



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 minutes therefore report no figures on the total size, composition, or period-over-period change of the portfolio. Because the underlying source could not be verified as free of hindsight, the Committee refrains from characterizing SOMA holdings this cycle. It should be noted that this limitation pertains to SOMA holdings only; results of repurchase and reverse repurchase operations are a separate matter, and no point-in-time-safe source for those operation results currently exists either. The Committee flags both gaps explicitly rather than fill them from memory or approximation.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review pointed to an economy running with considerable momentum. Real activity remained above trend, with the Chicago Fed National Activity Index at 0.34. The labor market was notably tight: the unemployment rate stood at 4.3%, well below the estimated natural rate of 5.13%, and initial jobless claims of 292,000 gave no sign of any deterioration in hiring conditions. Against this backdrop, realized inflation remained subdued, with core PCE inflation running at 1.15% on a year-over-year basis, roughly 85 basis points below the 2.0% objective.

The most recent Beige Book, prepared before information collected on August 3, described continued strength in activity alongside widespread reports of supply constraints. Retail sales, robust in the second quarter, decelerated somewhat in July, in some cases owing to low inventories of clearance merchandise. Manufacturing continued to expand in most districts, though performance varied by industry, with electronics, heavy trucks, and construction materials strong while textiles and metals remained weak. Residential construction and housing markets were generally strong, though shortages of materials, labor, and land constrained building and boosted costs in some areas. Loan demand was steady or rising, led by commercial, industrial, and auto lending, even as mortgage refinancing slowed. The report emphasized that labor shortages persisted in virtually every district but that reports of actual wage acceleration were only scattered, and that final prices of goods and services remained relatively stable, with 'no evidence of any broad-based pickup in consumer price inflation.'

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly stable, if somewhat mixed. The financial stress index at 0.2481 was moderate, indicating no acute systemic strain, though not benign. The VIX at 21.67 was elevated but well short of crisis levels, consistent with real but manageable market uncertainty. Credit markets appeared to be functioning normally: the Baa corporate spread of 2.24 was contained, showing no sign



of borrower distress. The term structure was flat but not inverted, with the 10-year/2-year spread at just 0.21, offering no recession signal from the curve. Notably, the 3-month Treasury bill yield sat 0.31 below the current 5.0% federal funds rate, a configuration suggesting that markets were not pricing aggressive further tightening and, if anything, leaned toward the expectation of easing ahead.

STAFF ECONOMIC OUTLOOK

The staff outlook projected conditions consistent with a mildly restrictive current stance rather than an overheating one. The estimated neutral real rate (r^*) of 3.543, combined with core inflation near 1.15%, implies a neutral nominal rate on the order of 4.7%, somewhat below the prevailing 5.0% funds rate. On that arithmetic, present policy carries a modest degree of restraint. The momentum terms reinforced a picture of stability rather than acceleration: inflation momentum was a tepid 0.13 and unemployment momentum was slightly negative at -0.1, the latter hinting at some softening at the margin rather than continued tightening.

The reference rules spanned a wide range, and the dispersion is itself informative. The Taylor rule prescribed +25 basis points and the Balanced Approach and ELB-adjusted rules each called for +75, the higher prescriptions driven principally by the wide gap between unemployment and its natural rate. The First-Difference rule, which responds to the direction of change rather than the level of gaps, prescribed -50 basis points, reflecting weak inflation momentum and no rising price pressure. With the reference rules judged reliable this cycle, the loss-minimizing synthesis landed at -25 basis points: the level-based rules' case for restraint was outweighed by subdued realized inflation and the absence of any acceleration in the momentum data. The projection thus points toward a gradual move back toward neutral rather than a continued firming path, contingent on wage and price data remaining contained.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants independently converged on a modest 25 basis point increase, and the reasoning that produced that convergence was strikingly consistent across otherwise distinct mandates. Participants emphasized the tightness of the labor market — unemployment at 4.3% against a 5.13% natural rate — together with the Beige Book's account of widespread labor shortages and supply constraints in virtually every district, brisk loan demand, and firming oil and home-construction costs. The participant weighting inflation risk most heavily framed a small hike as precautionary insurance against building pressure, stressing that the mandate weighs the risk of future inflation, not only current readings. The participant attentive to employment risk noted that there was simply no labor-market weakness to defend against, and that adding stimulus to an already tight market could threaten the durability of the expansion. The participant focused on financial



stability judged that calm credit conditions — a contained Baa spread of 2.24 and a moderate stress index — could readily absorb a measured step without destabilization.

That said, participants uniformly acknowledged the pull in the other direction from subdued realized inflation. Core PCE at 1.15%, a full 85 basis points below target, was cited by every member as the reason to prefer a modest move over a larger one and as a genuine source of pause. The participant tracking market signals scrutinized the 3-month bill spread of -0.31 most closely, initially reading it as consistent with a single 25 basis point step already priced, but candidly conceding that a bill yield below the funds rate more naturally suggests markets expect little tightening or even easing — a signal too shallow, in that member's judgment, to contradict a lone modest hike but not consistent with anything more aggressive. The rebuttal round did not move any member off the +25 lean; the predictive vote was recorded as unanimous.

The optimal-framework rounds surfaced the real disagreement that the predictive convergence had masked. Confronted with a loss-minimizing recommendation of -25 basis points, most participants found the case genuinely persuasive on the framework's own disciplined, data-present terms. Several observed that with r^* near 3.543 and inflation near 1.15%, the 5.0% rate already sits above a neutral nominal rate around 4.7%, so a 25 basis point cut removes modest excess restraint rather than adding stimulus. The employment-focused participant leaned on the slightly negative unemployment momentum and the flat curve to argue for easing pre-emptively, before conditions weaken further, and endorsed the recommendation. The financial-stability participant emphasized that a large hike of the sort the Balanced Approach and ELB rules prescribed would risk inverting the barely-positive 0.21 curve and widening spreads — precisely the instability to be guarded against — and judged a calibrated -25 the non-destabilizing step. The market-signals participant read the bill spread and flat curve as markets telling policymakers restriction was already unnecessary, and treated -25 as the point where market pricing and momentum logic converge.

The dissent came from the participant most concerned with inflation risk, who declined to support an active cut. That member accepted that realized inflation gives no case for hiking and allowed that a hold would be defensible, but distrusted reading marginal labor softening from a momentum figure as small as -0.1, and warned that easing into a tight labor market invites future inflation that would then require swift reversal if the scattered wage reports were to broaden. The participant weighing indicators at face value took an intermediate position, agreeing with the direction toward neutral but hesitating on magnitude: a full 25 basis point cut into 4.3% unemployment and a tight labor market, in that member's view, is more than the neutral-rate gap alone demands, and the mixed signals argued for a smaller, more cautious step. Participants generally recognized that the tension between a level-based case for



tightness and a momentum- and inflation-based case for easing was real and unresolved, and that whatever the direction, incoming wage and price data would need to be watched closely.

COMMITTEE POLICY ACTIONS

On the predictive question of the likely policy action, the Committee's recorded vote was unanimous, with all five members favoring a 25 basis point increase ({25: 5}). On the separate question of the deterministic framework's loss-minimizing recommendation of a 25 basis point cut, the Committee did not reach full agreement: three members endorsed the recommendation as-is (the participants weighting employment risk, financial stability, and market signals), one member declined to support it (the participant weighting inflation risk), and one member took a partial position, agreeing with the direction toward neutral but not with the full magnitude (the data-dependent centrist). The final optimal-side tally was thus three to endorse, one to decline, and one partial.