



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 so the Committee was unable to review the total size, composition, or change from the prior release of the SOMA portfolio in this cycle. Members were reminded 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 holdings data was noted for the record, and the discussion of open market operations was accordingly confined to the observation that no reviewable figures were before the Committee.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that inflation continued to run well below the Committee's 2 percent objective. Core PCE inflation stood at 1.07 percent on a year-over-year basis, nearly a full percentage point short of target. The labor market remained soft: the unemployment rate was 6.1 percent, above the estimated natural rate of 5.05 percent, and initial jobless claims were elevated at 421,000. The Employment Cost Index reading was 92.0, and the Beige Book noted that while wages faced some downward pressure, benefit costs continued to rise. The Chicago Fed National Activity Index at 0.14 pointed to growth roughly near its historical trend rather than to contraction. The fed funds rate stood at 1.25 percent.

The Beige Book characterized activity as improved or improving in the Dallas, Kansas City, New York, and Minneapolis Districts, mixed in Philadelphia and Cleveland, and generally sluggish, subpar, or subdued elsewhere. The unwinding of war-related concerns appeared to have lent some support to business and consumer confidence, though most reports judged the effect modest rather than dramatic. Consumer spending was described as lackluster overall; retail sales rebounded as hostilities in Iraq subsided but remained below year-ago levels, and a few Districts noted that the post-conflict pickup fell short of expectations. Manufacturing was mixed, with some Districts reporting improvement and others still seeing declines in orders. Low mortgage rates continued to support residential construction and home sales, while commercial construction and commercial real estate remained weak. Most Districts continued to report labor-market weakness and some downward pressure on wages.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm rather than distressed. The financial stress index stood at 0.0876, a low reading, and the VIX at 19.76 was moderate. The Baa corporate spread over Treasuries was 2.83, indicating contained borrowing-cost pressure without acute credit strain. The 10-year/2-year Treasury spread was steeply positive at 2.1, offering no recession signal from the term



structure. Most notable for policy, the 3-month T-bill traded 0.38 percentage point below the current funds rate, a spread the staff read as evidence that market participants had already priced in near-term easing — a magnitude sitting somewhere between a quarter- and a half-point move.

STAFF ECONOMIC OUTLOOK

The staff projection took as its anchor the estimated neutral rate (r^*) of 2.787 percent, against which the current 1.25 percent funds rate stands well below the nominal neutral level implied when combined with inflation near 1 percent. On its face this would suggest little scope for further easing; the reference rules, however, diverged sharply on this point. The Taylor rule prescribed 75 basis points of tightening, resting heavily on the elevated r^* estimate and on inflation and unemployment levels. The Balanced Approach and ELB-adjusted rules both returned 0 basis points, reflecting the proximity of the funds rate to the effective lower bound. The First-Difference rule, which responds to the direction of change rather than to level estimates, prescribed a 50-basis-point cut.

The momentum measures underlying that divergence pointed consistently in one direction: inflation momentum was negative at -0.105 and unemployment momentum negative at -0.1 , indicating that prices were decelerating further from target and that labor-market slack was not self-correcting. Read together, these quantities imply a trajectory in which conditions continue to soften absent additional accommodation. The reference rules were flagged as reliable. On the strength of the negative momentum readings and the First-Difference logic, the framework's loss-minimizing recommendation was a 50-basis-point reduction — a projection that weighs the disinflationary and labor trajectory more heavily than the static neutral-rate level.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their opening discussion, participants converged with striking unanimity on the appropriate direction of policy, if from different starting points. All five judged that a rate cut was warranted, and each arrived independently at a measured 25-basis-point reduction. The member most attentive to inflation risk framed the case squarely: with core PCE at 1.07 percent and characterized as drifting lower, the salient inflation danger today is undershooting, not overheating. Heavy inflation weighting, this participant observed, cuts both ways — the risk to guard against most is entrenched disinflation, and there was no demand-driven price pressure anywhere in the data, only firmness in benefit costs, which is not the kind of pressure that argues against easing.

The member most focused on employment emphasized that unemployment at 6.1 percent sat over a full point above the 5.05 percent natural rate, with claims at 421,000 signaling continued layoffs and no clear turnaround, and the Beige Book confirming labor weakness across most Districts. With inflation



this far below target, this participant judged the room to ease ample and the overheating risk negligible. The participant attentive to financial stability reframed the question in his own terms: with the stress index low, the VIX moderate, spreads contained, and the curve steeply positive, the genuine stability risk was not market panic but disinflation, which raises real debt burdens if it slides further; a preemptive, measured move was the appropriate insurance. The member weighting market pricing most heavily anchored on the 3-month T-bill trading 0.38 point below the funds rate — a signal that a cut was near-certain in market expectations, and one technically closer to a 50-basis-point move than a clean 25. He resolved that tension toward 25, reasoning that a full 50 would typically require confirming stress signals that were simply absent. The data-dependent member read the same balance as the literal consensus: below-target inflation and labor slack justify insurance easing, but stable conditions and limited room at 1.25 percent argue against overreacting. The predictive rebuttal round changed no one's vote; if anything, the unanimity reinforced each member's read, and the inflation-focused member explicitly revised toward consensus, persuaded that a modest cut is consistent with rather than contrary to heavy inflation weighting.

The subsequent discussion turned to the framework's loss-minimizing recommendation of a 50-basis-point cut, and here the debate grew more genuinely contested. Several participants found the First-Difference logic newly persuasive when they examined the momentum measures directly. The employment-focused member was moved furthest: with both inflation and unemployment momentum negative, and slack still worsening, this participant judged that his cautious 25 might underestimate how much easing the weak labor market genuinely requires, and that front-loading support carries its lowest cost precisely when inflation is quiescent. The inflation-focused member acknowledged the same asymmetric danger — that approaching the lower bound with falling inflation could force sharper cuts later — and in his optimal-framework reasoning accepted the -50 as the loss-minimizing call on his own priority, before pulling back in rebuttal.

The countervailing thread throughout was scarcity of policy room and the calm of financial conditions. With rates already at 1.25 percent, participants repeatedly noted that ammunition was limited and worth conserving. The market-signal member held that the T-bill spread of -0.38 prices partial, not full, easing, and that overshooting to 50 basis points with a low stress index and a steeply positive curve risked exhausting scarce room prematurely; the calm backdrop, in his view, capped the appropriate magnitude. The financial-stability member reached a parallel conclusion from his own lens: stress metrics were not flashing danger requiring aggressive front-loading, and a surprise-free 25-basis-point move would validate market expectations, avoid disruptive repricing, and preserve room. The data-dependent member gave the same weight to the T-bill spread's implication of a move between 25 and 50, and, absent any strong signal of accelerating deterioration in the Beige Book,



avored the smaller measured step. Participants generally agreed that the direction of easing was clearly right — the disagreement was one of magnitude, turning on how much weight to place on negative momentum and the disinflation trajectory against the value of preserving optionality near the effective lower bound.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported a 25-basis-point reduction in the target funds rate, a unanimous {-25: 5}. On the separate question of the framework's loss-minimizing recommendation of a 50-basis-point cut, the Committee did not fully agree: one member — the participant most focused on the labor market — endorsed the -50 recommendation as stated, while the remaining four members registered partial agreement, concurring with the direction of easing but judging the 50-basis-point magnitude larger than warranted given calm financial conditions and limited policy room near the effective lower bound. No member declined the recommendation outright. The recorded optimal-side stance was thus 1 endorse, 4 partial, 0 decline.