



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, and accordingly the Committee was unable to review the total size, composition, or change from the prior release of the SOMA portfolio. This limitation applies to the SOMA holdings series specifically. The Committee further notes that this section covers SOMA holdings only and does not address the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source currently exists. Members proceeded on the understanding that the discussion of open market operations would necessarily be constrained until such data becomes available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized the economy as decelerating but not contracting. Core PCE inflation stood at 2.18 percent on a year-over-year basis, modestly above the 2.0 percent target. The unemployment rate was 5.7 percent, above the estimated natural rate of 5.06 percent, indicating a degree of labor-market slack. Initial jobless claims registered 412,000, an elevated reading consistent with soft labor demand. The Chicago Fed National Activity Index came in at -0.34, signaling growth running below trend. The current federal funds rate was 1.75 percent.

The most recent Beige Book, prepared before September 3, reported that the growth of economic activity had slowed in recent weeks, with a good deal of variation across sectors and Districts. Two Districts reported modest improvement while most others described slow and uneven growth; two others reported little change in the overall level of activity. Retail sales were generally mixed, with seven Districts noting strong sales of home furnishings or appliances and several attributing soft apparel sales to unseasonably warm weather. Almost all Districts reported auto sales above year-earlier levels, mostly on aggressive financing and rebate incentives. Manufacturing was sluggish overall, with weakness in high-tech and building materials offset in some Districts by strength in autos and steel. Most Districts reported little or no gain in employment in July and August, though three noted stronger demand for temporary workers. Prices of inputs and final goods were generally flat to slightly higher, and while wage pressures were described as few, there was widespread concern about the effect of rising health care costs on labor costs. Nearly all Districts reported strong residential sales and construction activity.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions reflected notable stress alongside a still-normally-shaped yield curve. The VIX stood at 38.01, an elevated level indicating acute market volatility and risk aversion. The Baa corporate



spread was 3.51, pointing to meaningful strain in credit markets and elevated borrowing costs for firms. The broader financial stress index registered 0.1896, a moderate reading that confirmed some tightening in conditions beyond equity volatility alone. The 3-month Treasury bill spread relative to the current funds rate was -0.08, a mild negative reading suggesting markets leaned toward steady-to-easier policy rather than tightening. The 10-year/2-year yield curve spread was 1.81, steeply positive and not inverted, offering no strong near-term recession signal from the term structure.

STAFF ECONOMIC OUTLOOK

The forward-looking staff analysis drew on the estimated neutral rate and the momentum measures embedded in the policy framework. The r^* estimate used was 3.371, a figure implying that reference rules keyed to level gaps would call for policy well above the current 1.75 percent stance. Consistent with this, the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points above current, reflecting core PCE modestly above target combined with a comparatively small unemployment gap. The First-Difference rule, which responds to changes in conditions rather than to level gaps, prescribed 0 basis points.

The momentum figures suggest little forces pushing conditions strongly in either direction over the near term. Inflation momentum was 0.095 and unemployment momentum was 0.100, both small and stable, indicating neither an accelerating price impulse nor an abruptly deteriorating labor market. The gap between the level-based rules at 75 basis points and the First-Difference and loss-minimizing outputs at 0 basis points is best read as a signal that the current stance is only mildly accommodative rather than urgently miscalibrated, particularly if the vigor implied by the 3.371 r^* estimate is not corroborated by the below-trend activity data. On balance, the projection points toward conditions evolving without sharp change absent a fresh shock, with the principal risks being a further softening in labor demand on one side and a re-firming of inflation momentum on the other. The framework's loss-minimizing recommendation was 0 basis points, with reference rules judged reliable.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, participants converged on a picture of slowing but not collapsing activity, while dividing on the appropriate policy response. Three participants favored holding the funds rate unchanged and two favored a quarter-point cut. The participant most attentive to inflation risk noted that core PCE at 2.18 percent sits above the 2.0 percent target and argued this was precisely the constraint weighing against easing; at the same time, this participant acknowledged that input and final goods prices were flat to only slightly higher, that wage pressures were muted apart from health-care cost concerns, and that the steep positive yield curve did not signal an imminent recession requiring urgent action. Holding was characterized as the choice that preserved optionality while respecting the



above-target inflation reading.

Two participants pressed the case for insurance easing. The participant focused on the labor market emphasized that unemployment at 5.7 percent stood well above the 5.06 percent natural rate, that jobless claims at 412,000 were elevated, and that the Beige Book reported little or no employment gain across most Districts in July and August. With inflation contained and the recovery described as fragile, this participant judged a modest cut prudent insurance against further job deterioration without appearing to panic. The participant most attentive to financial stability made a complementary argument, treating the VIX at 38.01 and the Baa spread of 3.51 as the dominant concerns and framing a modest quarter-point move as enough to steady fragile credit conditions while small enough to avoid fueling the mild inflation overshoot. This participant candidly acknowledged that three of five members favored holding and that the data did not amount to a clear crisis.

The participant reasoning primarily from market pricing anchored on the -0.08 front-end spread, arguing that if markets expected a certain cut the 3-month bill would sit substantially more negative; the mildness of the signal was read as the efficient aggregation of exactly the labor and stress concerns others cited, implying markets leaned toward hold-with-easing-risk rather than a decisive cut. The participant emphasizing a literal reading of the data reached a similar conclusion, judging the mixed-but-not-crisis picture — above-target inflation set against elevated claims, a -0.34 CFNAI reading, and a still-steep curve — as favoring patience. In the rebuttal round, no participant was moved to change position; the easing pair held that a positively sloped curve offered little reassurance when labor data were already softening, while the holding majority maintained that inflation above target ruled out easing for some and that the data lacked an acute break.

Turning to the framework's loss-minimizing recommendation of 0 basis points, participants engaged directly with the divergence among the reference rules. Several observed that the Taylor, Balanced Approach, and ELB-adjusted rules all prescribed 75 basis points because they weight the inflation gap heavily and assume an r^* of 3.371, but that this implied vigor was contradicted by the incoming activity data. Participants across mandates found the First-Difference rule's 0 basis points most persuasive in the present setting, because it responds to momentum and change rather than level gaps, and both inflation momentum at 0.095 and unemployment momentum at 0.100 were tepid. The inflation-focused participant framed the practical question as hold versus hike, concluding that hiking into a VIX of 38 and a 3.51 Baa spread would imprudently amplify fragility, while inflation above target continued to rule out easing from that member's vantage.

The labor-focused participant, though instinctively inclined toward supporting employment, judged that 1.75 percent was not actually restrictive given the historically low level and the accommodative



-0.08 front-end spread, and that the gradual character of labor softening argued for holding limited room in reserve rather than spending it now — while flagging rising claims and weak hiring as clear triggers to ease at a future meeting. The financial-stability participant reiterated that fragility dominated a modest inflation overshoot this meeting, and the market-focused and centrist participants judged that front-end pricing, credit stress, and slowing activity all validated a hold. A couple of participants noted that the agreement between the framework's 0 basis point output and their own predictive votes suggested the current stance was appropriately calibrated — neither restrictive enough to fight the slowdown nor loose enough to be reckless.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy action, the Committee's members split three to two, with three favoring no change to the 1.75 percent federal funds rate and two favoring a modest quarter-point reduction; the majority position of 0 basis points prevailed. On the deterministic framework's recommendation of 0 basis points, the Committee reached full agreement: all five members endorsed the recommendation as-is, with none declining and none registering only partial agreement. The two participants who had favored a cut in the predictive vote nonetheless endorsed the framework's hold, judging that the tepid momentum readings and elevated financial stress did not warrant acting against a still-accommodative stance at this meeting, while noting the labor and credit indicators they would watch for signs warranting future easing.