



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data was available on or before the point-in-time-safe cutoff for this meeting. As a result, the Committee is unable to report the total size of the portfolio, its composition across security types, or any change relative to a prior release. It should be emphasized that this section pertains to SOMA holdings only; it does not encompass the results of temporary repurchase or reverse repurchase operations, for which no point-in-time-safe data source is currently available. Members were advised that the absence of these figures reflects a data limitation rather than any judgment about the conduct of open market operations, and the desk's activities are therefore not characterized here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that the economy was running well below trend. The Chicago Fed National Activity Index stood at -1.12, a level consistent with meaningfully subdued growth. Initial jobless claims were elevated at 453,000, pointing to softening in the labor market, though the unemployment rate at 4.9% remained modestly below the estimated natural rate of 5.08%. Core PCE inflation was 1.41% on a twelve-month basis, below the 2.0% reference point, and the Employment Cost Index reading of 86.4 was consistent with contained compensation pressures. M2 stood at \$5,285 billion. The Beige Book, prepared at the Federal Reserve Bank of Chicago from information collected before September 10, described overall activity as 'sluggish' in August and early September, with several Districts suggesting activity 'slowed further.'

The staff noted several details from the Beige Book that reinforced this picture. Consumer spending was generally flat to down, with over half the Districts reporting retail sales flat to lower, even as back-to-school buying gave some regions a lift. Residential real estate was characterized as 'brisk,' 'strong,' or 'steady' in most reports, supported by low mortgage rates, while demand for commercial space softened further. Manufacturing activity remained weak on a broad basis across nearly all regions. Labor markets were described as relatively soft, with a few Districts reporting further easing; upward wage pressure was subdued, though some contacts flagged rising health insurance premiums. Price pressures were again restrained nearly everywhere, and input cost pressures were said to be easing. The staff stressed that because the survey reflected conditions prior to the September attacks, it did not capture any subsequent shock to demand or confidence.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as strained. The VIX stood at 35.81, indicative of acute market volatility and fear, and the financial stress index was elevated at 0.1971. The Baa corporate bond



spread of 3.48 percentage points over Treasuries pointed to meaningful credit-market strain and higher borrowing costs for firms, a reading consistent with the Beige Book's account of lenders tightening standards on some commercial loans and flat-to-down business loan demand. The 10-year/2-year Treasury spread of 1.84 percentage points described a steep curve. Notably, the 3-month Treasury bill yielded roughly 0.65 percentage point below the current 3.0% federal funds rate, a configuration the staff read as the market having already priced in substantial near-term easing.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the available momentum measures. With r^* estimated at 3.877%, the level-based reference rules — the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule — each pointed to a funds rate on the order of 75 basis points above neutral, reflecting an output gap still read as positive and an unemployment rate near its natural level. Those rules are anchored on current gap and equilibrium estimates and are, by construction, slow to register a fresh downturn. Inflation momentum was essentially flat at -0.03 and unemployment momentum was 0.0, so the staff projection did not embed an accelerating deterioration in the realized series through the reference period, even as the activity indicators suggested weakening ahead.

By contrast, the First-Difference rule, which responds to the direction of change rather than to level gaps, recommended -25 basis points. The deterministic policy engine, treating the reference rules as reliable this meeting, produced a loss-minimizing recommendation of -25 basis points — a figure that sits between the upward-pointing level rules and the easing signal from the momentum-based rule. Read together, these quantities imply that a measured reduction in the funds rate was consistent with the framework: enough to respond to genuine slowing in activity and to the disinflationary tilt implied by below-target core inflation, but short of the aggressive move that market pricing or the acute stress readings alone might suggest. The staff framed the resulting path as one in which policy eases modestly from a stance that the forward-looking data judged somewhat too restrictive, while preserving room against the possibility that inflation reasserts once the disturbance passes.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, all five participants independently arrived at a call for a 50 basis point reduction, though they reached that conclusion from distinct starting points. The participant most attentive to inflation risk observed that his usual reluctance to ease simply did not bind here: core PCE at 1.41% was well below the 2.0% target, and the Beige Book documented restrained prices, easing input costs, and subdued wages across nearly all Districts, leaving no inflation threat to defend against. Against that backdrop he judged the growth and stability signals — the Chicago Fed index at -1.12,



claims at 453,000, broad manufacturing weakness, a VIX of 35.81, and the negative bill spread — as severe enough to warrant a substantial cut, adding the caution that the Beige Book predated the September attacks and so likely understated realized conditions.

The participant focused on the labor market emphasized that initial claims, the leading indicator he weighted most heavily, were pointing the wrong way, even with unemployment still below the natural rate; he read the direction of travel as more telling than the level. The participant concerned with financial stability stressed the acute volatility and the elevated Baa spread as evidence of credit-intermediation strain, and warned that failing to deliver the easing markets had priced would amount to a destabilizing passive tightening of financial conditions. The participant attentive to market signals read the -0.65 bill spread as implying a substantial amount of easing already embedded in prices, and the data-dependent participant characterized 50 basis points as the literal consensus reading of soft inflation paired with sharply weak but not yet collapsed activity. Several participants weighed whether a larger, 75 basis point move might better cushion the shock, but each declined to escalate, citing a desire to preserve room from the 3.0% starting point and to avoid overshooting what the bill spread supported.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, participants engaged closely with why the level rules and the momentum rule diverged. There was broad agreement that the Taylor, Balanced Approach, and ELB-adjusted rules, all pointing to a rate well above current levels, leaned on backward-looking gap estimates and an r^* near 3.877% that a fresh shock had not yet entered. The First-Difference rule, which several participants found most persuasive, was seen as better suited to a moment defined by deteriorating momentum. The inflation-focused participant embraced -25 basis points as the disciplined choice: it eased in response to genuine weakness while preserving room should inflation reassert itself, and he explicitly framed his own more aggressive predictive vote as a reflection of that same inflation caution rather than a contradiction of it. The data-dependent participant likewise endorsed -25 as the defensible, data-grounded optimum, noting that inflation momentum at -0.03 and unemployment momentum at 0.0 described negative but not collapsing conditions, and that the extra increment implied by the predictive votes rested on post-attack precaution beyond what the numbers directly supported.

Other participants agreed on the direction while judging the magnitude insufficient. The labor-market participant supported easing firmly but feared that 25 basis points would not provide enough of a cushion against a labor-market slide, given rising claims and a VIX at 35.81, and pointed again to the pre-September-10 caveat as evidence that the true downside was understated. The financial-stability participant, while conceding the discipline point that momentum was not collapsing, held that his



mandate weighted tail risk in credit and volatility more heavily than smooth-momentum readings, and concluded that a 25 basis point move might underdeliver against what stressed credit markets required. The market-signal participant made a parallel argument: the -0.65 bill spread implied the market wanted more than a single quarter-point cut, and he read incoming stress as a reason the framework understated the needed easing. Across the exchange, no participant argued for holding steady; the disagreement was confined to whether the correct easing step was a quarter point or a half point, with all agreeing that the current 3.0% stance was too restrictive for the conditions at hand.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported a 50 basis point reduction in the federal funds rate, a unanimous outcome recorded as {-50: 5}. On the deterministic framework's recommendation of a 25 basis point cut, the Committee did not divide on direction but did divide on magnitude: two participants — the one focused on inflation risk and the data-dependent participant — endorsed the -25 basis point recommendation as-is, while three — the participants attentive to the labor market, to financial stability, and to market signals — agreed with the easing direction but regarded 25 basis points as insufficient, preferring a larger move. No participant declined to support easing. The recorded optimal-side tally was two endorse, zero decline, and three partial.