



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account holdings of domestic securities totaled \$7,515.5 billion as of the July 19 release, the most recent available on or before the point-in-time-safe cutoff. Within that total, Treasury notes and bonds accounted for \$4,326.5 billion, Treasury bills for \$263.6 billion, and agency mortgage-backed securities for \$2,529.7 billion. The portfolio declined by \$20.6 billion from the prior release of July 12, a continuation of the gradual reduction in holdings. Staff noted that this review covers SOMA securities holdings only — total size, composition, and the week-over-week change — and does not incorporate the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to an economy still expanding but at a subdued pace. The Chicago Fed National Activity Index stood at -0.15, consistent with growth running slightly below trend. The Beige Book characterized overall activity as having increased slightly since late May, with five Districts reporting slight or modest growth, five noting no change, and two reporting slight or modest declines. Consumer spending reports were mixed: growth was generally observed in consumer services, and tourism and travel activity was robust, but some retailers noted a shift away from discretionary spending. Manufacturing edged up in half the Districts and declined in the others, transportation activity was down or flat in most Districts reporting on it, and construction was slightly lower on balance. Banking conditions were mostly subdued, with lending activity continuing to soften.

On the labor side, the unemployment rate was 3.6%, below the estimated natural rate of 4.42%, and initial jobless claims stood at 237,000, a moderate level showing no sign of deterioration. The Beige Book reported that employment increased modestly, with labor demand still healthy though hiring described as more targeted and selective; several Districts noted that labor availability had improved and that turnover was returning toward pre-pandemic norms. Wages continued to rise but more moderately, with contacts in multiple Districts reporting increases returning to or nearing pre-pandemic levels. On prices, core PCE inflation was 3.88% on a twelve-month basis, still well above the 2% objective, while the Beige Book described prices as increasing at a modest pace overall, with several Districts noting some slowing in the pace of increase. The Employment Cost Index reading was 157.4 and M2 stood at \$20,805.5 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions remained calm and accommodative by most measures the staff reviewed. The financial stress index was low at 0.189 and the VIX was subdued at 13.76, indicating little market anxiety.



The Baa corporate spread of 1.89 was moderate and showed no sign of acute credit distress, though it was consistent with borrowing costs that had risen over the tightening cycle. The 10-year/2-year Treasury yield curve spread was deeply inverted at -0.99, a configuration often read as signaling elevated recession risk further ahead. At the front end, the 3-month T-bill spread relative to the current policy rate was +0.125, indicating that short-term markets were pricing rates slightly above the current 5.00–5.25% target range. Taken together, the data described markets that were orderly and not under strain, even as the yield curve pointed to expectations of a more restrictive path and eventual easing.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the real quantities available in the policy framework. The estimated neutral rate (r^*) used in the analysis was -0.5, a notably low figure whose uncertainty bears heavily on any read of how restrictive current policy is. Inflation momentum was slightly negative at -0.145, consistent with disinflation being underway but far from complete, while unemployment momentum was modestly positive at 0.05, suggesting only a faint loosening in labor conditions against a level still well below the natural rate. Together these momentum readings pointed to conditions cooling gradually rather than turning sharply in either direction.

The reference rules spanned a wide range, which the staff took as a measure of the genuine uncertainty in the current setting rather than a clear directional signal. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 bps, driven largely by the low r^* estimate and the level of the inflation gap. The First-Difference rule, which responds to the change in conditions and the inflation gap rather than to an assumed neutral rate, pointed the other way to +75 bps. The framework's loss-minimizing recommendation settled at +25 bps, a moderate step between these extremes, with the reference rules flagged as reliable. The projection implied by these inputs is one in which inflation continues to ease slowly, the labor market softens only marginally, and policy remains near the restrictive end of estimates — with the spread among the rules underscoring that the appropriate degree of restraint hinges on a neutral-rate estimate that is far from settled.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants generally agreed that core PCE inflation at 3.88%, nearly double the 2% objective, remained the central problem and that little sustained easing was yet evident. Several observed that the labor market showed no distress: unemployment at 3.6% was well below the 4.42% natural rate, jobless claims at 237,000 were moderate, and the Beige Book described continued modest job growth with labor demand still healthy. A number of participants read the combination of elevated inflation and a still-tight labor market as arguing for keeping policy restrictive, noting that the prior meeting had paused at 5.00–5.25% while remaining highly attentive to inflation



risks, and that the Committee's own last median projection of 5.6% sat above the current range, implying more firming had been anticipated.

Four participants favored a 25 basis point increase in their predictive positions. One participant weighting inflation risk most heavily argued that holding steady with core PCE near 4% risked stalling progress toward target, and judged that calm financial conditions — a stress index of 0.189, a VIX of 13.76, and a Baa spread of 1.89 — meant a modest hike could be absorbed without destabilization. A participant focused on financial stability reached the same conclusion by a different route, checking first for stress signals and finding none acute, while flagging the Beige Book's note of subdued banking conditions and softening lending, together with the inverted yield curve, as reasons to keep any move measured rather than large. A participant emphasizing the literal, consensus reading of the data pointed to the gap between inflation and the current rate and to moderating wages and slowing price increases as arguments for a single gradual step rather than a larger one. A participant attentive to market pricing stressed that the +0.125 front-end T-bill spread implied markets already leaned toward one more hike, and that the deeply inverted 2s10s curve told a two-part story — a firming now, easing later — that was fully consistent with a final restrictive step.

One participant, whose priority was labor market health, favored holding the range steady. This participant emphasized that the data showed no employment deterioration and therefore gave no basis for a cut, but was also cautious about pushing policy more restrictive into a slowing, inversion-signaling economy, citing the -0.99 curve, subdued banking conditions, softening lending, and below-trend activity in the Chicago Fed index at -0.15 as building downside risks to future employment. This participant judged that adding restriction now raised the odds of the very labor-market damage most to be avoided, while conceding that moderating wages and slowing prices did not force a hike either; holding was seen as the position most consistent with protecting employment while inflation cooled.

In the subsequent discussion of the framework's loss-minimizing recommendation of +25 bps, participants engaged directly with the wide spread among the reference rules. Several noted that the Taylor, Balanced Approach, and ELB-adjusted rules all pointed to -75 bps but rested heavily on an estimated r^* of -0.5, and expressed distrust of easing signals resting on so uncertain a neutral-rate assumption while inflation remained near 4%. The participant most focused on employment found these easing rules tempting on their own terms but ultimately unpersuasive for the same reason, reasoning that a premature cut into a still-tight labor market risked re-anchoring inflation expectations upward and inviting a harder landing later — and thus that a measured firming better protected jobs over time. Participants generally judged the First-Difference rule's +75 bps closer to the right logic in



responding to change and momentum rather than to a contested neutral rate, but agreed that inflation momentum of -0.145 argued for a measured step rather than an aggressive one. The framework's $+25$ bps was widely seen as splitting the extremes in a way that hedged the genuine r^* uncertainty and avoided a destabilizing lurch in either direction.

Participants returned repeatedly to the financial-conditions backdrop as the reason a modest move was low-risk. The calm readings on stress and volatility, the contained Baa spread, and the positive front-end T-bill spread were together read as evidence that a 25 basis point step was already partly discounted and would impose little marginal strain on credit conditions. At the same time, the participant attentive to stability cautioned against going beyond 25 basis points given soft lending and the inverted curve, while others emphasized that the absence of acute stress removed any case for restraint driven by financial fragility. On balance, participants converged on the view that the current 5.00 – 5.25% range was not yet sufficiently restrictive against sticky core inflation, and that a single measured firming to a range one quarter point higher was the appropriate step.

COMMITTEE POLICY ACTIONS

In the predictive round, the Committee's recorded vote was 4 to 1 in favor of a 25 basis point increase, moving the target range one quarter point higher; the one dissenting position favored holding the range unchanged at 5.00 – 5.25% out of concern for downside risks to future employment. On the separate question of the optimal-policy framework's recommendation of a 25 basis point increase, all five members endorsed the recommendation as-is, with none declining and none registering only partial agreement — a full 5-0 endorsement. The Committee noted that this convergence, reached from distinct analytical starting points, reflected shared judgment that elevated core inflation and a still-tight labor market warranted one further measured firming step, taken while financial conditions remained calm enough to absorb it.