



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available on or before the cutoff for this meeting. As a result, the Committee could not review the total size, composition, or change from the prior release of SOMA holdings, and this section reflects that gap rather than any judgment about the portfolio itself. It should be noted that this discussion pertains to SOMA holdings only; results of temporary open market operations, including repurchase and reverse repurchase transactions, are not covered here, as no point-in-time-safe data source for those operation results currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that economic activity continued to expand at a moderate pace, though with clearer signs of deceleration than in prior months. The most recent Beige Book, prepared before September 11, characterized activity across the twelve Districts as expanding moderately in August and early September; most Districts described conditions as strong and several judged growth to be solid, with Richmond noting a pickup from earlier in the summer. In contrast, Atlanta, Chicago, St. Louis, and Minneapolis reported that the overall pace of growth had softened. Consumer spending was flat to modestly higher in most Districts, with several noting stronger sales in early September. Manufacturing generally grew on pace despite the temporary shutdown of a few automobile assembly plants tied to a shortage of tires. Home sales and construction continued to soften, while commercial real estate activity was robust in several Districts, and overall loan demand remained strong as firmer business borrowing offset weak mortgage activity.

Labor markets remained tight in most Districts, though Boston and Kansas City reported some easing. The unemployment rate stood at 4.1 percent, roughly a full percentage point below the 5.1 percent estimated natural rate, and initial jobless claims were 288,000. Reports of wage increases were widespread, and some firms described higher labor costs as an increasing problem; even so, there were few indications that higher wages were being passed through to consumers, as productivity gains and competitive pressures held prices in check. Several Districts cautioned that sharp increases in health care and energy costs might eventually reach consumers. On the price side, core PCE inflation was 1.36 percent on a twelve-month basis, below the 2.0 percent objective. The Chicago Fed National Activity Index registered 0.36, and M2 stood at \$4,828.1 billion, together consistent with ongoing, if moderating, expansion.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as broadly contained but showing pockets of caution. The federal funds rate stood at 6.5 percent, and the three-month Treasury bill traded roughly 0.5 percentage point below that level, suggesting market participants anticipated no further tightening and possibly some easing ahead. The 10-year/2-year Treasury spread was inverted at -0.26 percentage point, a configuration the staff flagged as a recognized recession-risk signal. The Baa corporate spread over Treasuries was 2.52 percentage points, indicating moderate credit caution rather than acute distress. The financial stress index registered 0.2394 and the VIX stood at 21.88 — elevated relative to calm periods but well short of crisis levels. Taken together, these readings pointed to a market that judged the current policy stance as restrictive, with volatility and credit spreads contained but not negligible.

STAFF ECONOMIC OUTLOOK

The staff projection framework pointed to conditions that were modestly cooling from an already restrictive starting point. The neutral real rate used in the framework was estimated at approximately 3.79 percent; against a nominal funds rate of 6.5 percent and inflation below target, this implied that the current stance was mildly restrictive. Inflation momentum was estimated at -0.125, indicating that price pressures were easing rather than building, while unemployment momentum was a slight +0.05, a marginal upward drift consistent with the early-slowing signals seen in several Districts and in the inverted yield curve.

The reference rules diverged sharply, a dispersion the staff read as characteristic of a genuinely balanced juncture rather than one calling clearly for action in either direction. The Taylor rule prescribed no change, reflecting inflation near objective offset against firm activity. The Balanced Approach and ELB-adjusted rules each pointed to +75 basis points, driven largely by the wide employment gap between the 4.1 percent unemployment rate and the 5.1 percent natural-rate estimate. The First-Difference rule, by contrast, prescribed -25 basis points, responding to the negative inflation momentum and the gentle upward drift in unemployment. Judging the reference rules reliable, the loss-minimizing output settled on -25 basis points, giving weight to the turning momentum and the softening evident across credit-sensitive sectors over the level-based gap that drove the tightening rules.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants independently arrived at holding the funds rate at 6.5 percent, though their reasoning drew on distinct emphases. The member most attentive to inflation risk noted that core PCE at 1.36 percent ruled out an immediate hike, but stressed that tight labor markets, widespread wage increases, and potential pass-through from energy and health care costs



kept upside price risk live; from that vantage a cut would be premature and could reignite pressures, while the already-restrictive 6.5 percent stance appropriately leaned against those risks. The member focused on employment likewise favored holding but leaned dovish, observing that unemployment well below the natural rate and no clear jump in claims meant there was as yet no urgent job-loss signal to justify easing, even as the inverted curve and softening in four Districts warranted watchfulness.

The financial-stability and market-signal members reinforced this convergence from their own perspectives. The former weighed the 10-year/2-year inversion and the sub-funds-rate T-bill heavily as recession-risk signals that ruled out further tightening, while judging that moderate Baa spreads, a contained stress index, and a non-crisis VIX offered no acute event to justify a preemptive cut. The market-signal member emphasized that while short-end pricing implied a stable-to-lower path, the modest -0.26 curve inversion and -0.5 T-bill spread signaled a softer path over coming quarters rather than an emergency ease now, so cutting would front-run signals the market itself had not fully committed to. The data-dependent centrist read the whole picture as balanced — contained inflation, tight labor, some slowing — with no indicator demanding a change. In the rebuttal round, no participant was moved off a hold; the predictive vote stood unanimous at no change.

The discussion took on a different character when participants turned to the framework's loss-minimizing recommendation of -25 basis points. Here genuine differences in weighting emerged. The employment-focused member found the First-Difference rule's logic most persuasive, arguing that it responded to the change in conditions — negative inflation momentum and the slight upward drift in unemployment — rather than to a possibly stale gap level, and that a small cut would insure against labor-market deterioration before it accelerated. The financial-stability member reached the same conclusion by a different route, treating a modest cut as prudent risk management against an inversion-driven downturn given below-target inflation and cooling in housing, construction, and mortgage activity.

The market-signal member and the centrist also endorsed the -25 basis point call. The former held that T-bill pricing 50 basis points below the funds rate and the inverted curve together said 6.5 percent was modestly too tight for the inflation reality, and that the tightening rules ignored the curve entirely. The centrist emphasized that the divergence between the predictive hold and the optimal recommendation was only a single 25 basis point increment — evidence that current policy was modestly, but only marginally, restrictive relative to optimal — and judged the First-Difference logic the analytically cleaner fit for the momentum data, with the +75 rules overstated because they leaned on a gap level while inflation stayed contained and its momentum negative.



The member weighting inflation risk most heavily declined to endorse the framework's cut. This participant accepted that policy might be mildly restrictive and that the wide rule dispersion, from -25 to +75, signaled a balanced moment, but maintained that mild restrictiveness was appropriate while upside inflation risks remained live. Core PCE below target was described as a lagging level rather than the forward risk of central concern; with unemployment a full point below the natural rate sustaining wage-cost pressure, and Beige Book warnings that energy and health care costs might eventually reach consumers, easing before those pass-through risks visibly receded was judged imprudent. That firm activity — a Chicago Fed index of 0.36 and 'moderate' expansion — and only moderate credit stress reinforced the view that no cut was yet warranted, with easing a future rather than immediate step.

COMMITTEE POLICY ACTIONS

On the near-term policy decision, the Committee's predictive vote was unanimous to hold the federal funds rate at 6.5 percent, with all five participants concurring (5-0). On the separate question of the framework's loss-minimizing recommendation of a 25 basis point reduction, the Committee was divided: four members endorsed the recommendation as-is — the members weighting employment risk, financial stability, market signals, and the data-dependent centrist — while the member weighting inflation risk most heavily declined to support it, judging that live upside inflation risks had not yet receded enough to justify easing. There were no partial endorsements.