



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent System Open Market Account holdings data, reported as of July 28, 2010. Total SOMA domestic securities holdings stood at \$2,048.4 billion, comprising \$712.0 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$1,117.5 billion in agency mortgage-backed securities. This represented a decline of \$7.1 billion from the prior release of July 21, 2010, with agency MBS continuing to make up the largest single component of the portfolio. Staff noted that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not reflect the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available for this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

Economic activity had continued to increase on balance since the previous survey, though the pace was modest in many Districts and two Districts, Atlanta and Chicago, reported that activity had slowed recently; the Cleveland and Kansas City Districts described activity as generally holding steady. Manufacturing continued to expand in most Districts, but several — including New York, Cleveland, Kansas City, Chicago, Atlanta, and Richmond — reported that the pace had slowed or leveled off, even as automobile manufacturing and parts supply stood out as areas of relative strength in a few Districts. Conditions in the services and transportation sectors improved, and tourism generally rose, though the Atlanta District flagged concern over decreased leisure travel to the Gulf Coast. Retail sales generally continued to rise, with necessities selling well while big-ticket items moved more slowly, and most Districts reporting on autos noted declines in recent weeks. Residential real estate was sluggish in most Districts following the expiration of the April 30 homebuyer tax credit, and commercial real estate, especially construction, remained weak. Banking conditions varied, with some Districts noting soft or decreased loan demand and credit standards remaining tight in most reporting Districts.

The labor market data pointed to substantial remaining slack. The unemployment rate stood at 9.5%, well above the estimated natural rate of 5.03%, and initial jobless claims remained elevated at 457,000. The Beige Book characterized labor market improvement as only modest across Districts, with several reports of temporary hiring and wage pressures described as contained on the whole. The Chicago Fed National Activity Index was slightly negative at -0.16, consistent with somewhat below-trend growth. On prices, core PCE inflation was running at 1.19% on a year-over-year basis, below the 2.0% objective; the Beige Book reported that consumer and input prices generally held steady, with only a few reports of cost increases, and the Employment Cost Index was recorded at 112.8.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as moderate rather than distressed. The financial stress index stood at 0.2277, elevated but not at crisis levels, and the VIX at 22.63 reflected some caution without signaling panic. The Baa corporate spread of 2.92 indicated contained credit stress, with borrowing costs firm but no acute widening. The Treasury yield curve remained steeply positive, with the 10-year/2-year spread at 2.41, showing no inversion and thus no imminent recession signal from the curve. At the front end, the 3-month T-bill spread against the current rate was just 0.025, essentially flat, indicating that short-term rates were anchored at the prevailing 0.0% to 0.25% target range and that markets were pricing no near-term change in policy.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the framework's forward-looking quantities, which pointed toward continued accommodation constrained by the effective lower bound. The estimated neutral rate (r^*) of 1.256, combined with core inflation running below the 2.0% objective, implied a low neutral nominal rate and suggested that the current 0.0% to 0.25% target range was already appropriately accommodative. Inflation momentum was negative at -0.115, indicating that underlying price pressures were likely to ease further rather than build in the near term, while unemployment momentum registered at zero, offering no evidence of near-term improvement in the large employment gap.

All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — returned 0 basis points, and the framework judged them reliable this meeting. The staff noted that the unconstrained prescriptions of the more gap-sensitive rules would, given both a below-target inflation reading and a wide unemployment gap, point lower than zero; their convergence at 0 basis points reflected truncation at the floor rather than a judgment that the stance was fully calibrated absent that constraint. Taken together, the projected path implied that conditions would likely warrant maintaining the current range, with easing capped by the lower bound and no inflation pressure emerging to warrant tightening over the projection horizon.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants generally agreed that the appropriate action at this meeting was to maintain the target range for the federal funds rate at 0.0% to 0.25%, and their reasoning converged from distinct starting points. The member most attentive to inflation risk observed that, despite that framing, there was simply no overheating signal to lean against: core PCE at 1.19% sat well below the 2.0% objective and momentum was negative, while the Beige Book described consumer and input prices as steady and wage pressures as contained, and the ECI at 112.8 showed no wage-driven acceleration. This member emphasized that the usual caution against easing while inflation runs above target did not bind here, since inflation was below target, and that a hike would require evidence of price pressure that the data



did not provide.

The participant most focused on the labor market weighted heavily the gap between the 9.5% unemployment rate and the 5.03% natural rate — nearly 4.5 percentage points — together with elevated jobless claims of 457,000 and a Beige Book characterization of hiring as only modest and largely temporary. This member noted that the CFNAI at -0.16 and reports of slowing activity in two Districts suggested fading rather than accelerating momentum. With rates already at the floor, this participant framed holding as the maximally supportive conventional stance available, while stressing that the committee was constrained rather than comfortable: the unconstrained prescription of the more employment-sensitive rules would be lower, and the hold reflected the binding lower bound, not a judgment that the stance was fully adequate to the size of the employment gap.

The participant attentive to financial stability judged conditions moderate rather than acute — a stress index of 0.2277, a VIX of 22.63, and a Baa spread of 2.92 all pointing to functioning credit markets without systemic strain, and a steeply positive yield curve at 2.41 showing no recession signal. From this vantage, the central risk was less the rate level than the character of the committee's accommodative posture: with credit standards tight and loan demand soft per the Beige Book, this member cautioned that any premature move toward tightening could widen spreads and choke off a fragile recovery. The participant most attentive to market signals reinforced this reading, noting that the T-bill spread of just 0.025 implied markets were pricing essentially no near-term move and that a steep curve here reflected rates pinned near zero rather than robust growth expectations.

The data-dependent participant read the indicators at face value and reached the same conclusion without leaning toward either mandate leg: below-target inflation and negative inflation momentum foreclosed any case for tightening, the large slack gap argued for accommodation, and the effective floor blocked further easing, leaving 0 basis points as the literal, consensus reading. Across the discussion, several participants acknowledged the concern that prolonged accommodation could seed future imbalances, but generally judged that current stress and spread data offered no support for that worry yet — the moderate readings on the stress index, VIX, and Baa spread showed no froth to lean against.

In discussing the framework's loss-minimizing recommendation, participants found that it aligned fully with their own reasoning. All four reference rules printed 0 basis points and were judged reliable, and participants variously found the Taylor, Balanced Approach, and ELB-adjusted rules most persuasive depending on their emphasis. Those weighting the employment gap stressed that the gap-sensitive rules were truncated at the floor, so agreement on 0 basis points masked a divergence in intent — the stance might be effectively too tight relative to the unconstrained prescription. Those weighting



inflation and financial stability read the same 0 basis point output as confirmation that the stance was appropriately calibrated given the low neutral rate implied by an r^* of 1.256 and the absence of any overheating. Both readings, however, led to the same action: with easing capped by the lower bound and hiking unjustified by soft inflation and weak labor conditions, the constrained optimum was to hold.

COMMITTEE POLICY ACTIONS

In the predictive round, all five members converged on no change to the target range, yielding a unanimous vote to maintain the federal funds rate range at 0.0% to 0.25% (5 members for 0 basis points, none for any change). On the framework's loss-minimizing recommendation of 0 basis points, the Committee was likewise in full agreement: all five members — the inflation hawk, the labor market dove, the financial stability voice, the data-dependent centrist, and the market signal realist — endorsed the recommendation as-is, with none declining and none registering only partial agreement. The predictive vote and the optimal-side outcome thus coincided fully.