



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings were available on or before the cutoff for this meeting. As a result, the Committee is unable to report the total size of SOMA holdings, their composition across securities, or any change from the prior release. This limitation applies specifically to the SOMA holdings series; it does not reflect any judgment about open market operations themselves. It should be noted that these observations pertain to SOMA holdings only and do not cover the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized economic activity as expanding at a moderate pace, with an accumulating set of signals pointing toward some slowing. Core PCE inflation stood at 1.5 percent on a year-over-year basis, below the 2.0 percent objective. The unemployment rate was 3.9 percent, well beneath the estimated natural rate of 5.1 percent, indicating a labor market that remained quite tight. Initial jobless claims were 331,000, a level that had not yet turned sharply higher. The Chicago Fed National Activity Index registered -0.36, consistent with growth running somewhat below trend. M2 stood at \$4,871.4 billion. The federal funds rate was 6.5 percent.

The most recent Beige Book, prepared at the Federal Reserve Bank of Atlanta on information collected before October 23, described regional economies as growing at a moderate pace during September and early October, but with 'additional signs of slowing growth in some areas.' Several Districts reported that the pace of activity had eased, while a smaller number reported solid expansion. Retail sales had generally slowed from earlier in the year, with growth described as modest. Residential housing sales and construction continued to slow in most of the country. Manufacturing was generally steady, though some reports noted problems from labor shortages, higher fuel prices, and import competition. Labor markets remained stretched, with some Districts indicating increasing wage pressures, and reports noted higher petroleum-based input costs. Importantly, strong competition among producers continued to prevent most firms from passing much of those cost increases on to customers.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions presented a mixed but broadly cautionary picture. The financial stress index stood at 0.2526, a moderate reading that was contained rather than acute. The VIX was 25.66, indicating elevated volatility and some investor nervousness, though short of crisis levels. The Baa corporate spread was 2.48, pointing to real if moderate credit-cost pressure for lower-rated borrowers. The 10-year/2-year Treasury yield curve spread was inverted at -0.12, a configuration the staff flagged as a



recession-risk signal. The 3-month Treasury bill yielded 0.28 percentage point below the current federal funds rate of 6.5 percent, an alignment consistent with market expectations that the next move in policy would be toward easing rather than tightening.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the estimated neutral rate and the momentum measures available. With the real neutral rate (r^*) estimated near 3.83 and core inflation at 1.5 percent, the implied neutral nominal rate lay well below the current 6.5 percent funds rate, indicating that the prevailing stance was materially restrictive. Inflation momentum was negative at -0.19, suggesting that price pressures were decelerating rather than building, while unemployment momentum was 0.0, implying no further tightening of the labor market from its already low level. Taken together, these figures pointed toward conditions in which restraint could gradually be reduced without an inflation flare-up.

The reference rules spanned a wide range, reflecting the tension between low, falling inflation and a very tight labor market. The Taylor rule prescribed no change, the First-Difference rule prescribed a 25 basis point reduction, and both the Balanced Approach and ELB-adjusted rules prescribed a 75 basis point increase, driven largely by the sizable gap between the 3.9 percent unemployment rate and the 5.1 percent natural rate. The rules were assessed as reliable in the current environment. Weighing the negative inflation momentum and below-trend activity against the stale character of the unemployment-gap signal, the loss-minimizing recommendation of the framework was a 25 basis point reduction, implying a modest unwinding of restriction if the projected path materialized.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive round, all five participants independently arrived at a preference to hold the federal funds rate at 6.5 percent. The participant most attentive to inflation risk emphasized that, although core PCE at 1.5 percent sat below target and thus offered no case for a hike, the very tight labor market and the Beige Book's notes on stretched labor conditions and rising wage pressures argued against any easing. This participant judged that firms' inability to pass through higher fuel and input costs was capping realized inflation for now, leaving a hold as the appropriate way to maintain restraint while the slowdown was assessed. The participant focused on employment agreed on holding but framed it differently: with unemployment at 3.9 percent and claims at 331,000 not yet spiking, there was no present labor-market deterioration to justify a preemptive cut, even as slowing-growth indicators warranted close watching.

The participants oriented toward financial stability and market signals brought the forward-looking indicators to the fore. The inverted 10-year/2-year spread, the negative T-bill spread, an elevated VIX



near 25.66, and the below-trend Chicago Fed index at -0.36 were all cited as genuine signals of softening and of markets pricing eventual easing. Yet both judged that stress remained contained rather than acute — the stress index at 0.2526 and the Baa spread at 2.48 did not, in their view, describe a credit emergency — and both cautioned that a cut this meeting could itself be a destabilizing surprise relative to what markets had priced. The data-dependent participant summarized the shared read: the data were mixed, with no inflation breakout and no labor collapse, and the most literal consensus was to hold and monitor. In the rebuttal round no participant was moved off that position; the convergence was reinforced rather than revised.

When the discussion turned to the framework's loss-minimizing recommendation of a 25 basis point reduction, the participants engaged directly with the divergence between that recommendation and their own predictive hold. Several worked through the reference-rule spread explicitly. The Balanced Approach and ELB-adjusted rules, prescribing a 75 basis point increase, were seen to rest almost entirely on the wide unemployment gap, which participants judged to be a stale signal given that unemployment momentum was 0.0 and, critically, that the tight labor market had not produced actual price acceleration. The First-Difference rule's call for a 25 basis point cut, by contrast, was found most persuasive by several participants precisely because it responded to the direction of travel — negative inflation momentum at -0.19 and below-trend activity — rather than to a static level gap.

The inflation-focused participant offered a notable reconciliation, observing that the upside inflation threat normally guarded against was simply absent, with core PCE half a point below target and falling. On that reasoning a 25 basis point cut would not violate an inflation mandate, since it would leave the funds rate at 6.25 percent, with real rates still well above the estimated r^* of 3.83 — restrictive, not reckless. The employment-focused participant emphasized that cutting now would front-run the risk that the inversion and any rise in claims translate into actual job losses. The financial-stability and market-signal participants converged on the view that current policy at 6.5 percent had become too tight relative to where forward markets and the neutral rate implied it should sit, and that a modest cut would relieve building credit pressure before it became instability. The centrist framed the same conclusion as the literal consensus of disinflation, slowing activity, and yield-curve inversion supporting a modest easing over standing pat.

Across both the rebuttal and the optimal-framework rounds, participants stressed that the recommended action was modest and proportionate — a single 25 basis point step consistent with slowing but not crisis conditions — and that it would leave policy restrictive relative to a neutral nominal rate participants placed near 5.3 to 5.8 percent. The tension that ran through the discussion was between the predictive judgment that the Committee would hold this meeting and the analytic



judgment that current policy had drifted modestly too restrictive; participants generally characterized the gap between the two as the measure of how much restraint the receding inflation risk no longer required.

COMMITTEE POLICY ACTIONS

In the predictive round, the Committee's members unanimously favored maintaining the federal funds rate at 6.5 percent, a tally of 5 to hold with no votes for a change in either direction. On the separate question of the framework's loss-minimizing recommendation of a 25 basis point reduction, the Committee was likewise unanimous: all five members endorsed the recommendation as-is, with none declining and none registering only partial agreement. The record thus shows a predictive expectation to hold this meeting alongside full agreement that a modest easing represented the analytically appropriate direction, reflecting the members' shared reading that receding inflation risk and below-trend activity had left the current stance modestly more restrictive than warranted.