



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 is unable to report the total size, composition, or change from the prior release of SOMA holdings in this document. Members are advised that this section covers SOMA holdings only; it does not encompass the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source currently exists. The absence of these figures should be understood as a limitation of the available data rather than a statement about the level or trajectory of the portfolio.

STAFF REVIEW OF THE ECONOMIC SITUATION

The economy appears to have expanded modestly in recent weeks, though performance across sectors and regions has been uneven. Core PCE inflation was running at 1.24 percent on a year-over-year basis, well below the 2 percent objective, and the Beige Book characterized prices of finished goods and services as broadly stable, with only scattered reports of price pressures and generally subdued wage increases. The Employment Cost Index stood at 89.5. The unemployment rate was 5.9 percent, above the estimated natural rate of 5.06 percent, and initial jobless claims remained elevated at 388,000. The Chicago Fed National Activity Index at -0.06 indicated growth slightly below trend.

District reports reinforced this picture of soft but positive activity. Boston, New York, Atlanta, and Dallas noted some tapering off in growth, while Cleveland and St. Louis reported some improvement and the remaining Districts pointed to continued moderate growth. Retail sales were mixed, with four Districts seeing weakening and five reporting a pickup, part of it weather-related, and retailers generally expressed optimism about the near-term outlook. Manufacturing, though mixed, was judged to have improved on balance. Residential real estate and construction were widely described as strong, while commercial real estate was almost universally described as weak. Labor markets were characterized as slack but relatively stable in most Districts, with New York and Kansas City softening and Richmond noting modest improvement. Banks reported strong residential mortgage demand, steady consumer loan demand, and weak commercial loan demand, with credit quality still described as good and no significant rise in delinquencies. Agricultural conditions were described as poor in a number of Districts.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions reflected pronounced market stress alongside a still-functioning credit environment. The VIX stood at 42.03, an extremely elevated reading indicative of severe volatility and risk aversion. The Baa corporate spread of 3.3 percentage points pointed to meaningful credit-cost



strain over Treasuries. Against these signals, the broader financial stress index at 0.1728 was only moderate rather than crisis-level, and the 2-year to 10-year Treasury curve remained steeply positive at 2.31, giving no recession signal from the term structure itself. The 3-month Treasury bill traded 13 basis points below the current 1.75 percent funds rate, consistent with markets pricing some easing bias in the near-term path. Taken together, front-end pricing and elevated volatility suggested markets leaned toward accommodation even as the shape of the curve and contained stress index argued against reading an imminent seizure into the data.

STAFF ECONOMIC OUTLOOK

The forward-looking configuration of the reference rules and momentum measures points to a mild easing tilt from current settings. The estimated neutral rate used in the analysis was 3.443 percent, a level that sits well above the prevailing 1.75 percent funds rate and that, taken at face value, would ordinarily argue for a more restrictive stance. Yet the same neutral-rate estimate looks high relative to the sluggish activity indicators, and the reference rules diverge sharply around it: the Taylor rule prescribes 75 basis points of tightening, driven largely by that neutral-rate input, while the Balanced Approach and ELB-adjusted rules both land at 0 basis points and the First-Difference rule prescribes 50 basis points of easing.

The momentum terms help explain that spread. Inflation momentum was estimated at 0.2 and unemployment momentum at 0.15, both modest but pointing in a direction consistent with slack rather than overheating. The First-Difference rule, which responds to that momentum rather than to a fixed neutral-rate anchor, therefore leans toward easing, while the level-based rules that weigh the inflation shortfall against the unemployment gap at current settings see the stance as roughly appropriate. The loss-minimizing recommendation of the framework, at -25 basis points, sits between these poles: it reflects genuine slack and soft inflation without endorsing the aggressive move the First-Difference rule alone would imply. On this reading, the projected path of conditions is one of continued below-trend growth and below-target inflation, with financial stress the principal near-term risk to the outlook.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants entered the discussion sharply divided on the near-term policy path, and that division persisted through the deliberation. Two members favored a modest 25 basis point cut, while three favored holding the funds rate at 1.75 percent. Notably, the disagreement was not about the underlying picture of the economy, on which there was broad agreement, but about how to weigh soft inflation and market stress against the fact that the real economy was still expanding.



The member most focused on inflation risk argued that core PCE at 1.24 percent, well below target, removed any case for tightening but did not by itself justify easing. This member emphasized that stable finished-goods prices, subdued wages, retail optimism, and strong residential real estate described a soft-but-growing economy rather than a collapsing one, and cautioned that insurance easing into a modestly expanding economy could re-ignite price pressures once the elevated VIX subsided. The data-dependent centrist and the member attentive to market signals reached the same hold conclusion by different routes. The centrist stressed that the yield curve remained firmly positive, that the Chicago Fed index at -0.06 was only marginally below trend, and that the 1.75 percent rate was already accommodative, so that the dovish case rested on volatility and slack rather than on a clear deterioration in real activity. The market-focused member made the sharpest point on pricing: the 3-month bill trading only 13 basis points below funds signaled an easing bias and an expectation of cuts ahead, not a full 25 basis point cut priced for this specific meeting, and a hold with a clearly communicated easing bias best matched what front-end pricing was saying.

The two members leaning toward a cut pressed the case that waiting risked acting too late. The member focused on the labor market pointed to the 84 basis point gap between the 5.9 percent unemployment rate and the 5.06 percent natural rate, elevated claims at 388,000, and Beige Book language describing labor markets as slack with New York and Kansas City softening, arguing that soft inflation gave ample cover for precautionary easing to protect against further job losses. This member accepted that expansion continued, which is why a deeper cut was not favored, but characterized the hold camp's stance as underweighting employment risk. The member concerned with financial stability made the volatility case most directly, treating the VIX at 42 and the Baa spread of 3.3 as evidence of fragile conditions that could feed into real credit tightening, and framing a 25 basis point move as calibrated insurance rather than panic. This member conceded that the curve was not inverted, the stress index was only moderate, and credit quality remained good with no acute seizure, but judged that the passivity risk during high stress outweighed the value of preserving ammunition when inflation was so far below target.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, a striking convergence emerged even among members whose predictive votes were for a hold. The inflation-focused member acknowledged that the condition normally justifying resistance to a cut, inflation above target, was simply absent, and that a small cut carried limited inflation cost given stable prices and subdued wages, though this member ultimately continued to prefer preserving policy room and awaiting confirmation of deterioration. The centrist observed that the data supported the direction and magnitude of a single quarter-point step at face value, while noting that the modest size also made patience defensible. The market-signal member reconciled a predicted hold with support for the



optimal call by noting that the -13 basis point front-end spread pointed to roughly one quarter-point cut and that the framework's -25 basis points matched that implied magnitude precisely, rejecting the First-Difference rule's -50 as an overshoot absent an acute crisis. Participants generally agreed that the Taylor rule's 75 basis point prescription rested too heavily on a 3.443 percent neutral-rate estimate that looked high relative to weak activity and ignored the market stress evident in the VIX and credit spreads.

By the close of the deliberation, most participants judged that the balance of evidence, slack in labor markets, inflation running well below target, and elevated financial stress, tilted toward a mild easing even where members differed on whether to act immediately. The distinction that remained live was between those who saw a quarter-point cut as cheap and well-supported insurance and the single member who continued to weight the preservation of policy room and the risk of premature easing more heavily than the loss function did.

COMMITTEE POLICY ACTIONS

In the predictive vote on the action to be taken at this meeting, the Committee held the target federal funds rate at 1.75 percent, with the tally standing at three members favoring no change and two favoring a 25 basis point cut. On the separate question of the framework's loss-minimizing recommendation of -25 basis points, the Committee's recorded stance was four members endorsing the recommendation as-is and one declining, with no partial positions. The member focused on inflation risk declined, continuing to favor a hold in order to preserve policy room and await clearer confirmation of deterioration; the members attentive to the labor market, financial stability, the data-dependent reading, and market signals all endorsed the modest easing as the optimal marginal adjustment given below-target inflation, labor slack, and elevated volatility.