



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available for this meeting, and so the Committee was unable to review the total size, composition, or change from the prior release of the SOMA portfolio. Members were reminded that this limitation applies specifically to SOMA holdings; it does not extend to, nor should it be read as a statement about, the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source currently exists. The desk's operational review was therefore confined to the acknowledgment of this gap rather than any characterization of holdings or transaction flows.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review pointed to an economy growing slowly or moving sideways. The Chicago Fed National Activity Index stood at -0.43, a reading consistent with below-trend growth, and the most recent Beige Book, prepared on information collected before July 30, described slow growth or lateral movement in activity across most Districts during June and July. Retail sales were generally sluggish and frequently below expectations despite substantial discounting on a wide range of consumer goods. Manufacturing activity declined further in nearly all sectors and regions as producers adjusted to weak domestic and foreign demand and worked down accumulated inventories, and that weakness spilled into related services, with several Districts noting softer demand for office space and for trucking and shipping. Residential real estate stood out as an area of relative strength, aided in part by lower mortgage rates.

On prices and labor, the picture was one of easing pressure. Core PCE inflation was 1.46 percent on a year-over-year basis, below the 2.0 percent objective. The Beige Book reported that continued slow growth had loosened labor markets and eased wage pressures in most Districts, though rising benefit costs continued to add to compensation. Prices for energy, fuel, and many material inputs fell in most regions, and a combination of falling input costs and stiff domestic and foreign competition kept consumer goods prices in check. The unemployment rate was 4.5 percent, still below the estimated natural rate of 5.08 percent, but initial jobless claims at 394,000 were elevated. Financial institutions across the country reported reduced demand for a wide variety of loans, tighter credit standards, and stable-to-deteriorating quality of existing loans and leases, with residential mortgages the notable exception.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as strained but orderly rather than acute. The financial stress index stood at 0.1506, a contained reading, while the VIX at 20.48 was elevated but well short of panic levels. The Baa corporate spread of 2.89 signaled genuine credit stress, with borrowing costs for weaker



firms having risen, a picture consistent with the Beige Book reports of tighter credit standards and softer loan demand. The 10-year/2-year Treasury spread was positively sloped at 1.23, giving no acute recession signal from the yield curve. The 3-month Treasury bill traded roughly 40 basis points below the current 3.75 percent funds rate, a negative spread the staff read as an indication that markets anticipated further easing ahead.

STAFF ECONOMIC OUTLOOK

The staff outlook emphasized that current policy appeared to be sitting close to neutral. With the estimated neutral rate (r^*) at 3.895 percent against a current funds rate of 3.75 percent, real policy was only modestly accommodative, suggesting limited distance between the prevailing stance and an estimated neutral setting and, by extension, a limited case for a large move in either direction. Momentum measures were small: inflation momentum was 0.185 and unemployment momentum 0.1, indicating that neither mandate was deteriorating rapidly enough to force decisive action over the near term.

The reference rules, judged reliable this meeting, straddled the current rate and pointed in conflicting directions. The Taylor rule recommended a 75 basis point increase and both the Balanced Approach and the ELB-adjusted rules recommended 50 basis point increases, all reflecting an unemployment rate below the estimated natural rate and inflation not far beneath target. The First-Difference rule, keyed to change and momentum rather than levels, recommended a 25 basis point cut, consistent with the broadly softening activity data. Reconciling the upward pull of the level-based rules against the downward pull of the change-based rule, the deterministic policy engine's loss-minimizing recommendation netted to a hold at 0 basis points. The projection implied by these figures was one in which conditions could plausibly hold near current settings absent a clearer signal, with the balance of risks contingent on whether the softening pipeline in claims and activity, or the tighter credit conditions, materialized more forcefully in the coming weeks.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants independently arrived at a 25 basis point cut. Participants generally judged that inflation posed no constraint on easing: core PCE at 1.46 percent was well below the 2.0 percent objective, and the Beige Book confirmed falling energy, fuel, and input prices, eased wage pressures, and consumer prices held in check by domestic and foreign competition. The participant most attentive to inflation risk observed that the price danger he would normally guard against was simply not present, with rising benefit costs the only offsetting factor, and concluded that subdued inflation with ample slack permitted a measured cut without stoking prices. At the same time, several participants stressed that the growth picture was soft but not collapsing: manufacturing was



declining broadly, retail was sluggish, and the activity index at -0.43 confirmed below-trend growth, yet the yield curve was not inverted, financial stress was contained, and volatility was moderate.

The participant focused on labor emphasized the leading indicators, noting that initial claims at 394,000 were elevated and that the Beige Book documented loosening labor markets and manufacturing weakness spilling into services. His instinct was to get ahead of deterioration rather than wait for it to appear in the unemployment rate, though he acknowledged that with joblessness still below the natural rate and no acute distress, a measured step rather than a larger one was appropriate. The participant most attentive to financial stability identified credit tightening as his central concern, pointing to reduced loan demand, tighter standards, and stable-to-deteriorating loan quality across Districts, but judged that the contained stress index and moderate spreads indicated strain rather than a systemic event requiring a shock-sized move. The market-oriented participant weighted the negative 3-month bill spread most heavily, reading it as a clean signal that markets expected one further 25 basis point cut and not a hold or a 50 basis point move. In the rebuttal round, no participant was moved off easing, and none was persuaded that a larger cut was warranted; both under-delivering and over-delivering were seen as carrying risk, and the committee's predictive consensus settled firmly at 25 basis points.

The optimal-framework discussion opened against the deterministic engine's recommendation of a hold at 0 basis points, which diverged from every participant's predictive lean. Participants worked to understand why holding could be loss-minimizing. Most focused on the proximity of the estimated neutral rate at 3.895 percent to the current 3.75 percent, which suggested policy was already near neutral and reduced the urgency of a cut, and on the way the level-based rules recommending increases offset the First-Difference rule's recommended cut, netting toward zero. The inflation-focused participant found holding defensible on his own terms: muted inflation removed the case for hiking but did not compel a cut, and neutrality preserved ammunition and guarded against over-stimulating an economy near neutral before growth stabilized. The financial-stability participant likewise concluded that non-restrictive policy combined with orderly, if strained, stress metrics meant no cut was yet required, adding that he would watch Baa spreads and credit standards closely and that further widening would justify easing at a subsequent meeting.

Others were less willing to embrace the hold. The labor-focused participant remained unpersuaded, arguing that a stance described as neutral was still too tight for his mandate when leading labor indicators were flashing, and that a 25 basis point cut represented prudent insurance against the deterioration the data already signaled. The market-oriented participant held that neutrality was not appropriate when growth was broadly softening, and that the framework's tidy cancellation of rules



ignored both the market's aggregated expectation of a cut and the real credit stress evident in the Baa spread and the Beige Book's account of tightening standards. The data-dependent participant took an intermediate view: he accepted that the near-neutral reading tempered the magnitude of any move, but held that the backward-looking premise of the level rules, that the labor market remained tight, was directly undercut by the Beige Book's account of loosening labor and easing wages. When forward-looking data and level-based rules conflict, he reasoned, the observed data leaned dovish, and so he agreed with the easing direction while disagreeing with the exact zero magnitude, favoring a small cut over a hold.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported a 25 basis point cut, a unanimous 5-0 tally. On the deterministic framework's recommendation of a hold at 0 basis points, the Committee was divided: two participants, those most attentive to inflation risk and to financial stability, endorsed the recommendation as consistent with a near-neutral policy stance and contained stress; two participants, those focused on labor-market risk and on market pricing, declined to support it, judging that softening activity and market expectations favored easing now; and one participant, the data-dependent centrist, took a partial position, agreeing with holding steady over hiking but favoring a modest cut over an exact hold. The recorded optimal-side outcome was thus two endorse, two decline, and one partial.