



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, so the Committee is unable to report a total portfolio size, its composition across security types, or any change from a prior release. This gap concerns SOMA holdings specifically. It should also be noted that this section does not cover the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists; accordingly, no figures on temporary open market operations are presented here.

STAFF REVIEW OF THE ECONOMIC SITUATION

Incoming data described an economy still expanding but showing accumulating signs of moderation. Core PCE inflation stood at 1.47 percent on a year-over-year basis, below the 2.0 percent target. The unemployment rate was 4.0 percent, well beneath the estimated natural rate of 5.1 percent, and initial jobless claims of 315,000 pointed to a labor market that remained firm rather than deteriorating. The Chicago Fed National Activity Index at -0.36 indicated growth running below its trend pace. The fed funds rate stood at 6.5 percent, and M2 was reported at \$4,790.3 billion.

The Beige Book, prepared at the Federal Reserve Bank of Dallas from information collected before July 31, reported that activity continued to expand in all Districts through June and July but that the expansion was moderating in a majority of them. Seven Districts described slowing growth, four reported essentially unchanged growth rates, and one reported acceleration. Consumer spending, manufacturing, and construction were characterized as slightly softer than in the prior report, with several Districts noting retail sales below plan and slower vehicle sales. Easing demand appeared to be restraining price increases. Energy prices remained high but were described as possibly having peaked, with most of the indirect costs absorbed by final goods producers for the time being. Labor markets were characterized as very tight, with worker shortages limiting activity in some areas and many Districts reporting wage increases and growing use of benefits.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were mixed but not distressed. The 10-year/2-year Treasury spread was inverted at -0.47, a configuration commonly read as a recession-risk signal, and the 3-month T-bill traded roughly 0.4 below the current funds rate, consistent with market expectations of no further tightening and possibly easing ahead. Credit conditions bore watching but showed no acute strain: the Baa corporate spread was elevated at 2.43, while the broader financial stress index at 0.25 and the VIX near 18 were both moderate, indicating markets that were calm rather than panicked.

STAFF ECONOMIC OUTLOOK



The staff outlook drew on the forward-looking quantities available. With the estimated neutral rate (r^*) at 3.76 and core inflation near 1.5 percent, a nominal funds rate of 6.5 percent implies a real rate meaningfully above neutral, consistent with a policy stance that continues to restrain activity. Inflation momentum was slightly negative at -0.08, suggesting price pressures were softening rather than building, while unemployment momentum was flat at 0.0, indicating the labor market was neither tightening nor loosening further at the margin. Taken together, these figures point toward continued moderation in activity with little near-term upward pressure on prices.

The reference rules spanned a wide range and captured the tension in the data. The Taylor rule prescribed no change; the First-Difference rule, which responds to momentum rather than level gaps, prescribed a 25 basis point reduction; and both the Balanced Approach and ELB-adjusted rules prescribed a 75 basis point increase, driven largely by the wide unemployment gap. The loss-minimizing recommendation was a 25 basis point cut, reflecting the greater weight the framework placed on negative inflation momentum and moderating activity relative to the gap-based rules that lean on lagging labor-market tightness. The reference rules were assessed as reliable under current conditions.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants judged that holding the funds rate at 6.5 percent was the appropriate course, though they arrived there from different vantage points. The inflation-focused participant emphasized that core PCE at 1.47 percent showed no current overshoot and that policy at 6.5 percent was already restrictive, while stressing that the very tight labor market — 4.0 percent unemployment against a 5.1 percent natural rate, with worker shortages and rising wages reported in the Beige Book — remained the lingering inflation risk warranting vigilance. The participant weighting employment risk agreed that no cut was yet justified: there were no realized job losses to defend against, and a premature easing into a still-tight labor market risked reigniting demand, even as the inverted curve and below-trend activity index were noted as forward warnings deserving attention.

The participants attentive to financial stability and to market signals converged on the same hold but framed it around the yield curve and market pricing. Both pointed to the inverted 10-year/2-year spread at -0.47 and the 3-month bill trading 0.4 below the funds rate as evidence that markets expected no further tightening, and argued that forcing rates higher would fight the market-implied path unnecessarily. At the same time, they observed that moderate readings on the stress index, the VIX, and the Baa spread signaled no acute disruption that would demand a defensive cut. The data-dependent participant summarized the balance plainly: growth was cooling and inflation contained, but tight labor and wage pressures argued against easing, leaving holding steady as the



most data-supported course. The rebuttal round reinforced rather than shifted these views, and the predictive vote was unanimous for no change.

When participants turned to the framework's loss-minimizing recommendation of a 25 basis point cut, the discussion evolved. Several stressed that the divergence between their hold and the recommended cut was small — a single quarter-point — and that it reflected timing rather than direction. The inflation-focused participant acknowledged that with a real funds rate near 5 percent against an r^* of 3.76, policy was meaningfully tighter than neutral, and that the First-Difference rule's logic — responding to negative inflation momentum and moderating activity rather than stale level gaps — was persuasive; a 25 basis point cut would leave real rates around 4.75 percent, still above neutral, preserving inflation vigilance. The employment-focused participant read the same figures as insurance against falling behind on jobs, treating the 4.0 percent unemployment rate as a lagging snapshot alongside cooling forward indicators.

The financial-stability participant, who had preferred to wait one meeting for confirmation, was moved by the observation that a small cut was already priced into markets; acting in line with the market-implied path would relieve pressure from the inverted curve without risking a repricing shock, whereas diverging from it might create the surprise a later cut would carry. The market-signals participant emphasized that the inverted curve and negative bill spread lead while the gap-based rules lag, making the modest cut consistent with what markets had already anticipated. The data-dependent participant concluded that the confirmation originally sought — soft inflation together with moderating activity — was already present in the data. Participants generally agreed that the +75 basis point rule prescriptions overweighted a labor-market tightness that was not showing through in realized prices, and that calm financial conditions argued for a small, reversible calibration rather than an aggressive or emergency move.

COMMITTEE POLICY ACTIONS

In the predictive phase, all five participants voted to maintain the fed funds rate at 6.5 percent, a unanimous 5-0 outcome. On the framework's loss-minimizing recommendation of a 25 basis point reduction, the Committee's recorded stance was full agreement: all five members endorsed the recommendation as-is, with none declining and none supporting only its direction while dissenting on magnitude or timing. The endorsement spanned every archetype represented on the Committee — the inflation-focused, employment-focused, financial-stability, data-dependent, and market-signals participants alike.