



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available for this meeting, and the Committee therefore had no current figures on the total size, composition, or change from the prior release of the SOMA portfolio before it. Members were reminded that this limitation pertains to SOMA holdings only; it does not extend to repurchase and reverse repurchase operation results, for which no point-in-time-safe data source currently exists either. In the absence of these inputs, the desk's operational review was necessarily confined to the broader market and financial-conditions data described in the sections that follow.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity continued to expand through the summer. Core PCE inflation stood at 2.19 percent on a year-over-year basis, modestly above the 2.0 percent objective. The unemployment rate was 6.1 percent, still above the estimated natural rate of 5.43 percent, while initial jobless claims at 326,000 were characterized as moderate rather than pointing to any deterioration in hiring. The Chicago Fed National Activity Index at 0.12 placed overall activity close to trend. M2 stood at \$3,597.2 billion.

The most recent Beige Book described expansion continuing in most Districts, with regions that had been lagging generally said to be doing better while several of the stronger areas saw growth plateau. Consumer spending was described as healthy but decelerating, and retailers' expectations for holiday sales were generally favorable. Most manufacturers reported at least moderate strength, and summer tourism outpaced last year. Single-family home sales were seen slowing modestly, with home construction easing in some areas, even as commercial real estate conditions were described as improved. There were more reports of tightening labor markets than before, though wage pressures were still described as modest. Industrial materials prices edged up further, but businesses reported that competitive pressures continued to restrain price increases on finished goods. Higher interest rates were reported to be slowing real estate lending in most areas.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly calm. The financial stress index stood at 0.0738, a low reading indicating no visible systemic strain, and the VIX at 14.45 pointed to subdued equity-market volatility. The Baa corporate spread of 1.51 was moderate, consistent with contained borrowing costs and no evident credit stress. The Treasury yield curve remained positively sloped, with a 10-year/2-year spread of 1.09 and no sign of inversion. The 3-month Treasury bill traded 13 basis points below the current 4.75 percent funds rate, a configuration the staff read as markets not pricing an imminent,



aggressive tightening step. Taken together, these readings described accommodating conditions absorbing prior policy adjustments without dislocation.

STAFF ECONOMIC OUTLOOK

The staff's projection took as its reference an estimated neutral real rate (r^*) of roughly 1.417 percent. With the nominal funds rate at 4.75 percent and inflation near 2.2 percent, the implied real funds rate sits somewhat above this neutral estimate, suggesting the current stance is mildly restrictive. Inflation momentum was modestly positive at 0.025, and unemployment momentum was negative at -0.15, indicating that joblessness was falling rather than rising even as prices edged higher. On these momentum measures alone, conditions did not point toward an abrupt shift in either direction over the near term.

The reference rules gave a wide dispersion. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 basis points, driven principally by the unemployment gap against the estimated natural rate together with inflation only modestly above target. The First-Difference rule, which responds to the change in conditions rather than to level gaps against an uncertain r^* , pointed to 0 basis points. The deterministic policy engine, treating the reference rules as reliable, returned a recommendation of 0 basis points. The projection thus implies a path in which prior restraint is allowed to continue working through rate-sensitive sectors such as real estate lending, with the level-based rules serving as a caution that the current stance may already be closer to restrictive than the momentum measures alone would suggest.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, participants divided across a fairly narrow range. Two participants opened at a larger firming step. The participant weighting inflation risk most heavily pointed to core PCE at 2.19 percent above target, tightening labor markets, and rising industrial materials prices as evidence that pressure could build if restraint were relaxed prematurely, while noting that low financial stress and a subdued VIX left no market fragility to block a hike. The participant most attentive to financial stability likewise leaned to a larger firming step, judging that calm credit markets could absorb a measured firming, though this participant's own reasoning conceded that prior guidance had implied a pause and that a large move risked disrupting stable conditions. Two participants opened at +25 basis points, and one participant, focused on the labor market, favored holding, emphasizing that unemployment at 6.1 percent remained meaningfully above the 5.43 percent natural rate, that wage pressures were still described as modest, and that consumer spending and home sales were decelerating.



The rebuttal round produced notable convergence. Both participants who had opened at the larger firming step revised down to +25, persuaded chiefly by two points raised by the participants attentive to market signals: the 3-month bill trading below the funds rate indicated markets were not pricing an imminent hike, so a larger move would be a sharp surprise to calm markets, and the prior statement's language that tightening was 'expected to be sufficient, at least for a time' argued against a large step. The inflation-focused participant held to firming in direction while accepting that magnitude should be smaller. The labor-focused participant was unmoved, judging that a modest overshoot of target did not justify tightening into persistent slack and incomplete labor-market recovery. The data-dependent participant characterized +25 as the literal balance the majority and the data supported, reading the larger-hike case as overweighting a modest overshoot and the hold case as underweighting above-target inflation and high resource utilization.

When the deliberation turned to the framework's optimal recommendation of 0 basis points, the discussion shifted from how much to firm toward whether any move was warranted at all. Participants across viewpoints found the First-Difference rule the most persuasive of the reference rules, on the grounds that it responds to the small observed momentum in inflation and unemployment rather than to level gaps against an uncertain r^* estimate of 1.417. Several participants expressed discomfort with the -75 basis point signal from the Taylor, Balanced Approach, and ELB-adjusted rules, viewing a deep cut as reckless given continued expansion in the Beige Book, positive inflation momentum, and unemployment that was actually falling. The participant focused on financial stability stressed that cutting into already-loose credit could refuel rate-sensitive real estate lending, and that a real funds rate of roughly 2.5 percent against neutral near 1.4 percent left policy only mildly restrictive, which several judged appropriate with inflation above 2 percent.

The labor-focused participant observed that the negative unemployment momentum removed the strongest trigger for advocating cuts, so that holding neither added restraint that would threaten jobs nor eased prematurely into a firming labor market. The market-signal participant emphasized that the negative bill spread and flat-but-positive curve embedded the pause the prior statement had hinted at, so the burden of proof for moving was unmet by the pricing signals they weighted most. The inflation-focused participant agreed on the direction of no easing but continued to lean slightly firmer than a flat hold, preferring one more increment as insurance against building pressure. In the end participants generally judged that the genuine debate was between holding and a small nudge upward, with no support for the level rules' call for aggressive cuts and a general reading that the current stance sits close to neutral-to-mildly-restrictive.

COMMITTEE POLICY ACTIONS



On the predictive question of the likely policy action at the upcoming meeting, the Committee's vote was 4 in favor of a 25 basis point increase and 1 in favor of no change, the dissenting preference coming from the participant most focused on labor-market slack. On the separate question of the framework's optimal recommendation of 0 basis points, four of the five members endorsed the recommendation as-is: the labor-market participant, the financial-stability participant, the data-dependent participant, and the market-signal participant. One member, the participant weighting inflation risk most heavily, registered a partial position, agreeing with the direction of no easing but preferring a small firming step over a flat hold. No member declined the recommendation.