



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$7,611.5 billion as of the July 21 release, the most recent report available as of the point-in-time-safe cutoff. Holdings were composed of \$4,490.2 billion in Treasury notes and bonds, \$326.0 billion in Treasury bills, and \$2,412.4 billion in agency mortgage-backed securities. The portfolio rose by \$41.1 billion from the prior release of July 14, a continued expansion in line with recent weekly changes. It should be noted that this review covers SOMA holdings only — total size, composition, and the week-over-week change — and does not cover repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed data indicating that economic activity had continued to expand at a moderate pace. Core PCE inflation stood at 2.75 percent on a twelve-month basis, running well above the Committee's 2 percent longer-run objective. The unemployment rate was 5.9 percent, still substantially above the estimated natural rate of 4.46 percent, and initial jobless claims at 360,000 remained elevated relative to pre-pandemic norms, signaling that the labor-market recovery, while under way, was incomplete. The Chicago Fed National Activity Index at 0.29 was consistent with somewhat above-trend growth, and the Employment Cost Index reading of 143.7 was in keeping with the wage firming described in the anecdotal reports. M2 stood at \$20,370.1 billion, an elevated level reflecting abundant liquidity in the financial system.

Reports gathered from business contacts across Districts described broadly similar conditions. Activity expanded at a moderate pace, labor markets improved, and wage pressures picked up for some positions while several nonlabor costs remained elevated. Retail sales rose, and leisure, hospitality, and tourism activity strengthened; residential real estate demand stayed strong and commercial real estate conditions improved. A recurring theme was that supply and labor shortages were restraining the ability of firms to meet customer demand, with several Districts noting that these constraints were more widespread than in the prior report. On prices, contacts reported that inflation pressures remained elevated, though with varying degrees of pass-through to customers. One District noted that prices 'rose strongly' even as wages rose more moderately, and another reported that outlooks stayed positive though uncertainty had increased.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as accommodative and orderly. The financial stress index at 0.0903 was very low, and the VIX at 17.91 was subdued, indicating little market anxiety. Credit markets



showed no sign of distress: the Baa corporate spread of 1.98 was historically tight, consistent with ready access to borrowing. The 10-year/2-year Treasury spread of 1.08 was positively sloped, offering no recession signal from the curve, and the 3-month T-bill spread of -0.075 relative to the current rate pointed to no near-term tightening priced into the front end of the market and, if anything, a slight easing bias. Taken together, the signals described calm conditions with abundant liquidity and no funding-market dislocation to lean against.

STAFF ECONOMIC OUTLOOK

The staff's outlook drew on the forward-looking quantities embedded in the reference framework. The estimated neutral real rate (r^*) was -0.252, a deeply negative reading implying that even a modest nominal firming would leave the policy stance accommodative relative to neutral. Inflation momentum was positive at 0.515, suggesting that price pressures were building rather than dissipating, while unemployment momentum at -0.2 indicated that joblessness was continuing to fall, albeit from a level still well above the estimated natural rate. On this basis, the staff projected that inflation was likely to remain above target in the near term and that labor-market slack would continue to narrow, though the pace of that narrowing was clouded by the supply and labor constraints described in the anecdotal reports.

The reference rules diverged in their prescriptions, reflecting the tension between an inflation overshoot and residual employment slack. The Taylor rule prescribed 75 basis points, responding strongly to the inflation gap; the First-Difference rule prescribed 50 basis points, adjusting incrementally from the current stance; and both the Balanced Approach and ELB-adjusted rules prescribed 0 basis points, weighting the unemployment gap more heavily. The framework's loss-minimizing recommendation was 50 basis points, with the reference rules judged reliable. The staff noted that the deeply negative and uncertain r^* estimate weakened the reliability of level-based rules relative to difference-based ones, and that the projected path implied a gradual removal of accommodation would be consistent with the data if inflation pressures proved persistent rather than transitory.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants converged on the view that the target range should be held at 0.0 to 0.25 percent at this meeting, though the reasoning that led them there differed by lens and the balance of risks was read in more than one way. The participant most focused on inflation risk emphasized that core PCE at 2.75 percent stood well above the 2 percent target and that the Beige Book documented broad-based wage acceleration, persistent labor shortages, and robust selling-price increases across nearly every District, developments that cast genuine doubt on the



'transitory' characterization. Even so, this participant judged an immediate move premature, observing that unemployment at 5.9 percent remained far above the 4.46 percent natural rate and that a lone firming would contradict the Committee's standing commitment to accommodation while the employment goal remained unmet.

The participant weighting employment most heavily argued that roughly 1.4 points of remaining slack and still-elevated jobless claims of 360,000 made the labor recovery the binding constraint, and that wage pressures reflected supply and labor shortages rather than demand-driven overheating. With the range already at its effective floor, this participant noted that further easing was neither feasible nor warranted given inflation above target. The participant attentive to financial stability reported that every stress signal was benign — stress index at 0.0903, VIX at 17.91, Baa spread at 1.98, a positively sloped curve — and concluded there was no dislocation to lean against and no offsetting stability benefit to a surprise move into calm markets. The data-dependent participant read the dual mandate literally: inflation exceeded target but the employment goal was unmet and prior guidance had committed to allowing inflation moderately above 2 percent for some time. The participant focused on market signals stressed that the negative front-end bill spread showed markets pricing no July move despite full visibility into the same inflation data, which he took as evidence that the transitory framing and labor slack had already been aggregated into expectations.

When participants turned to the framework's loss-minimizing recommendation of 50 basis points, the discussion sharpened considerably and the apparent unanimity of the predictive stance gave way to real disagreement. The inflation-focused participant endorsed the recommendation, finding the convergence of the Taylor rule at 75 and the First-Difference rule at 50 persuasive, and reading the gap between the current stance and the recommended 50 basis points as a measure of accumulating inflation risk — with a negative r^* meaning even 50 basis points would leave policy accommodative. He argued that supply constraints, not weak demand, restrained output, so that continued accommodation would only fuel prices, and that waiting to confirm transitoriness risked entrenching pressures.

Two participants agreed with the direction of firming but not the full magnitude. The financial-stability participant accepted that benign credit conditions could absorb a 50 basis point move, but found the market-signal participant's point decisive in the other direction: with no tightening priced into the front end, a 50 basis point step would be a surprise, and surprise into calm markets was precisely the stability harm he was tasked to weigh. He therefore favored a smaller, more incremental step consistent with First-Difference gradualism. The data-dependent participant likewise judged the rule signals genuinely divided — two of four rules prescribing zero — and concluded that the labor gap and prior guidance



argued for tightening by less than the full 50 basis points, endorsing the direction while resisting the magnitude.

Two participants declined the recommendation outright. The employment-focused participant maintained that the rules aligned with his mandate — the Balanced Approach and ELB-adjusted rules — both printed zero, and that even the gradualism of the First-Difference rule would front-run a recovery he judged incomplete; a 50 basis point step, he warned, risked choking hiring before the slack gap closed, with particular harm to vulnerable groups. The market-signal participant, weighting market pricing above rule math, held that he could not endorse a move markets rejected, and made clear this was not merely a question of magnitude — the front-end easing bias contradicted even a smaller step. Several participants acknowledged that inflation would warrant eventual normalization, but the persistence of slack, the calm of financial conditions, and the Committee's prior guidance left the balance, for now, on the side of patience.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy decision for this meeting, all five participants supported holding the target range for the federal funds rate at 0.0 to 0.25 percent; the tally was unanimous, 5 to 0. On the separate question of the reference framework's loss-minimizing recommendation of 50 basis points, the Committee did not reach agreement. One participant, focused on inflation risk, endorsed the recommendation as-is. Two participants — the one attentive to financial stability and the data-dependent participant — took a partial position, agreeing with the direction of firming but not its full magnitude or timing. Two participants — the one focused on the labor market and the one weighting market signals — declined the recommendation. The final recorded stance on the framework's recommendation was therefore one endorse, two partial, and two decline.