



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account continued to expand over the intermeeting period. As of the most recent release on 2020-07-22, total SOMA domestic securities holdings stood at \$6,203.5 billion, an increase of \$34.7 billion from the prior release on 2020-07-15. The composition remained weighted toward Treasury notes and bonds, which accounted for \$3,620.9 billion of the total, alongside \$326.0 billion in Treasury bills and \$1,961.4 billion in agency mortgage-backed securities. It should be noted that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change. They do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is available at this time; the staff therefore confined this review to the securities holdings that can be documented from the published account data.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to an economy still operating far below its pre-pandemic level despite the onset of a partial recovery. The unemployment rate stood at 11.1 percent, well above the estimated natural rate of 4.42 percent, and initial jobless claims remained elevated at 1,300,000 per week, indicating that layoffs were continuing even as some workers were recalled. Core PCE inflation was running at 0.56 percent on a year-over-year basis, far beneath the Committee's 2 percent objective. The Chicago Fed National Activity Index registered 4.11 and the Employment Cost Index was reported at 140.0. M2 money supply stood at \$18,357.3 billion, an elevated level relative to recent history.

The Beige Book reported that economic activity increased in almost all Districts but remained well below where it stood prior to the pandemic. Consumer spending picked up as many nonessential businesses reopened, with retail sales rising in all Districts, led by a rebound in vehicle sales and continued strength in food and beverage and home improvement. Leisure and hospitality spending improved but stayed far below year-ago levels, and manufacturing moved up from a very low base. Employment increased on net in nearly all Districts, but payrolls everywhere remained well below pre-pandemic levels, job turnover stayed high, and contacts across Districts reported new layoffs as well as difficulty bringing workers back. Prices were little changed overall, with input and selling prices largely flat and only scattered increases tied to supply-chain challenges for health and safety equipment. Loan demand was flat outside of some Paycheck Protection Program activity and residential mortgages, and contacts characterized their outlooks as highly uncertain given questions about the duration of the pandemic.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions had continued to normalize from earlier crisis levels. The financial stress index registered 0.159, a comparatively low reading consistent with relatively calm markets rather than acute dislocation. The VIX stood at 24.32, elevated relative to tranquil periods but well below the peaks seen earlier in the year. The Baa corporate bond spread was 2.63 percentage points, reflecting moderate but not extreme credit-cost stress, while the 3-month T-bill spread against the current policy rate was essentially nil at 0.005, indicating stable short-term funding markets and intact policy transmission. The 10-year/2-year Treasury spread was positive at 0.46, showing no acute recession-signaling inversion. Taken together, these measures pointed to conditions that had eased considerably while still bearing the imprint of the ongoing shock.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the momentum measures available this period. With the estimated neutral rate (r^*) at -0.206 percent, the current target range of 0.0 to 0.25 percent already places policy at or below neutral in real terms, implying that the present stance is accommodative relative to the estimated resting point of the economy. Inflation momentum was estimated at -0.435, consistent with continued disinflationary drift rather than building price pressure, suggesting that upward movement toward the 2 percent objective is unlikely to materialize quickly. Unemployment momentum registered 5.6, a reading that points to persistent and substantial labor-market slack even as reopening supports some rehiring.

The reference-rule outputs reinforced this picture and were judged reliable this period. The Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule each returned 0 basis points. The convergence of the unconstrained rules with the ELB-adjusted rule reflects the binding effect of the effective lower bound: absent the floor, the weak inflation and enormous employment gap would call for deeply negative rates, but with the range already near zero the constrained-optimal path is to hold. The staff projection thus implied that conditions would likely remain characterized by wide slack and subdued inflation over the near term, with the policy rate expected to stay at its current setting absent a material change in the outlook.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants approached current conditions from their several vantage points but arrived at a common reading. Those most attentive to inflation risk observed that the usual trigger for resistance to accommodation was simply absent: core PCE at 0.56 percent was deeply below the 2 percent objective, and the Beige Book confirmed that prices were little changed, with input and selling prices largely flat and only isolated pressure on health and safety equipment. With disinflation rather than overheating evident, participants of this orientation saw no case for a hike, and noted that hiking would



in any event be gratuitous against 11.1 percent unemployment and depressed demand. One participant flagged the elevated level of M2, at \$18,357.3 billion, as a matter to watch for potential inflation implications down the road, while emphasizing that no action was warranted on that basis now.

Participants focused on the labor market described the situation in stark terms. The gap between the 11.1 percent unemployment rate and the 4.42 percent natural rate was characterized as catastrophic, and initial claims still running at 1,300,000 weekly were read as evidence that layoffs were ongoing despite reopening. The Beige Book's reports of new layoffs across all Districts and payrolls well below pre-pandemic levels everywhere reinforced this concern. A participant of this view stated a willingness to cut aggressively were conventional room available, but acknowledged that with the range already at 0.0 to 0.25 percent, the only space below was negative territory, which the Committee has avoided. This participant judged that a negative-rate move could destabilize money-market and short-term funding channels — an outcome that would ultimately harm the very workers of greatest concern — and concluded that holding at the floor was itself the maximally supportive rate choice.

Participants attentive to financial stability read the data as showing conditions that had eased substantially from crisis peaks. The financial stress index at 0.159 signaled relative calm, the VIX at 24.32 was elevated but far from panic levels, and the Baa spread of 2.63 pointed to moderate rather than blown-out credit stress. The near-zero T-bill spread and the positively sloped yield curve were cited as evidence that funding markets were stable and transmission intact. A participant of this orientation stressed that the prevailing calm was itself in part a product of the current stance, so that changing it risked destabilizing it, and observed that with highly uncertain outlooks described in the Beige Book, steadiness would itself be stabilizing. The participant emphasizing market signals concurred, noting that the 3-month T-bill spread of 0.005 indicated markets had fully absorbed a hold and that no market pricing pointed to a need for further action.

As the discussion turned to the optimal-policy framework, participants found their predictive judgments confirmed. Several highlighted the estimated neutral rate of -0.206 percent as showing that the current range already sits near or below neutral, and pointed to inflation momentum of -0.435 and unemployment momentum of 5.6 as evidence of disinflation alongside deep, persistent slack. Participants generally judged the ELB-adjusted rule the most persuasive of the reference rules, since it explicitly accounts for the binding floor and still recommends 0 basis points; a couple of participants noted that the Taylor and Balanced Approach rules would call for deeply negative rates were the floor not in place, so that the market pricing and the ELB logic together confirmed the constraint. The centrist participant characterized the unanimity of all four rules at 0 basis points as an unusually clean signal, judged reliable this period, and observed that the data offered no argument on either mandate



side to move.

Across both the predictive and the framework rounds, no participant reported being moved from an initial position, and each described the others' reasoning as reinforcing rather than challenging their own. Participants emphasized continuity with the prior dovish stance and agreed that, with inflation absent, rates at the floor, and no acute dislocation demanding emergency action, holding was the loss-minimizing course. Several noted that with conventional rate policy exhausted at the lower bound, any additional support to employment and credit flows would need to come through channels other than the policy rate.

COMMITTEE POLICY ACTIONS

In the predictive round, all five participants supported maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous vote of 5 to 0 for no change. When the Committee turned to the deterministic optimal policy engine's recommendation of 0 basis points — a recommendation echoed by the Taylor, Balanced Approach, First-Difference, and ELB-adjusted reference rules — all five members endorsed the recommendation as-is, with none declining and none registering only partial agreement. The predictive vote and the optimal-side outcome were thus in full agreement: the Committee unanimously judged holding the target range at 0.0 to 0.25 percent to be the appropriate and loss-minimizing course.