



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The manager reported on the composition and size of the System Open Market Account. As of the most recent release covering data through July 25, 2018, total SOMA domestic securities holdings stood at \$4,050.3 billion, comprising \$2,206.6 billion in Treasury notes and bonds and \$1,709.5 billion in agency mortgage-backed securities. Relative to the prior release covering data through July 18, holdings declined by \$12.7 billion. The Committee noted that this review reflects SOMA securities holdings only — total size, composition, and the week-over-week change — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe queryable data source currently exists; accordingly, no such figures were presented.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to continued expansion in economic activity. The Chicago Fed National Activity Index registered 0.43, consistent with above-trend growth. Labor market conditions remained firm: the unemployment rate stood at 4.0%, well below the estimated natural rate of 4.62%, and initial jobless claims were low at 207,000. Core PCE inflation on a twelve-month basis was 1.72%, modestly below the Committee's 2% objective. The Employment Cost Index reading was 132.5, and M2 money supply stood at \$14,112.4 billion.

The most recent Beige Book indicated that economic activity continued to expand across the country, with 10 of the 12 Districts reporting moderate or modest growth; the Dallas District reported strong growth driven in part by the energy sector, while growth in the St. Louis District was described as slight. Labor markets were described as tight in all Districts, with shortages of qualified workers — spanning skilled engineers, specialized construction and manufacturing workers, IT professionals, and truck drivers — cited as constraining growth in some Districts. On balance, wage increases were modest to moderate, with a couple of Districts citing a pickup in the pace of wage growth. Prices rose in all Districts at a pace that was modest to moderate on average, with upticks noted in several Districts. Key input prices, including fuel, construction materials, freight, and metals, rose further, and manufacturers in all Districts expressed concern about tariffs, which contributed to increases for metals and lumber; however, the extent of pass-through from input to consumer prices remained slight to moderate. Six Districts specifically cited trucking capacity as an issue, attributing it to a shortage of commercial drivers.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and accommodative. The financial stress index registered 0.051, a very low reading, and the VIX stood at 12.29, reflecting subdued market volatility.



Credit markets showed no signs of strain: the Baa corporate bond spread was tight at 1.88. The 10-year/2-year Treasury yield curve spread was positive at 0.28, though flattening — a development the staff flagged as worth monitoring but not yet indicative of inversion. The 3-month T-bill spread relative to the current policy rate was 0.105, consistent with market expectations of modest further tightening over coming quarters. Taken together, these measures indicated that financial conditions posed no constraint on the current policy stance in either direction.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment weighed a set of reference-rule outputs that diverged sharply. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each recommended -75 bps, while the First-Difference rule pointed to 0 bps. The staff noted that the level-based rules were driven substantially by an estimated neutral rate (r^*) of -0.5, together with core inflation running below target; a deeply negative r^* estimate mechanically pulls those rules toward easing regardless of the strength evident in real activity. The First-Difference rule, by contrast, responds to changes in conditions rather than to a contested estimate of the neutral level, and its 0 bps reading better reconciled the mixed signals.

Momentum measures reinforced this reading. Inflation momentum was slightly positive at 0.04, consistent with the Beige Book's reports of firming input prices and building tariff pass-through, while unemployment momentum was -0.15, indicating that unemployment was still falling rather than rising. The loss-minimizing recommendation from the framework landed at 0 bps, with the reference rules judged reliable. On this basis the staff projection was for conditions to remain broadly stable near the current stance — accommodative enough to support continued expansion, but with the balance of small positive inflation momentum and a tightening labor market implying limited scope for the substantial easing the level rules mechanically suggested.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants agreed that the incoming data described a strong, expanding economy with a tight labor market and inflation running modestly below the 2% objective. All members took as given that core PCE at 1.72% was near but under target, that unemployment at 4.0% sat well below the 4.62% estimated natural rate, and that financial conditions were benign. The disagreement centered not on the state of the economy but on whether those conditions called for a further 25 bps step at this meeting or for holding the target range at 1.75% to 2.00%.

Two participants favored an immediate 25 bps hike. One, weighting inflation risk most heavily, emphasized that the Beige Book showed clear upside momentum — tariff-driven increases in metals,



lumber, freight, and fuel, with a few Districts describing input price pressures as elevated or strong, and a couple citing a pickup in wage growth. This participant argued that the current range remained accommodative relative to the FOMC's own median projected path of 2.4%, that pass-through described as slight-to-moderate meant pressure was still in the pipeline, and that calm markets could readily absorb tightening. A second participant, focused on market signals, pointed to the 3-month T-bill spread of 0.105 as evidence markets expected a near-term move, and to the very low stress index, subdued VIX, and tight Baa spread as confirmation that conditions could accommodate a continued gradual step toward the projected path.

Three participants preferred to hold. The participant most attentive to the labor market found no employment softening to guard against — jobless claims at 207,000 were very low and shortages were constraining growth — and saw no case for a cut, but was also reluctant to add restriction at consecutive meetings with inflation still below target. The financial stability voice stressed that the absence of stress was a reason there was no urgency to move rather than a reason to hike, and cautioned that a further hike risked pressing on an already flattening yield curve. The data-dependent centrist framed the question as one of pace: the prior meeting had already delivered a 25 bps move to the current range, and a gradual normalization path implied spacing the moves out rather than hiking at every meeting absent a data emergency. On the predictive question, the market-pricing participant noted that the T-bill spread was consistent with tightening over coming quarters rather than necessarily at this specific meeting.

When the discussion turned to the framework's optimal recommendation, participants engaged directly with the divergence between the reference rules. Several observed that the Taylor, Balanced Approach, and ELB-adjusted rules called for -75 bps only because they leaned on an estimated r^* of -0.5, a contested and deeply negative neutral-rate figure that sat uneasily alongside a hot labor market and firming prices. Participants across mandates found the First-Difference rule's 0 bps most persuasive, on the grounds that it responds to change rather than to an uncertain level: inflation momentum was slightly positive at 0.04 and unemployment momentum was -0.15, neither pointing toward the slack that would justify substantial easing. Even the participant most concerned with inflation, who would never have supported a cut into building tariff pass-through, took the gap between the -75 bps level rules and the 0 bps loss-minimizing outcome as evidence that policy was near neutral rather than tight.

Participants generally concluded that holding at 1.75% to 2.00% left policy accommodative enough to support the expansion while restrained enough to guard against inflation, and preserved optionality in both directions — to hike should tariff and wage pressures push inflation above target, or to respond



should labor conditions later deteriorate. The financial stability voice's caution about not inverting the flattening curve with a further hike drew explicit support from other members in the rebuttal round. No participant was moved to favor easing, and the case for holding was described as confirmed by the convergence of the real-economy data, market pricing, and the framework's own recommendation.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate policy action at this meeting, the Committee's five members split three to two in favor of holding the target range at 1.75% to 2.00%, with two members favoring a 25 bps increase. On the separate question of the deterministic policy engine's 0 bps recommendation, all five members endorsed the recommendation as-is — a unanimous outcome, with no member declining and none registering partial agreement on direction or magnitude. The two documents describing this deliberation reflect the same recorded stances.