



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent data on the System Open Market Account. As of the July 23, 2014 release, total SOMA domestic securities holdings stood at \$4,124.4 billion, comprising \$2,300.2 billion in Treasury notes and bonds and \$1,684.3 billion in agency mortgage-backed securities. This represented an increase of \$10.5 billion from the prior release of July 16, 2014, consistent with the ongoing, measured pace of accumulation. Members were reminded that these figures cover SOMA holdings only — total size, composition, and week-over-week change — and do not encompass the results of repurchase and reverse-repurchase operations, for which no point-in-time-safe data source currently exists; nothing in this review should be read as characterizing those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that the economy continued to expand at a moderate pace. Core PCE inflation on a twelve-month basis was 1.21 percent, well below the Committee's 2 percent objective. The unemployment rate stood at 6.1 percent, above the estimated natural rate of 5.5 percent, leaving a gap of roughly six-tenths of a percentage point. Initial claims for unemployment insurance were low at 302,000, and the Chicago Fed National Activity Index registered 0.12, both consistent with steady, near-trend growth rather than any pronounced acceleration or deterioration. The Employment Cost Index reading of 120.5 was consistent with only modest wage gains. M2 stood at \$11,351.7 billion.

The Beige Book material, drawn from the Eighth District, described economic activity as having increased modestly since the previous report. Retail activity expanded at a modest pace, with openings in the apparel, auto, and home and garden sectors partly offset by a few closures, and some establishments reported historically strong revenue during the World Cup festivities. Manufacturing and services reports of planned activity were positive on net, with firms in areas such as auto parts, medical equipment, and business and transportation services citing hiring and expansion plans, while a smaller number of firms in food, pharmaceutical, and health care lines reported planned reductions. Residential real estate conditions continued to deteriorate across the District even as commercial real estate improved, and lending at a sample of small and mid-sized banks increased slightly. Wage and employment levels grew modestly, while prices increased only slightly.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as extraordinarily accommodative and calm. The financial stress index registered 0.003, near the bottom of its range, indicating no systemic tightening pressure. The VIX stood at 11.52, a very low level that some staff read as bordering on complacency. The Baa corporate spread was compressed at 2.19, pointing to easy borrowing conditions and ample credit



availability, and the 10-year/2-year Treasury spread was comfortably positive at 1.98, showing no inversion and no recession signal from the curve. The 3-month Treasury bill yield sat about 9.5 basis points below the current target-range midpoint, consistent with market participants pricing no near-term change in the policy rate.

STAFF ECONOMIC OUTLOOK

The staff outlook pointed to a continuation of gradual, non-inflationary improvement rather than any near-term inflection. Inflation momentum was estimated at 0.1, weak enough that, combined with a twelve-month core PCE reading well under target, price pressures were projected to remain subdued in the period ahead. Unemployment momentum of -0.2 indicated a labor market that was healing — joblessness edging down toward, but not yet at, the 5.5 percent natural rate. The estimated neutral real rate (r^*) of -0.5 percent implied that a nominal target range of 0.0 to 0.25 percent remained modestly accommodative relative to neutral rather than deeply stimulative, so the current stance was projected to continue supporting the recovery without generating overheating.

The reference rules reinforced this projection. The Taylor rule, Balanced Approach rule, First-Difference rule, and ELB-adjusted rule each returned 0 basis points, an unusually clean convergence, and the rules were judged reliable in the current environment. Read together, these outputs implied that conditions were likely to evolve along the existing gradual path: inflation drifting only slowly toward target, unemployment continuing to decline, and no build-up of pressures that would call for a change in the near term. The staff noted that the more consequential policy questions would arise later, as inflation approached the objective; on the current projection, the constraints of the effective lower bound and the low neutral rate together suggested that maintaining the present range was the outcome most consistent with the anticipated trajectory.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants converged early on the view that no change in the target range was warranted, though they reached that conclusion from distinct vantage points. The member most attentive to inflation risk emphasized that core PCE at 1.21 percent was well below the 2 percent objective — an undershoot, not an overshoot. In this member's framework, being inflation-focused does not mechanically imply tightening; it means responding to the direction of inflation risk, which currently pointed down. With the Beige Book describing only 'slight' price increases and 'modest' wage growth, and with the Employment Cost Index and low jobless claims depicting a stable rather than overheating labor market, this participant saw no price pressure to lean against and no case for a hike.



The participant most focused on the labor market noted the 6.1 percent unemployment rate remained above the 5.5 percent natural rate but stressed that the gap was closing: unemployment momentum of -0.2 signaled a labor market healing rather than weakening, and claims at 302,000 confirmed stability. This member observed that the conditions that would trigger a call for easing — rising joblessness or slowing hiring — were simply absent, and, in any event, with the range already at the 0.0 to 0.25 percent floor, a further cut was not operationally feasible. Accommodation, this participant emphasized, was already being delivered through the near-zero range.

The participant attending to financial stability drew attention to the extraordinarily low stress index of 0.003, the compressed Baa spread of 2.19, and a VIX of 11.52 that suggested market calm bordering on complacency. This member's residual concern was that prolonged low spreads and low volatility could breed reach-for-yield and a build-up of imbalances. Others took the point, but this participant was clear that such risk was prospective rather than present, and that an abrupt hike into markets showing zero stress would itself be gratuitous and potentially destabilizing — counter to the mandate to avoid disrupting financial conditions. The data-dependent member weighed the indicators at face value and read both mandate sides as pointing the same way: below-target inflation removed the case for tightening, persistent slack removed any argument for premature action, and calm markets forced no defensive move. The market-signal participant added that the 3-month bill trading below the current range and a positively sloped curve at 1.98 showed market pricing already aggregated to an expectation of continuity.

When the discussion turned to the framework's optimal-policy recommendation, participants found their predictive judgments and the loss-minimizing recommendation coincided. Several noted the rare full agreement across the Taylor, Balanced Approach, First-Difference, and ELB-adjusted rules, all returning 0 basis points and judged reliable this meeting. The Taylor rule persuaded several members most directly: with inflation below target and unemployment above the natural rate, both gaps prescribed accommodation. The inflation-focused member and the labor-focused member each highlighted the estimated neutral real rate of -0.5 percent, reading it as confirmation that the 0.0 to 0.25 percent range was already appropriately accommodative relative to neutral rather than excessively so. The labor-focused member found the ELB-adjusted rule the most resonant, since it captured directly the constraint that no cheaper tool was available at the floor.

In the final round of rebuttal, no participant was moved to deviate. The financial-stability member reiterated the caution about compressed spreads and complacency but again characterized it as a future risk to monitor rather than a basis for action today. The others acknowledged the point without altering their emphasis. Participants generally judged that policy was well-calibrated to current



conditions — no inflation risk to lean against, no labor emergency demanding support, no room below the floor, and calm financial markets — and that the more consequential decisions would arrive later, as inflation approached the objective.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action at this meeting, all five members supported maintaining the federal funds target range at 0.0 to 0.25 percent, a unanimous 5-0 result. On the framework's optimal-policy recommendation of 0 basis points, the Committee was likewise in full agreement: all five members — the inflation-focused member, the labor-market-focused member, the financial-stability member, the data-dependent centrist, and the market-signal member — endorsed the recommendation as-is, with none declining and none registering only partial support. The predictive vote and the optimal-side outcome thus coincided fully in favor of holding the target range unchanged.