



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held a total of \$3,594.3 billion in domestic securities as of July 24, 2019, comprising \$1,939.6 billion in Treasury notes and bonds and \$1,521.5 billion in agency mortgage-backed securities. This represented a decline of \$5.5 billion from the prior release of July 17. The manager noted that this review covers SOMA securities holdings only — their total size, composition, and week-over-week change — and does not encompass the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity continued to expand at a modest pace overall from mid-May through early July, with little change from the prior reporting period. Core PCE inflation was running at 1.29 percent on a twelve-month basis, well below the Committee's 2 percent objective, and the Beige Book characterized the rate of price inflation as stable to down slightly. Districts generally saw some increases in input costs stemming from higher tariffs and rising labor costs, though firms' ability to pass these along appeared limited. The Chicago Fed National Activity Index stood at -0.02, close to trend growth. Retail goods sales rose slightly on balance while vehicle sales were flat; nonfinancial services activity rose further, tourism was broadly solid, and home sales picked up somewhat even as residential construction was flat. Manufacturing production was generally flat, agricultural output declined modestly after heavy rainfall in some areas, and oil and gas production fell somewhat. Demand for loans increased on a broad basis.

Labor market conditions remained tight. The unemployment rate was 3.7 percent, well below the estimated natural rate of 4.6 percent, and initial jobless claims were low at 216,000. The Beige Book noted that employment grew at a modest pace, slightly slower than the previous reporting period, with contacts across the country continuing to report difficulty filling open positions, especially in construction, information technology, and health care. At the same time, some manufacturing and information technology firms in the Northeast reduced their number of workers. The Employment Cost Index registered 136.2. Compensation grew at a modest-to-moderate pace similar to the prior period, though some contacts emphasized significant increases in entry-level wages and most Districts reported employers expanding benefit packages in response to tight conditions. M2 stood at \$14,770.6 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were calm and orderly. The financial stress index registered 0.048, a very low reading, and the VIX stood at 12.07, consistent with subdued market volatility rather than fear. The Baa



corporate spread was 2.23, a moderate level showing no sign of credit-market distress. The yield curve was flat but not inverted at the longer horizon, with the 10-year/2-year spread positive at 0.22. At the short end, however, the 3-month Treasury bill traded 0.355 percentage point below the current target rate, an inversion that indicated market participants were already discounting some near-term easing. The staff observed that the combination of benign stress and credit readings alongside a negative bill-to-target spread pointed to markets that were calm but nonetheless positioned for a reduction in the policy rate.

STAFF ECONOMIC OUTLOOK

The staff's outlook drew on several forward-looking quantities. The estimated neutral real rate (r^*) used in the analysis was -0.42 , implying that the current target range of 2.25 to 2.50 percent stood somewhat above the level consistent with a neutral policy stance. Both inflation momentum, at -0.065 , and unemployment momentum, at -0.1 , were modestly negative — the former suggesting prices were drifting a touch further from target rather than back toward it, the latter a mild indication of change in labor-market dynamics rather than acute deterioration. The reference rules diverged in magnitude but agreed in direction: the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to a 75 basis point reduction, driven principally by the inflation shortfall and the low neutral-rate estimate, while the First-Difference rule indicated a 25 basis point reduction.

Reconciling these inputs, the deterministic policy engine — with reference rules judged reliable — arrived at a loss-minimizing recommendation of a 25 basis point reduction. The gap between the level-based rules' call for 75 basis points and the recommended 25 reflected the tension between a meaningful inflation shortfall and a still-tight labor market against a backdrop of calm financial conditions. The projection implied by these figures was one of continued modest expansion in which policy, though modestly restrictive relative to the low neutral-rate estimate, would be brought closer to neutral by an incremental step rather than a large recalibration, leaving room to respond should inflation momentum or labor-market dynamics weaken further.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants converged on the view that a modest reduction in the target range was warranted, though they arrived there from distinctly different starting points. The member most attentive to inflation risk noted that core PCE at 1.29 percent was well below the 2 percent objective rather than above it, and that the Beige Book's characterization of price inflation as stable to down slightly, together with negative inflation momentum, deprived the usual case for holding tight of its footing. This participant's principal reservation was the tightness of the labor market — unemployment at 3.7 percent against a 4.6 percent natural rate, worker shortages, and rising input



costs from tariffs — which represented latent upside pressure and argued firmly against anything larger than a 25 basis point move. This participant acknowledged a personal preference to hold, but judged that persistent below-target inflation and the modest growth reading made a single insurance cut acceptable rather than grounds to dissent.

The participant most focused on employment risk emphasized that, while the labor market remained tight in level terms, the Beige Book flagged employment growth that was slightly slower than the prior period and pointed to some Northeast manufacturing and information technology firms reducing workers — an early softening at the margin. With inflation soft and imposing no constraint, this participant saw a precautionary 25 basis point cut as the right size to support employment against trade-related and global-growth downside risks, while low jobless claims and the absence of acute stress ruled out a more aggressive move. The participant attentive to financial stability read the picture as one of calm rather than distress — a stress index of 0.048, a VIX of 12.07, and a contained Baa spread — but stressed that the 3-month bill trading 0.355 below the current rate indicated markets had already discounted easing, and that failing to deliver risked an abrupt, destabilizing repricing of financial conditions. This participant was equally clear that a 75 basis point move could itself signal alarm and disturb orderly credit conditions.

The centrist participant, weighing both mandates at face value, described an imbalance in which the labor mandate looked satisfied while the inflation mandate was clearly falling short, and judged that this asymmetry tilted the literal reading of the data toward some accommodation. The participant most attentive to market pricing regarded the negative bill-to-target spread as the strongest single signal, one that discounted roughly one 25 basis point cut rather than several, and viewed the barely positive 10-year/2-year spread of 0.22 as a recession-risk warning favoring modest accommodation. All members observed that prior guidance had signaled a readiness to act as appropriate to sustain the expansion, and that one earlier dissent had favored a cut.

When the discussion turned to the framework's loss-minimizing recommendation, participants engaged directly with the divergence between the level-based rules calling for 75 basis points and the 25 basis point outcome. Several found the First-Difference logic most persuasive, reasoning that incremental adjustment from the current stance was more appropriate than a full reset to a new level given the still-strong labor market, the low neutral-rate estimate, and calm financial conditions. The inflation-focused member framed the divergence as judgment tempering mechanics — the -75 rules were directionally correct on inflation but too large given labor tightness and one-time trade effects, and overcutting risked unanchoring expectations upward should tariff costs feed through later. The employment-focused member found the Balanced Approach direction most congenial to a



dual-mandate weighting but agreed that a full 75 basis points would overreact when unemployment remained historically low and no crisis was evident, preferring a measured first move with room to do more. The stability- and market-oriented members both emphasized that market pricing did not corroborate a 75 basis point move and that gradualism protected orderly conditions.

In the concluding exchange, no participant was moved toward either a larger reduction or a hold. Participants generally judged that the current range was only modestly restrictive relative to the low neutral-rate estimate, that the inflation shortfall and near-flat yield curve justified insurance against downside risk, and that calm stress readings ruled out the shock of a larger move. A couple of participants underscored that a 25 basis point step preserved ammunition and validated the prior easing bias without overcommitting to a path markets were not demanding.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action, all five members supported a 25 basis point reduction, lowering the target range from 2.25 to 2.50 percent to 2.00 to 2.25 percent; the vote was unanimous, {-25: 5}. On the framework's loss-minimizing recommendation of a 25 basis point cut, the Committee was likewise in full agreement: all five members — the inflation-focused member, the employment-focused member, the financial-stability member, the centrist, and the market-signal member — endorsed the recommendation as-is, with none declining and none registering only partial agreement (endorse 5, decline 0, partial 0).