



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data was available from the New York Fed's public source on or before the point-in-time-safe cutoff for this meeting. As a result, the Committee is unable to report total SOMA size, its composition across securities types, or any change from a prior release. This absence pertains specifically to SOMA holdings; it should be noted separately that no point-in-time-safe data source currently exists for the results of repurchase or reverse repurchase operations, which are likewise not reported here. The staff will incorporate holdings and operations detail as reliable point-in-time data becomes available.

STAFF REVIEW OF THE ECONOMIC SITUATION

Economic activity expanded through July and August in all twelve Federal Reserve Districts, according to the most recent Beige Book. About half the Districts reported that their region's overall pace picked up over the two months, while the remainder described continued moderate growth. Retail results ranged from 'mixed' to growing at a 'solid clip,' with strong back-to-school, apparel, and tourism sales cited in most Districts. Manufacturers reported generally rising orders and revenues, with durables manufacturing described as especially strong. Residential and commercial real estate markets were mostly improving, though the level of new construction varied widely across regions. The Chicago Fed National Activity Index stood at 0.63, consistent with above-trend growth.

Labor markets were characterized as tight across most Districts, with recruiting difficulties and growing labor shortages widely reported. The unemployment rate was 4.9 percent, below the estimated natural rate of 5.23 percent, and initial jobless claims stood at 317,000, a level the staff read as moderate with no sign of deterioration. Notably, two-thirds of Districts reported that these supply-demand imbalances were not translating into generally higher wages, though wages were said to be rising faster in selected industries, occupations, or localities; several Districts noted firms using creative recruiting or compensation techniques to hold down wage pressure. On the price side, with a few exceptions, goods prices were reported to be 'moving very little, if at all,' at both the manufacturing and retail levels. Core PCE inflation was 1.62 percent on a twelve-month basis, below the 2.0 percent objective. M2 stood at \$3,965.5 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly benign. The financial stress index was low at 0.1122, and the Baa corporate spread was narrow at 1.54, indicating no evident credit-market distress. The 10-year/2-year Treasury spread was positive at 0.3, showing no yield-curve inversion or recession signal, though its flatness was consistent with a modestly restrictive policy stance. The VIX was 22, a moderate level of



implied volatility—elevated but well short of crisis territory. The 3-month Treasury bill traded 0.61 percentage point below the current 5.5 percent funds rate, a spread the staff read as market pricing that embeds no imminent hike and, if anything, a modest expectation of easing ahead.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff point to a policy setting that is mildly restrictive relative to underlying conditions. With the estimated neutral real rate (r^*) at 3.027 percent and core PCE inflation near 1.6 percent, the current 5.5 percent nominal funds rate implies a real rate well above neutral. Inflation momentum was slightly negative at -0.09 and unemployment momentum at -0.05 , both suggesting a gradual drift toward softer price pressure and marginally firmer employment rather than any buildup of overheating. Taken together, these readings imply that, absent a change in stance, conditions would continue to reflect an above-neutral real rate against a backdrop of below-target inflation.

The reference rules, judged reliable at this meeting, spanned a meaningful range: the Taylor rule prescribed -50 basis points, the First-Difference rule -25 basis points, and both the Balanced Approach and ELB-adjusted rules $+25$ basis points. The dispersion reflects the genuine tension in the data—the Taylor prescription leaning heavily on the inflation shortfall, the Balanced Approach and ELB variants weighting the tight labor market and sub-natural unemployment. The deterministic loss-minimizing recommendation resolved to -25 basis points, aligning with the First-Difference rule, which adjusts from the current stance in response to the negative momentum on both mandates rather than resetting to a level. This projection is offered as an analytical benchmark for the likely direction of appropriate policy and does not represent participants' judgments.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening positions, all five participants arrived at the same predictive read: hold the funds rate at 5.5 percent. The reasoning converged from distinct lenses. The participant most focused on inflation risk noted that core PCE at 1.62 percent sat below target and that goods prices were barely moving, but emphasized that unemployment at 4.9 percent, below the 5.23 percent natural rate, together with the Beige Book's account of tight labor markets and growing shortages, described a classic setup for building wage and price pressure. That member judged a hike defensible in principle but concluded that muted realized wage and price data argued for patience—preferring to hold while keeping a tightening bias in reserve, to be deployed if wage acceleration emerged.

The employment-focused participant reasoned from the absence of any labor deterioration: unemployment below the natural rate, moderate initial claims at 317,000, and no slowing in job growth



removed the case for a cut, while contained wages and below-target inflation removed the urgency to tighten. The financial-stability participant pointed to the low stress index of 0.1122, the narrow Baa spread of 1.54, a positive (if flat) yield curve, and a VIX of 22, arguing that a surprise hike could needlessly disrupt calm conditions while no stress signal justified easing. The data-dependent participant framed the balance as symmetric—neither side of the mandate flashing—and the market-signal participant observed that the -0.61 Treasury bill spread showed markets pricing no hike, so that a hold was consistent with efficient market expectations. The Round 2 rebuttals produced no movement; each participant reaffirmed the hold, and the final predictive vote was unanimous.

The optimal-framework rounds, conducted after the predictive vote was final, opened a more substantive divergence. Confronted with the deterministic recommendation of -25 basis points, participants examined the reference-rule split and the real-rate arithmetic. A recurring observation was that a 5.5 percent nominal rate against roughly 1.6 percent core inflation implied a real rate near 3.9 percent, well above the 3.027 percent neutral estimate—genuinely restrictive relative to an economy where inflation was undershooting and both momentum readings were negative. Several participants found the First-Difference rule most persuasive precisely because it adjusts gradually from the current stance in response to that softening momentum, rather than resetting to a level as the Taylor rule's more aggressive -50 prescription would.

Participants generally discounted both extremes of the rule range. The Taylor rule's -50 was seen as overweighting the inflation gap while ignoring the tight-labor upside risk, and as potentially destabilizing to a market pricing only modest easing. The Balanced Approach and ELB rules' $+25$ were discounted in the opposite direction: tightening into low stress and below-target inflation, with wage pass-through absent per the Beige Book, was judged to needlessly stiffen conditions. The employment-focused participant framed a 25-basis-point cut as insurance—relieving excess restrictiveness while preserving room before any labor softening appeared—and the financial-stability participant emphasized that benign spreads meant such a cut could proceed without a stability penalty. The market-signal participant read the -0.61 bill spread as the front end quietly pricing accommodation, with -25 matching that lean without overshooting neutral.

The inflation-focused participant remained the dissenting voice on magnitude. That member conceded that contained, decelerating inflation and an above-neutral real rate made a measured single step defensible in direction, but continued to warn that sub-natural unemployment was exactly the condition under which latent wage pressure could later ignite. With CFNAI at 0.63 and Districts still expanding, that participant viewed a cut as premature absent visible labor softening—framing the reservation as one about pace, not direction. The others noted that the dove's own caution about



cutting into a tight labor market reinforced vigilance, but concluded that the absence of realized wage pass-through left ample room for a modest, cautious easing.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy decision for this meeting, the Committee voted unanimously to hold the federal funds rate at 5.5 percent, 5 to 0. On the separate optimal-side question of whether to support the framework's -25 basis point recommendation, four participants endorsed the recommendation as-is—the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist—while one participant, the inflation hawk, took a partial position, agreeing with the direction of a modest cut but not fully endorsing its adoption at this meeting given the still-tight labor market. No participant declined the recommendation outright.