



## **DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS**

The System Open Market Account held \$4,225.5 billion in domestic securities as of the July 20 release, the most recent available on or before the point-in-time cutoff. The portfolio was composed of \$2,337.9 billion in Treasury notes and bonds and \$1,757.3 billion in agency mortgage-backed securities. Total holdings rose \$11.6 billion from the prior release on July 13. The staff noted that these figures describe SOMA holdings only — the size, composition, and week-over-week change of the portfolio — and do not encompass the results of repurchase and reverse repurchase operations, for which no point-in-time-safe data source is presently available.

## **STAFF REVIEW OF THE ECONOMIC SITUATION**

The staff reported that inflation continued to run below the Committee's 2 percent objective, with core PCE prices up 1.38 percent over the prior twelve months. The unemployment rate stood at 4.9 percent, essentially at the staff's estimate of the natural rate of 4.9 percent's near neighbor at 4.8 percent, and initial claims for unemployment insurance remained low at 254,000. Broader activity readings were softer: the Chicago Fed National Activity Index registered -0.51, consistent with growth somewhat below its historical trend. The Employment Cost Index stood at 126.0 and M2 was reported at \$12,807.6 billion.

The Beige Book material available for review, drawn from the Ninth District, described economic activity increasing at a moderate pace since the prior report, with growth in consumer spending, tourism, construction, real estate, manufacturing, and professional services, and with energy, mining, and agriculture rising from low levels. Employment grew modestly and wage pressure was characterized as moderate, while price pressures were described as 'modest overall.' Anecdotes pointed to genuine unevenness beneath the aggregate: a Minnesota-based retailer reported sales up 9 percent over three months and Duluth tourism was called 'strong and resilient,' even as casinos in Deadwood saw activity fall 9 percent for two consecutive months and a Rapid City dealership reported new-vehicle sales off 50 percent, tied to layoffs in nearby coal mines and oil fields. Visits to Glacier National Park were up 18 percent for the year, reportedly aided by favorable gas prices. Nonresidential building rose strongly in Minnesota and Montana but fell in the Dakotas.

## **STAFF REVIEW OF THE FINANCIAL SITUATION**

The staff characterized financial conditions as calm. The financial stress index stood at 0.123, a low reading, and the VIX at 11.77 pointed to notably subdued expected volatility. The Baa corporate spread of 2.67 was moderate and gave no indication of credit-market distress. The 10-year/2-year Treasury spread remained positive at 0.86, so the yield curve showed no inversion, though it had flattened. The



3-month T-bill was trading 6.5 basis points below the current rate, a slightly negative spread that the staff read as consistent with market expectations of steady-to-slightly-lower short rates rather than any near-term tightening.

### **STAFF ECONOMIC OUTLOOK**

Looking ahead, the staff's forward-looking inputs pointed toward a low-neutral environment. The estimated neutral real rate ( $r^*$ ) was placed at -0.5 percent, implying that the current target range of 0.25 to 0.50 percent sits closer to — and by some measures modestly above — neutral than its nominal level would suggest. Inflation momentum registered 0.0, indicating no upward pull on prices from current dynamics and no evident risk of the target being breached from above; the persistent shortfall of core PCE from 2 percent therefore looked likely to endure absent a change in conditions. Unemployment momentum at -0.1 suggested some continued easing in the jobless rate, but against a backdrop of below-trend activity signaled by the Chicago Fed index, the projected path for job creation appeared to soften rather than accelerate.

The reference-rule outputs reinforced this reading. The Taylor rule, Balanced Approach rule, First-Difference rule, and ELB-adjusted rule each pointed to -25 basis points, and the rules were judged reliable for this meeting. That unanimity across specifications reflected the combination of a durable inflation shortfall and a negative estimated neutral rate rather than any recession signal; the projection implied that, on a pure loss-minimizing basis, the current stance was somewhat tighter than fundamentals would prescribe, even as benign stress readings gave no indication of imminent disruption.

### **PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK**

In their opening assessments, all five participants independently arrived at holding the current target range of 0.25 to 0.50 percent. Participants generally judged that the data offered no case for tightening and no case for easing. On the inflation side, the shortfall of core PCE to 1.38 percent, well below the 2 percent objective, was seen as removing any rationale for a hike; one participant focused on inflation risk noted that with prices undershooting rather than overshooting, and with market-based inflation compensation having declined per the prior meeting, the usual caution against acting simply was not triggered. On the employment side, unemployment at 4.9 percent near the 4.8 percent natural rate, together with low initial claims of 254,000, was read as a labor market close to balance rather than deteriorating. A couple of participants flagged the prior minutes' observation of slowing job gains and the Chicago Fed index at -0.51 as genuine caution flags, but concluded that softer growth from a low-unemployment base is not the same as rising unemployment and did not justify a cut.



Participants attentive to financial conditions observed that the low stress index of 0.123, the VIX at 11.77, and the moderate Baa spread of 2.67 signaled calm-to-complacent markets with no distress demanding accommodation and no froth demanding restraint. The participant weighting market pricing most heavily emphasized the slightly negative 3-month T-bill spread as evidence that markets priced no hike and leaned, if anything, toward mild easing — a reading that anchored the case for patience. Across the first two rounds, no participant advanced an argument that moved any other toward a hike or a cut, and the predictive discussion converged firmly on a hold, consistent with the prior unanimous decision.

The discussion then turned to the framework's loss-minimizing recommendation of -25 basis points, and here the character of the deliberation shifted from what the Committee expected to do toward what the data, taken on its own terms, prescribed. Participants engaged seriously with the estimated neutral real rate of -0.5 percent, the flat inflation momentum, and the unanimous agreement of the four reference rules. The participant most focused on inflation acknowledged a real tension: while instinct counseled preserving optionality and avoiding a preemptive move before signals became clearer, no upside inflation risk existed to justify the current range's tightness, and the persistent 62-basis-point undershoot argued that closing the gap toward a low neutral was the sound direction. The employment-focused participant found the Balanced Approach logic most persuasive, reasoning that with inflation posing no barrier and activity softening, easing now protected jobs at low cost. The participant attentive to stability leaned on the ELB-adjusted rule, arguing that quiet markets are precisely when preemptive easing is cheapest, functioning as low-cost insurance before any stress materializes.

The centrist participant, reading the indicators at face value, judged that the durable inflation gap dominated the near-zero unemployment gap and that no single indicator argued for holding on its own merits — only institutional patience did. That framing captured a recurring theme: several participants noted that the gap between the expected hold and the framework's cut itself revealed that current policy, accommodative in name at 0.25 to 0.50 percent, was modestly tight relative to a negative neutral rate. The participant weighting market signals dissented in degree rather than direction. Endorsing the easing logic, this participant argued that the 6.5-basis-point T-bill spread implied a mild lean toward lower rates ahead, consistent with holding now and easing later if data confirmed, and that a full 25-basis-point move would overshoot what calm conditions and market pricing actually justified at this moment — agreement on direction, divergence on timing and magnitude.

By the close of the discussion, participants had reconciled their predictive caution with the framework's math without collapsing the two into one. Several emphasized that the absence of any recession signal



— a positive yield curve at 0.86, contained credit spreads, low claims — meant nothing forced an immediate move, even as the inflation shortfall and negative  $r^*$  meant policy leaned restrictive relative to fundamentals. The prevailing sense was that the easing direction was well-grounded in the data, with genuine differences remaining over whether to act now or await clearer confirmation.

### COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate policy action at this meeting, all five participants supported maintaining the target range for the federal funds rate at 0.25 to 0.50 percent; the vote was unanimous, 5 to 0. On the separate question of the framework's loss-minimizing recommendation of -25 basis points, four participants — those focused on inflation risk, on the labor market, on financial stability, and the data-dependent centrist — endorsed the recommendation as stated, agreeing on both direction and magnitude. One participant, weighting market-implied pricing most heavily, offered partial support: agreeing with the easing direction but judging that the magnitude and timing of a full 25-basis-point cut ran ahead of what current market signals and calm conditions justified. The recorded tally was thus four endorse, one partial, and none declining.