



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Manager reported on developments in the System Open Market Account. As of the July 20 release, total SOMA domestic securities holdings stood at \$8,369.8 billion, comprising \$4,909.9 billion in Treasury notes and bonds, \$326.0 billion in Treasury bills, and \$2,717.5 billion in agency mortgage-backed securities. This represented an increase of \$5.8 billion from the prior release of July 13. It was noted that this account covers SOMA domestic securities holdings only — total size, composition, and week-over-week change — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists; the discussion was accordingly limited to the holdings data available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators bearing on current economic conditions. Core PCE inflation stood at 3.85 percent on a twelve-month basis, well above the Committee's 2 percent objective. The labor market remained tight: the unemployment rate was 3.6 percent, below the estimated natural rate of 4.44 percent, and initial jobless claims were 244,000, a level consistent with moderate rather than sharp labor-market deterioration. The Chicago Fed National Activity Index registered 0.01, indicating growth roughly at trend. The Employment Cost Index reading was 150.1, and M2 money supply was reported at \$21,754.2 billion. The Committee's most recent median projected fed funds rate was 3.4 percent, well above the current target range of 1.5 to 1.75 percent.

The Beige Book indicated that economic activity had expanded at a modest pace, on balance, since mid-May, though several Districts reported growing signs of a slowdown in demand and contacts in five Districts noted concerns over an increased risk of recession. Most Districts reported that consumer spending moderated as higher food and gas prices diminished households' discretionary income. Housing demand weakened noticeably amid affordability concerns, contributing to non-seasonal declines in sales, a slight rise in inventory, and more moderate price appreciation; commercial real estate conditions slowed as well. Manufacturing activity was mixed, with supply chain disruptions and labor shortages continuing to hamper production. On labor, most Districts continued to report employment rising at a modest to moderate pace and conditions remaining tight overall, but nearly all Districts noted modest improvements in labor availability amid weaker demand for workers, particularly among manufacturing and construction contacts. Wage growth continued to be reported broadly, and the outlook for future growth was described as mostly negative, with contacts expecting further weakening of demand over the next six to twelve months.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff reviewed financial conditions. The financial stress index stood at 0.2443, a moderate reading that did not signal acute systemic stress. The VIX was 23.88, elevated relative to calm periods but below levels associated with market panic. The Baa corporate bond spread was 2.26, modestly wide but not at distressed levels, suggesting borrowing costs had firmed without a credit crunch. The 10-year/2-year Treasury yield spread was inverted at -0.21, a signal historically associated with rising recession risk. The 3-month T-bill spread relative to the current policy rate was 0.835, consistent with market pricing of roughly 75 to 85 basis points of near-term tightening. On balance, conditions had tightened but remained orderly, with no acute credit dislocation evident in the data.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available. The estimated neutral rate (r^*) was -0.5, implying that the current target range of 1.5 to 1.75 percent was already meaningfully into restrictive territory in real terms and that additional increments would push policy further toward restraint at a faster pace than the headline inflation level alone might suggest. Inflation momentum was negative at -0.405, indicating that price pressures, while elevated in level, were decelerating in trend. Unemployment momentum was -0.1, consistent with a labor market that remained tight but was cooling at the margin, corroborated by improving labor availability reported across nearly all Districts and by the trend-level activity reading.

The reference rules were judged reliable for this meeting and split evenly on the appropriate increment: the Taylor rule and the First-Difference rule each prescribed 75 basis points, weighting the still-large inflation gap heavily, while the Balanced Approach rule and the ELB-adjusted rule each prescribed 25 basis points, giving more weight to the low neutral rate and the decelerating inflation momentum. The loss-minimizing recommendation from the framework was 25 basis points. Taken together, these quantities pointed to a projected path in which policy continues to move toward restraint, but at a more measured pace as cumulative tightening accumulates, inflation momentum turns, and the inverted yield curve signals building growth risk over the projection horizon.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, participants generally judged that inflation remained the dominant near-term concern, with core PCE at 3.85 percent running near double the 2 percent objective and the labor market still tight at 3.6 percent unemployment, below the estimated natural rate. Four of the five participants favored a 75 basis point increase in the target range. The member most focused on inflation risk emphasized that the prior meeting had delivered 75 basis points and signaled ongoing increases as appropriate, that the Committee's own last median projection of 3.4 percent sat well above the current range, and that moderate financial stress and



elevated-but-not-crisis volatility suggested the system could absorb another large step. The member attentive to market signals stressed that the 3-month T-bill spread of 0.835 implied roughly 75 to 85 basis points was already priced in, making a move of that size the least disruptive choice. The member focused on financial stability reached the same increment, noting that the stress index, VIX, and Baa spread pointed to firmer but orderly conditions, while cautioning against anything larger given the inverted curve and recession concerns in five Districts. The data-dependent participant read the indicators at face value as supporting the established aggressive pace.

One participant, weighting employment risk most heavily, dissented from the majority pace and favored a 50 basis point increase. This member acknowledged that current labor data offered no basis for a cut or pause — unemployment below the natural rate, moderate claims, and activity near trend — but placed considerable weight on forward-looking warnings: the inverted yield curve, the negative growth outlook in the Beige Book, weakening housing demand, moderating consumer spending, and improving labor availability amid softer worker demand. In this view, a 75 basis point move risked overtightening into a visibly slowing economy and threatening employment down the road, while a 50 basis point step would still act firmly on inflation. In rebuttal, the majority did not shift; participants favoring 75 basis points reiterated that the slowdown signals were early and not yet reflected in the hard labor or activity data, and that front-running priced expectations was not itself a reason to move more slowly. The employment-focused member likewise held to 50, characterizing the position as a minority view against a 75 basis point consensus that nonetheless reflected the accumulating slowdown signals.

When participants turned to the framework's loss-minimizing recommendation of 25 basis points, the discussion converged more fully. Several participants observed that the recommendation, while diverging from their predictive votes, was well grounded in the forward-looking data. The negative estimated neutral rate of -0.5 implied that the current range was already meaningfully restrictive, so that even modest hikes push policy toward restraint faster than the headline inflation level suggests. Negative inflation momentum of -0.405 indicated that price pressures, though high in level, were decelerating, reducing the case for another supersized step. The even split among reliable reference rules — Taylor and First-Difference at 75, Balanced Approach and ELB-adjusted at 25 — was read as capturing the tension between the still-large inflation gap and the turning trend.

The inflation-focused member found the Balanced Approach logic most persuasive on this reading, explaining that the predictive vote leaned on the inflation level while the framework read the turning trend, and emphasizing that 25 basis points remained a hike rather than a cut — a direction that member would not reverse while core PCE stood near 3.85 percent. The employment-focused



participant judged that the gap between the 75 basis point forecast and the 25 basis point optimal call itself revealed a stance close to sufficiently restrictive, with the symmetric treatment of the employment gap in the Balanced Approach rule matching that member's read of cooling labor demand. The financial-stability member pointed to the credit channel already transmitting prior hikes — weakening residential loan demand, slowing commercial real estate — and to the Baa spread and VIX as reasons a smaller step would preserve fragile-but-orderly conditions. The market-signal member noted that the 3-month spread of 0.835 was consistent with roughly one more modest step rather than another jumbo move, and that the Taylor and First-Difference prescriptions underweighted the inverted curve's forward warning. The data-dependent participant found the literal reading and the framework already pointing the same way. Across the rebuttal round, no participant was moved toward the larger increment, and all emphasized that direction remained tighter while pace should downshift as restrictiveness accumulated.

Participants generally agreed that they stood ready to move more forcefully again should inflation momentum reverse, but that the balance of decelerating momentum, a low neutral rate, an inverted yield curve, and mounting recession signals in the Beige Book argued for a measured step at this meeting rather than a maximal one.

COMMITTEE POLICY ACTIONS

In the predictive vote on the size of the increase in the target range, the Committee recorded a tally of four members in favor of 75 basis points and one member in favor of 50 basis points, with the majority citing still-elevated inflation, a tight labor market, prior-meeting momentum, and market pricing, and the dissenting member emphasizing employment risk from overtightening into a slowing economy. On the framework's loss-minimizing recommendation of a 25 basis point increase — moving the target range from 1.5 to 1.75 percent toward 1.75 to 2.00 percent — the Committee reached full agreement: all five members endorsed the recommendation as-is, with none declining and none registering only partial support. Members grounded that endorsement in the negative estimated neutral rate, decelerating inflation momentum, the inverted yield curve, and the even split of reliable reference rules, while noting that a 25 basis point step preserved the tightening direction without front-loading overshoot risk.