



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$651.4 billion in domestic securities as of the July 30 release, the most recent available under the point-in-time-safe cutoff. Of that total, Treasury notes and bonds accounted for \$398.9 billion and Treasury bills for \$239.7 billion. Holdings were unchanged from the prior release of July 23, a week-over-week change of \$0.0 billion. It should be noted that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available. The account's composition therefore tilted toward longer-dated coupon securities, with bills making up somewhat under two-fifths of the domestic portfolio, and the flat week reflected no net additions or runoff over the interval.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data suggesting an economy that was firming modestly but still running below trend. Core PCE inflation stood at 0.96 percent on a year-over-year basis, well under half the 2.0 percent objective. The unemployment rate was 6.2 percent, above the estimated 5.05 percent natural rate, indicating meaningful labor market slack, and initial jobless claims registered 401,000, at a level often associated with continued labor weakness. The Chicago Fed National Activity Index at -0.15 pointed to growth somewhat beneath its historical trend. The fed funds rate stood at 1.0 percent, and M2 was reported at \$6,046.4 billion.

The Beige Book, prepared at the Federal Reserve Bank of Richmond on information collected before July 21, described additional signs that the pace of activity 'increased a notch' during June and the first half of July. Only the Chicago, St. Louis, and San Francisco districts characterized activity as sluggish, while Atlanta described conditions as mixed and the remaining districts reported somewhat stronger growth. Manufacturing edged higher in most districts, with Philadelphia and Richmond citing an end to recent declines in production, and several districts noted increased optimism about coming months. Against that, consumer spending remained lackluster, with only New York reporting a noticeable improvement in retail sales. Housing sales and starts stayed strong across districts, supported by low mortgage rates, while commercial real estate remained soft. Prices were generally little changed, though some districts reported higher health insurance costs being passed on to employees.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were calm on the staff's reading. The financial stress index stood at 0.09, a very low level consistent with the absence of systemic strain, and the Baa corporate spread at 2.62 was moderate rather than distressed. The 10-year/2-year Treasury spread was steeply positive at 2.59,



carrying no recession signal from the term structure. The VIX at 22.68 was somewhat elevated but short of acute-crisis territory. On the short end, the 3-month T-bill traded roughly 6 basis points below the current 1.0 percent funds rate — a small negative spread consistent with market expectations of rates holding near current levels with, at most, a faint tilt toward easing rather than pricing an imminent, sizable move.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the reference-rule set and the underlying momentum estimates to characterize the likely direction of conditions. The neutral real rate assumption embedded in the analysis was 2.69 percent, notably above the prevailing real funds rate given sub-1 percent core inflation, implying that the current 1.0 percent nominal setting was less accommodative than the low headline rate might suggest. Inflation momentum was slightly negative at -0.05, pointing to continued drift below target rather than a firming of prices, while unemployment momentum was positive at 0.15, indicating that labor market slack was still widening rather than closing.

The reference rules spanned a wide range. The Taylor rule prescribed +75 basis points, anchored on the high neutral-rate assumption; the Balanced Approach and ELB-adjusted rules each indicated -25 basis points, giving greater weight to the combined inflation and unemployment gaps and, in the latter case, to proximity to the effective lower bound; and the First-Difference rule, keyed to the negative inflation and rising unemployment momentum, indicated -75 basis points. With the reference rules judged reliable, the framework's loss-minimizing recommendation of -50 basis points sat between the easing-oriented rules while discounting the Taylor result as an outlier under these low-inflation conditions. Taken together, the forward-looking quantities implied that, absent a stronger and broader pickup in activity than the incoming data yet showed, conditions were likely to remain characterized by below-target inflation and above-natural unemployment for some time.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive discussion, four of the five participants favored holding the funds rate at 1.0 percent, while one favored a 25 basis point reduction. Participants generally agreed on the underlying picture even as they weighed it differently. Core PCE at 0.96 percent was recognized across the committee as evidence that the near-term price risk was disinflation, not overheating; the participant most attentive to inflation risk was explicit that no overheating signal warranted tightening, since prices were 'generally little changed' per the Beige Book. The same participant, however, cautioned that cutting from an already very accommodative 1.0 percent into a firming economy could stoke inflation once slack eventually closed, and judged that holding preserved accommodation while guarding against that later risk.



The dissenting view came from the participant most focused on the labor market, who stressed that unemployment at 6.2 percent stood well above the 5.05 percent natural rate and that claims at 401,000 sat at a level often read as a sign of continued labor stress. With inflation less than half the objective, this participant saw no constraint on providing insurance easing to support employment before slack became entrenched, and favored a modest 25 basis point cut while acknowledging the committee majority was likely to hold. The strongest counter to that case, which this participant conceded gave genuine pause, came from the participant attentive to financial stability: with the rate already near the lower bound, further compression toward zero risked distorting short-term funding markets for limited marginal benefit, and with the stress index at 0.09 and no acute distress there was no financial trigger compelling a defensive move. The participant weighing market signals reinforced the hold, reading the small negative T-bill spread as consistent with a hold plus a faint easing tilt rather than demand for an actual cut, and the data-focused centrist read the mixed-to-firming data at face value as favoring steady policy while monitoring the recovery.

When the discussion turned to the framework's -50 basis point recommendation, the balance of participants' reasoning shifted noticeably. Several participants observed that the same data supporting a hold in the predictive round — sub-1 percent inflation with negative momentum, unemployment above natural with positive momentum, and a neutral real rate of 2.69 percent far above the prevailing real rate — implied that the current stance was in fact tighter than its low nominal level suggested. The inflation-focused participant acknowledged that institutional caution against easing did not apply when the inflation risk pointed downward, and found the ELB-adjusted logic persuasive in treating deflationary drift as a risk to be pre-empted. The financial-stability participant made a parallel argument from a different starting point, noting that entrenched disinflation raises real debt burdens and stresses credit intermediation, making it a stability concern in its own right, and that acting from a position of calm markets was preferable to being forced into disorderly moves later.

Participants differed on how far the reasoning should carry them. The labor-market participant endorsed the -50 recommendation outright, judging that the First-Difference rule's attention to worsening momentum best captured the case for acting before slack became entrenched, and that a move approaching the floor was justified by the width of the employment gap. The others, while agreeing on the direction of easing, resisted the magnitude. The inflation-focused participant argued that a smaller step would provide disinflation insurance while preserving scarce room and respecting the Beige Book's evidence of activity ticking up a notch, firmer manufacturing, and strong housing. The financial-stability participant similarly held that a full -50 into non-distressed credit markets would spend half the remaining room at once and preferred a more measured -25. The centrist found the Balanced Approach's symmetric weighting of the two gaps most consistent with the data and viewed



the First-Difference rule's -75 as overreacting to only modest slowing. The market-focused participant noted that the roughly 6 basis point negative T-bill spread implied only a mild easing lean, not a recession-scale response, and that the steep 2.59 yield curve pointed to expected recovery — again supporting easing in direction but a smaller increment in size.

The common thread in this second phase was a recognition that the gap between a predictive hold and the framework's easing call reflected a stance that, on the loss-minimizing math, was somewhat too tight relative to conditions. Participants nonetheless emphasized the countervailing evidence — the Beige Book's improving tone, lackluster but not collapsing consumer spending, and proximity to the lower bound — as reasons the direction of adjustment mattered more than a large single move.

COMMITTEE POLICY ACTIONS

In the predictive vote on the current policy decision, the Committee's recorded tally was four members in favor of holding the funds rate at 1.0 percent and one member favoring a 25 basis point reduction. On the framework's -50 basis point recommendation, the recorded outcome was one endorsement and four partial positions, with no member declining outright. The participant most focused on the labor market endorsed the recommendation as-is; the inflation-focused participant, the financial-stability participant, the data-dependent centrist, and the market-signal participant each recorded a partial stance, agreeing with the direction of easing but not with the -50 magnitude, generally favoring a smaller, more measured move given signs of firming activity and proximity to the effective lower bound.