



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account (SOMA) holdings was available on or before the 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 the prior release. This absence pertains to SOMA holdings specifically. It should be noted separately that no point-in-time-safe data source currently exists for the results of repurchase or reverse repurchase operations either, so no discussion of those operations is presented here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed a broad set of indicators pointing to sluggish economic activity. Core PCE inflation stood at 1.46 percent on a year-over-year basis, comfortably below the 2.0 percent objective. The unemployment rate was 5.6 percent, above the estimated natural rate of 5.06 percent, indicating a degree of slack in the labor market. Initial jobless claims registered 409,000, an elevated reading, and the Chicago Fed National Activity Index at -0.35 was consistent with below-trend growth. The Employment Cost Index was reported at 90.1, and M2 stood at \$5,709.5 billion. The federal funds rate at the time of the meeting was 1.75 percent.

The most recent Beige Book, prepared before mid-October, characterized economic activity as remaining sluggish across most Districts in September and early October. Retail sales were weak across the nation, including some declines in motor vehicle sales from very high levels, and most Districts noted that manufacturing activity had declined or grown more slowly. Home building and residential markets were generally described as upbeat, while commercial real estate softened. Labor markets were reported as 'lackluster in all Districts.' Overall wage and price increases were characterized as moderate, though significant increases were noted in health care, insurance, and shipping. Most Districts reported strong consumer loan demand alongside weak commercial lending, and credit quality deterioration was reported in some Districts.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions showed signs of strain. The VIX stood at 31.23, an elevated level indicative of heightened market volatility and investor anxiety. The financial stress index at 0.1845 pointed to moderately tight conditions, and the Baa corporate spread of 3.83 reflected meaningful borrowing-cost pressure for lower-rated corporate issuers. The 3-month T-bill spread relative to the current funds rate was -0.27, suggesting that money markets were pricing the short rate below the prevailing 1.75 percent funds rate and, by extension, anticipating some easing. In contrast, the 10-year/2-year yield curve spread was steeply positive at 2.25, showing no inversion and thus no signal



of imminent recession from the term structure itself.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff sent mixed signals about the likely path of policy and conditions. The neutral real rate (r^*) used in the analysis was estimated at 3.271, a comparatively high figure that, taken at face value, implies the current 1.75 percent funds rate is already accommodative relative to neutral. Inflation momentum was modestly positive at 0.435, suggesting that price pressures were building rather than fading despite the current shortfall of core PCE below target. Unemployment momentum was essentially flat at -0.05, consistent with labor-market slack that was persistent but not rapidly deteriorating.

The reference rules spanned a wide range. The Taylor rule prescribed 75 basis points of tightening and both the Balanced Approach and ELB-adjusted rules pointed to 50 basis points, each reflecting the high r^* estimate and the positive inflation momentum. The First-Difference rule, by contrast, called for a 25 basis point cut, weighing the sluggish activity and the unemployment gap more heavily. With the reference rules judged reliable, the loss-minimizing framework reconciled these opposing pulls and landed on a recommendation of no change. The projection implied by these inputs is one in which policy is already positioned somewhat below neutral, activity is soft but not in crisis, and the balance between rising inflation momentum and stable unemployment momentum does not, on the framework's reading, call for a directional move at this time.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In the initial round of independent positions, four of the five participants favored a 50 basis point cut, with one favoring a more modest 25 basis point reduction. Those advocating the larger move grounded their reasoning in the breadth of the weakness on display. The participant most focused on the labor market emphasized that unemployment at 5.6 percent stood above the 5.06 percent natural rate, that jobless claims at 409,000 were elevated, and that the Beige Book had described labor markets as lackluster in every District. This participant argued that the cost of acting too late on employment exceeded the cost of a modest overshoot, especially with core PCE at 1.46 percent leaving ample room to ease.

The participant attentive to financial stability pointed to the elevated VIX, the wide Baa spread, and the Beige Book's notes of weak commercial lending and credit-quality deterioration in some Districts as direct warning signs, arguing that supporting conditions before stress compounded was the prudent course. The market-focused participant emphasized the negative T-bill spread as evidence that markets were already pricing easing, while noting that the steeply positive, un-inverted yield curve



argued against any panic-level move. The data-dependent participant, initially inclined toward a hold or a modest cut given the low starting rate, was persuaded toward the larger move by the combination of the negative T-bill spread and the broad-based activity weakness. The inflation-focused participant declined to join the consensus on magnitude; while acknowledging that soft inflation removed the primary reason for hawkishness and warranted moving off a hold, this participant stressed that the funds rate was already low, that ammunition was scarce, and that the un-inverted curve did not justify a decisive 50 basis point step, settling on a cautious 25 basis point cut.

When the discussion turned to the optimal-policy framework, which recommended no change, the tenor of the conversation shifted markedly. Several participants found the hold defensible on its own terms. The inflation-focused participant noted that with r^* estimated at 3.271, the current 1.75 percent stance was already deeply accommodative, and that positive inflation momentum of 0.435 counseled against adding further stimulus. The data-dependent participant observed that three of the four reference rules pointed above the current rate, placing the literal center of gravity of the rules above 1.75 percent, and was persuaded by the argument that the steep, un-inverted curve reflected easing that was already anticipated rather than fundamentally demanded. The market-focused participant reached a similar conclusion, reasoning that market signals were anticipating accommodation rather than requiring it, and that cutting amid a VIX of 31 risked being read as a signal of panic.

Not all participants were reconciled to the hold. The labor-market participant distrusted the high r^* estimate given uniformly sluggish activity and maintained that slack persisting above the natural rate demanded action rather than patience, preferring to insure against labor deterioration before confirming data arrived. The financial-stability participant accepted that a hold was defensible but continued to view the elevated VIX and wide Baa spread as live stress that warranted insurance, leaning toward a modest cut over standing pat while acknowledging the framework's judgment that the current stance was already easy enough. The tension running through both the predictive and the optimal-framework discussions was consistent: mechanical rules and the high neutral-rate estimate suggested policy was already accommodative, while the breadth of soft activity and elevated market stress pushed several participants toward a case for easing insurance.

COMMITTEE POLICY ACTIONS

In the predictive vote, the Committee's recorded stance on the likely policy action was a 50 basis point cut, with four participants favoring -50 basis points and one favoring -25 basis points. On the separate question of the framework's recommendation of no change, the Committee did not reach full agreement: three participants endorsed the recommendation as written, one declined to support it, and one supported the direction but not the magnitude or timing. The inflation-focused,



data-dependent, and market-focused participants endorsed the hold; the labor-market participant declined, favoring easing to protect employment; and the financial-stability participant registered a partial position, agreeing with the direction of avoiding tightening but preferring a modest cut as insurance against credit-market stress.