



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held a total of \$2,638.6 billion in domestic securities as of the most recent release, dated July 27, 2011. The composition was concentrated in Treasury notes and bonds, which stood at \$1,544.9 billion, alongside \$18.4 billion in Treasury bills and \$897.3 billion in agency mortgage-backed securities. Total holdings declined by \$4.5 billion from the prior release of July 20, a modest week-over-week change. The Committee noted that these figures cover SOMA holdings only — total size, composition, and the change from the prior release — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available. Reinvestment of principal was understood to be continuing over the period.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that inflation remained subdued. Core PCE inflation was running at 1.22 percent on a year-over-year basis, well below the Committee's 2.0 percent objective. The Employment Cost Index stood at 115.1, and Beige Book contacts in the First District pointed to reduced commodity cost pressures relative to the prior report, though scattered upward pressures persisted on inputs such as paint, copper, plastics, and cotton. Respondents indicated they were passing along price increases where possible, and one contact reported that vendors had given notice of increases to take effect in coming months, while another noted a lessening of cost pressures.

Labor market conditions remained weak. The unemployment rate was 9.2 percent, far above the estimated 5.2 percent natural rate, and initial jobless claims stood near 398,000, still elevated. The Chicago Fed National Activity Index registered -0.46, consistent with growth running below trend. Beige Book reports described First District activity as continuing to increase but somewhat more mixed than in recent reports: retailers cited modest, varied sales increases; manufacturers noted generally good conditions with a few softer segments; and advertising and consulting firms reported strong growth and continued hiring. Headcounts across most contacts were largely unchanged or up only slightly. Commercial real estate showed slow improvement while housing markets remained, in the words of the report, in the doldrums. A recurring theme across sectors was heightened uncertainty attributed in part to the unresolved federal debt ceiling dispute and the associated unclear course of federal spending and taxes, which weighed on business outlooks even where those outlooks remained cautiously positive.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions appeared broadly accommodative and did not exhibit acute strain. The financial stress index was low at 0.111, and the Baa corporate spread over Treasuries stood at 2.74, a moderate



level that did not signal severe credit-market deterioration. The 10-year/2-year Treasury yield curve spread was strongly positive at 2.33, showing no inversion and no near-term recession signal from the term structure. The VIX, at 24.79, was elevated but not at panic levels, a reading the staff associated with the debt-ceiling uncertainty prominent in the Beige Book. The 3-month Treasury bill spread relative to the current target rate was slightly negative at -0.025, consistent with market pricing of no near-term change in policy and, if anything, a modest easing bias.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and on measures of momentum in the two mandate variables. The estimated real neutral rate (r^*) was 0.662, a low level that, combined with core inflation near 1.2 percent, implies a low neutral nominal rate and suggests that the current 0.0 to 0.25 percent target range is not deeply restrictive relative to neutral despite the large unemployment gap. Inflation momentum was estimated at 0.135 and unemployment momentum at 0.1 — both small in magnitude — indicating no dramatic deterioration or acceleration in either direction that would force an abrupt shift in the policy stance over the near term.

The reference-rule outputs reinforced this reading. The Taylor rule, Balanced Approach rule, First-Difference rule, and ELB-adjusted rule each returned 0 basis points, and the reference rules were judged reliable for this meeting. Rules weighting the unemployment gap heavily would, on an unconstrained basis, call for a lower policy rate given the roughly four-percentage-point gap between the 9.2 percent unemployment rate and the 5.2 percent natural rate; the effective lower bound truncates that prescription at zero. Taken together, these quantities point to conditions likely remaining soft but not collapsing, with the projected path of policy pinned at the floor and no near-term impetus toward either tightening or an emergency easing beyond the constraints already in place.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants uniformly saw no case for tightening at this meeting. With core PCE inflation at 1.22 percent, well below the 2.0 percent objective, the member most attentive to inflation risk observed that there was simply no elevated reading to defend against, and that the Beige Book's reports of reduced commodity cost pressures corroborated the view that recent price increases were largely transitory. This member emphasized that even under an inflation-weighted framework the data offered no justification for a hike, and that raising rates into 9.2 percent unemployment, a Chicago Fed activity index of -0.46, and jobless claims near 398,000 would be reckless given the deep slack and the downside risks flagged throughout the Beige Book.



The member most focused on the labor market underscored that the roughly four-point gap between unemployment and its 5.2 percent natural rate was the central concern, with claims still elevated near 398,000 and largely flat headcounts confirming that hiring had not accelerated. This participant noted that the environment would ordinarily call for maximum accommodation to support employment, but that the binding constraint was the target range already sitting at the 0.0 to 0.25 percent floor, leaving no conventional room to cut. Subdued inflation was seen as no barrier to accommodation, and this member stressed that a vote to hold reflected an exhausted rate tool rather than any judgment that employment risk had passed, expressing continued support for reinvestment and extended-period guidance to keep effective policy supportive of jobs.

The participant attentive to financial stability began from the stress signals rather than the mandate legs, noting the low financial stress index of 0.111, a moderate Baa spread of 2.74, and a positively sloped yield curve at 2.33 — none of which pointed to acute systemic strain. The one genuine flag from this vantage was the debt-ceiling uncertainty repeatedly cited in the Beige Book and reflected in an elevated VIX of 24.79, characterized as a fiscal rather than monetary risk that had not yet materialized into measurable credit or funding stress. This member argued that tightening amid such uncertainty would needlessly destabilize fragile confidence, and that the appropriate posture was to hold, maintain reinvestment, and preserve readiness to respond should the debt-ceiling situation translate into an actual spike in market stress.

The data-dependent member read both mandate legs as pointing the same direction — toward maximally accommodative policy — and noted that the slightly negative 3-month T-bill spread of -0.025 confirmed that markets priced no move. The market-oriented participant reached the same conclusion from pricing directly: the near-flat T-bill spread signaled expectations of no near-term change, the steep positive yield curve ruled out any recession-driven emergency easing, and low stress readings offered no basis for action in either direction. As the deliberation turned to the framework's loss-minimizing recommendation, participants noted the convergence of all four reference rules on 0 basis points and their reliability this meeting. Several found the ELB-adjusted rule most directly relevant, observing that rules weighting the unemployment gap heavily — the Taylor and Balanced Approach rules among them — would want a lower rate but were truncated at the zero floor. With the estimated neutral rate at 0.662 and both inflation momentum (0.135) and unemployment momentum (0.1) small, participants generally judged that the current stance was already the constrained optimum: rules would go lower if they could, markets accepted that conventional easing was unavailable, and no inflation reading justified a hike.



Across the rounds, no participant was moved to revise, and none advanced a mechanism to ease below the floor or a rationale to tighten above it. A couple of participants emphasized that holding steady was itself the prudent choice amid the debt-ceiling uncertainty, since deviating in either direction would surprise markets and risk destabilizing already fragile confidence. The inflation-focused member added that holding preserved optionality to move promptly should commodity effects prove non-transitory or inflation expectations become unanchored, while the labor-market member reiterated that the hold should not be read as complacency about the employment gap.

COMMITTEE POLICY ACTIONS

In the predictive round, all five members voted for no change, leaving the target range for the federal funds rate at 0.0 to 0.25 percent with continued reinvestment (tally: 5 to 0 for 0 basis points). On the deterministic optimal policy engine's recommendation of 0 basis points, the Committee was likewise unanimous: 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 partial agreement. The predictive vote and the optimal-side outcome were thus in full agreement.