled at -25 basis points — a midpoint between the Taylor signal and the three rules counseling patience. The projection implied that, absent a fresh inflation or stability trigger, conditions were likely to remain characterized by contained prices and a tight but not deteriorating labor market.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive discussion, all five participants judged that holding the federal funds rate at 5.5% was the most likely and most appropriate course. Participants generally observed that core PCE at 1.72% sat below the 2.0% objective, so no acute inflation pressure demanded tightening, while the tightness of the labor market — unemployment at 4.8%, below the 5.23% natural rate — gave no ground for easing on employment terms. The member most focused on inflation risk framed the tight labor



market as a classic setup for future wage and price pressure, but acknowledged that with only scattered wage pressures reported and inflation still under target, a preemptive hike was not yet justified; the appropriate posture was to hold and remain ready to tighten should wage pressures broaden. The participant weighting employment risk most heavily reached the same conclusion from the opposite direction, noting that neither rising unemployment nor slowing job growth was present, and that cutting into an already-tight market could stoke the very pressures that might later force a sharp and employment-damaging reversal.

The member attentive to financial stability emphasized that conditions were unambiguously benign — a low stress index, a narrow Baa spread, a positively sloped curve, and a VIX short of panic levels — and concluded that neither a hike, which would tighten conditions unnecessarily, nor a cut, for which no credit stress argued, was warranted. The data-dependent participant read the same figures literally and found no signal demanding a move in either direction, while the member weighting market pricing pointed to the negative T-bill spread and the flat but positive curve as evidence that markets were not pricing an imminent change. Across two rounds of rebuttal, no participant was persuaded to shift, and the case for holding was reinforced from each distinct vantage point. The final predictive vote was unanimous for no change.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, participants engaged more directly with the gap between their hold vote and a modest cut. Several members converged on the view that the current stance was genuinely restrictive: with r^* near 3.0% and inflation around 1.72%, the funds rate at 5.5% stood well above an estimated neutral of roughly 4.7%, and the real rate exceeded r^* by a meaningful margin. The participant focused on employment argued that unwinding some of this excess restraint would serve as insurance for a strong labor market before any softening appeared, and endorsed the modest cut. The financial-stability member reasoned that sustained excess restraint could eventually widen spreads and stress borrowers, and that because stress and spreads were currently low, a small and orderly cut carried little risk of disorderly repricing; this participant likewise endorsed -25 basis points. The member weighting market signals viewed -25 as the disciplined version of the market-implied easing bias already visible in the negative bill spread — honoring the inflation shortfall and the restrictive real rate while respecting firm Beige Book activity — and endorsed it as well.

Two participants were less comfortable. The inflation-focused member accepted that policy was modestly above neutral and that a small cut could be defended as reversible insurance, but ultimately declined the recommendation, arguing that with unemployment below the natural rate and momentum still tightening at -0.25, restrictiveness was a feature rather than a flaw, and that easing



into a hot labor market risked reigniting latent inflation. This participant noted that three of the four reference rules — Balanced Approach, First-Difference, and ELB-adjusted — counseled no move, a cluster that better matched an inflation-risk asymmetry than the Taylor rule's -50. The data-dependent participant agreed with the direction of easing given mild restrictiveness, but judged the full -25 a step ahead of the data: with solid growth, strong retail, high manufacturing, and a still-tightening labor market, the economy did not demand action now, and a smaller or delayed move was more defensible. That member's stance was thus a partial one — accepting the direction but not the magnitude or timing.

Taken together, the deliberation revealed a committee united in its near-term reading — hold at 5.5% — but genuinely divided on whether the mild restrictiveness relative to neutral warranted acting on it. The disagreement was one of degree and emphasis rather than a fundamental split on the state of the economy: all participants agreed inflation was contained, the labor market tight and still tightening, and financial conditions calm. The dividing line lay in how much weight to place on the restrictive real rate and below-target inflation against the risk of easing into a hot labor market.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely policy decision, all five participants supported no change to the federal funds rate, leaving it at 5.5% (5-0). On the separate question of the framework's loss-minimizing recommendation of -25 basis points, the committee did not reach full agreement: three participants — the member weighting employment risk, the financial-stability member, and the member weighting market signals — endorsed the recommendation as it stood; the inflation-focused member declined it, preferring to hold given the risk of easing into a tight labor market; and the data-dependent member gave partial support, agreeing with the direction of a cut but judging the -25 basis point magnitude premature relative to still-firm activity and a still-tightening labor market. The recorded optimal-side stance was thus three endorse, one decline, and one partial.