



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the composition and size of the System Open Market Account. As of the July 19 release, total domestic securities holdings stood at \$4,234.0 billion, comprising \$2,325.7 billion in Treasury notes and bonds and \$1,779.4 billion in agency mortgage-backed securities. This represented an increase of \$9.3 billion from the prior release of July 12. It was noted that this review covers SOMA holdings only — total size, composition, and the week-over-week change — and does not encompass repository or reverse-repository operation results, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity had expanded across all twelve Districts in June, with the pace of growth ranging from slight to moderate, and a majority of Districts expected modest to moderate gains in the months ahead. Consumer spending appeared to be rising in most Districts, led by nonauto retail sales and tourism, though many Districts noted some softening — particularly in auto sales, which declined in half of the Districts. Manufacturing and nonfinancial services continued to post modest to moderate gains, loan demand was steady to increasing, and construction activity was flat to expanding, with low home inventory constraining sales in many areas. The Chicago Fed National Activity Index stood at -0.26, consistent with growth somewhat below trend.

Labor markets remained tight. The unemployment rate was 4.4 percent, below the estimated natural rate of 4.74 percent, and initial jobless claims were low at 247,000. The Beige Book described employment expansion at a modest to moderate pace, though the Atlanta and St. Louis Districts noted flat employment levels, and contacts across a broad range of industries cited shortages of qualified workers that had limited hiring, especially in construction and IT. Wages grew at a modest to moderate pace, with many firms attributing gains to tighter labor conditions. Price pressures were modest: prices continued to rise modestly in most Districts, a few noted pressures had eased slightly, construction materials and freight costs rose while gasoline prices fell, and low agricultural prices weighed on some farmers. Against this backdrop, core PCE inflation was 1.16 percent on a twelve-month basis, well below the 2 percent objective and having declined recently.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as notably accommodative and calm. The financial stress index registered 0.03, near the low end of its range, and the VIX stood at 9.79, an exceptionally subdued level. Credit conditions showed no signs of strain, with the Baa corporate spread at 2.08. The term structure gave no recession signal: the 10-year/2-year Treasury spread remained positive at 0.9,



consistent with a flat but not inverted curve. The 3-month Treasury bill spread relative to the current policy rate was slightly negative at -0.075 , an indication that the front end of the market was not pricing in near-term additional tightening.

STAFF ECONOMIC OUTLOOK

The staff projection took as reference the estimated neutral real rate (r^*) of -0.5 percent, a level implying that the current target range of 1.00 to 1.25 percent sat somewhat above neutral in real terms given inflation running near 1.16 percent. Inflation momentum was estimated at -0.1 , indicating that price pressures were drifting further from the 2 percent objective rather than converging toward it, while unemployment momentum was -0.25 , a signal to be monitored for any incipient softening in labor conditions even with the unemployment rate presently below its natural rate.

Standard policy benchmarks, judged reliable under current conditions, pointed uniformly toward some easing. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each implied roughly -75 basis points, driven heavily by the sizable inflation shortfall and the low estimated neutral rate. The First-Difference rule, which adjusts incrementally from the prevailing setting rather than targeting a full level correction, implied -25 basis points. Reconciling the large inflation gap against a labor market at or beyond full employment, the loss-minimizing recommendation settled at -25 basis points — a modest easing rather than the larger move the gap-based rules would mechanically imply.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their assessment of current conditions, participants agreed that the labor market remained tight and that inflation was running persistently below the Committee's objective. All five participants entered the meeting favoring no change to the target range. The member most attentive to inflation risk observed that, although a tight labor market — unemployment at 4.4 percent against a 4.74 percent natural rate, with worker shortages limiting hiring — would normally raise the prospect of future wage-driven price pressure, the realized data pointed the other way: core PCE at 1.16 percent had declined recently, and wage and price gains in the Beige Book were characterized only as modest to moderate. This member judged the inflation risk to be currently to the downside, not the upside, and concluded that back-to-back increases so soon after the recent move to 1.00 to 1.25 percent would break the Committee's emphasis on gradual adjustments without confirming data. The preferred course was to hold, preserve the option to tighten later should wages feed through to prices, and monitor inflation closely.

The participant most focused on employment risk reached the same holding conclusion by a different route: with no deterioration in the labor market — low jobless claims, worker shortages, and only two



Districts reporting flat employment — the conditions that would trigger easing on employment grounds were absent, while soft inflation and below-trend growth as reflected in the Chicago Fed index argued against further tightening. The participant attentive to financial stability emphasized that the stress index at 0.03, the VIX at 9.79, a contained Baa spread of 2.08, and a positive 10-year/2-year spread of 0.9 left no market strain requiring a defensive move; a slightly negative bill spread further suggested that acting would surprise markets and risk disturbing benign conditions. This member noted, as a longer-run caution, that exceptionally low volatility and compressed spreads could reflect complacency, but concluded that complacency alone did not warrant tightening into weak inflation. The centrist read the data at face value — a recent hike, gradualist framing, weak inflation, and no urgency in the activity data — and the participant weighing market signals most heavily stressed that the negative front-end bill spread indicated no near-term hike was priced, with the prior projected path implying moves spaced out rather than an imminent second increase. The Committee's predictive discussion thus converged unanimously on holding.

The discussion then turned to the framework's loss-minimizing recommendation of -25 basis points, a call that diverged from every participant's predictive hold. Participants engaged with this divergence directly rather than dismissing it. Several observed that the gap between a forecast hold and an optimal cut of one increment revealed that the current stance was modestly tight relative to a low neutral rate given the inflation undershoot — not dangerously restrictive, but slightly above where the rules judged neutral to lie. There was broad agreement that the aggressive -75 basis point rules overweighted the inflation gap and gave insufficient regard to labor-market strength, and that the First-Difference rule, which adjusts incrementally in the direction conditions point, offered the more persuasive logic. The inflation-focused member endorsed -25 basis points as the disciplined, gradualist response that corrected mild over-tightness without abandoning vigilance, explicitly rejecting the larger cut. The financial-stability member added that a -75 basis point move would itself be jarring given how calm markets were and could signal alarm, whereas a measured -25 basis points preserved the low-stress environment while gently addressing the sub-target inflation.

The employment-focused participant found the easing case genuinely persuasive on its own terms, citing unemployment momentum of -0.25 and a Chicago Fed reading of -0.26 alongside Beige Book notes of softening consumer and auto sales as early signals that growth and hiring might be fading; with r^* near -0.5 and disinflation underway, this member judged that holding restrictive policy risked the employment side of the mandate, though labor was still tight enough in level terms that the full -75 basis points would overshoot. The market-signal participant tied the framework's conclusion to the negative bill spread, arguing that markets were already whispering the easing bias the -25 basis point recommendation crystallized. The centrist framed the divergence institutionally: the mechanical



optimum isolated a real inflation shortfall with negative momentum, while the predictive hold incorporated the cost of whipsawing policy one meeting after a hike absent new deterioration. On the framework's own terms, however, participants agreed the -25 basis point direction and magnitude were defensible and coherent — below-target inflation with negative momentum and a low neutral rate justified a slight easing, and the modest size respected a labor market at full employment.

COMMITTEE POLICY ACTIONS

In the predictive vote on policy for this meeting, all five participants supported maintaining the target range for the federal funds rate at 1.00 to 1.25 percent; the vote was 5 to 0 for no change. On the separate question of the framework's loss-minimizing recommendation of a 25 basis point reduction, all five participants endorsed the recommendation as stated, with none declining and none supporting the direction while dissenting on magnitude or timing — a tally of 5 endorse, 0 decline, 0 partial. Participants thus held to a predictive hold while unanimously judging the framework's measured -25 basis point easing to be the coherent, First-Difference-consistent optimum given the inflation undershoot and low neutral rate.