



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$692.8 billion as of the September 8 release, essentially unchanged from the prior week's report — a rise of just \$0.1 billion from the \$692.7 billion recorded on September 1. The composition remained weighted toward coupon issues, with Treasury notes and bonds accounting for \$422.5 billion and Treasury bills for \$255.3 billion of the total. The near-flat week-over-week change is consistent with maintenance operations rather than any deliberate shift in the size or structure of the portfolio. The staff noted that this review covers SOMA securities holdings only — total size, composition, and the change from the prior release. It does not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists; those operations are therefore outside the scope of what can be reported here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity continued to expand through late July and August, though at a pace that had eased in several Federal Reserve Districts. Characterizations in the Beige Book ranged from slow in St. Louis to solid in San Francisco, with most Districts describing modest to moderate growth. Household spending had softened in many parts of the country, reflecting lackluster retail sales and some cooling in both new and existing home sales; by contrast, the manufacturing sector improved further nationwide, particularly among makers of capital equipment and other durable goods. Residential construction remained at high levels but slowed somewhat in some regions, while nonresidential construction and demand for commercial and industrial space stayed tepid. The Chicago Fed National Activity Index registered 0.17, consistent with growth modestly above trend.

On the labor side, employers in most Districts continued to expand payrolls, though the Beige Book noted unevenness across sectors. The unemployment rate was 5.4 percent, somewhat above the estimated natural rate of 5.04 percent, and initial jobless claims stood at 331,000, a level the staff characterized as moderate. Wage pressures were described as modest, even as persistently rapid increases in nonwage labor costs remained a concern for many employers. On prices, consumer inflation was generally flat or up modestly, with noticeable increases confined largely to energy and some material inputs. Core PCE inflation was running at 1.43 percent on a twelve-month basis, below the 2 percent objective. The current federal funds rate was 1.5 percent.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were benign across the measures the staff reviewed. The financial stress index stood at 0.09, a very low reading indicating little tightness in overall conditions, and the VIX at 13.56 pointed to subdued equity-market volatility and an absence of investor anxiety. Credit markets showed



no evident distress, with the Baa corporate spread at 2.15 — a moderate level consistent with orderly borrowing conditions. The Treasury yield curve remained comfortably positive, the 10-year/2-year spread at 1.68, offering no recession signal. The 3-month Treasury bill was trading about 13 basis points above the current funds rate, which the staff read as market pricing consistent with expectations of a modest further firming of policy.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the estimated real neutral rate of 1.838 percent, against which the current 1.5 percent funds rate implies that policy remains on the accommodative side even after accounting for below-target inflation. With inflation momentum estimated at a mildly positive 0.17 and unemployment momentum slightly negative at -0.05, the near-term trajectory pointed toward prices firming gradually rather than decelerating further, and toward the unemployment gap closing modestly on its own rather than widening. Taken together, these quantities suggested an economy healing at a measured pace, with neither an inflationary acceleration nor a labor-market deterioration evident in the momentum readings.

The reference rules spanned an unusually wide range, which the staff flagged as the central feature of the projection. The Taylor rule prescribed a firming of 50 basis points, responding to above-trend activity and positive inflation momentum, while the Balanced Approach and ELB-adjusted rules both called for easing of 75 basis points, weighting the remaining unemployment gap and the inflation shortfall heavily; the First-Difference rule pointed to a gentle 25-basis-point cut. The reference rules were judged reliable in the current environment. Reconciling these opposing signals, the deterministic optimal policy engine returned a loss-minimizing recommendation of 0 basis points — a hold that balances the hawkish level-based Taylor prescription against the dovish gap-weighted rules. The projection thus implied that the funds rate at 1.5 percent sits near, if slightly below, a balanced point, with the case for a large move in either direction weak given the modest momentum in both prices and employment.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants arrived independently at a quarter-point firming, though from distinct starting points. The member most attentive to inflation risk emphasized that the 1.5 percent funds rate leaves the real rate near zero — deeply accommodative — and that holding at that level while energy and material input prices firm and nonwage labor costs rise persistently would invite a future overshoot costly to unwind. This participant nonetheless declined to argue for a larger 50-basis-point step, observing that core PCE at 1.43 percent remains below target and wage pressures are modest, so no runaway price dynamic yet demands an aggressive shock. The participant most



focused on the labor market reasoned in parallel: unemployment at 5.4 percent sits only modestly above the 5.04 percent natural rate, claims at 331,000 are moderate rather than spiking, and payrolls continue to expand in most Districts, so a measured hike that still leaves policy accommodative supports rather than threatens the expansion.

The participant attentive to financial stability grounded the same conclusion in the calm of the markets — the stress index at 0.09, the VIX at 13.56, a contained Baa spread of 2.15, and a steeply positive yield curve — judging that a predictable, expected step would be the least disruptive path, validating market expectations rather than surprising them. The member weighting market signals most heavily pointed to the 3-month bill trading 13 basis points above the funds rate as pricing in a move toward roughly 1.75 percent, so that a quarter-point hike would meet, not jar, the priced path. The data-dependent participant read the balance of evidence — accommodative policy, below-target inflation, benign financial conditions, and moderate if slowing growth — as favoring continued measured normalization over either a pause or an acceleration. Through the rebuttal round, no participant was moved from this convergence; several noted that the softening in household spending and cooling home sales flagged in the Beige Book argued against accelerating, but not against the gradual path, given how accommodative the starting point remained.

When the discussion turned to the framework's loss-minimizing recommendation of a hold, a more genuine divergence emerged. The participant focused on employment and the one attentive to financial stability found the 0-basis-point call persuasive on its own terms. The labor-focused member reasoned that with unemployment edging down on its own — momentum at -0.05 — and no wage or price pressure demanding restriction, holding neither abandons employment support nor adds restraint to a market still below potential, and it preserves the option to ease quickly should labor data deteriorate. The stability-focused participant, scanning the stress signals first, concluded that no credit-market trigger justified acting against benign conditions, and that with inflation soft, patience was both the prudent and the loss-minimizing choice; a quarter-point would be safe given the ample cushion, but standing pat carried no disruption risk.

The other three participants agreed with the framework's direction of restraint but not with a hold this meeting. The inflation-focused member accepted that a hold avoids easing but argued it leaves excess accommodation in place while inflation momentum is positive and the funds rate sits far below the 1.838 r^* , favoring a quarter-point as measured insurance against building price pressures. The data-dependent participant characterized the framework's 0 as a defensible literal midpoint of sharply opposing rules, but held that with policy accommodative and CFNAI at 0.17 signaling above-trend activity, the direction of travel points clearly to firming and a measured 25 basis points aligns better



than standing pat. The market-signal participant made the sharpest case against a hold, contending that the framework's averaging of a hawkish Taylor prescription with the dovish gap-weighted rules understates the accommodation removal the economy tolerates; with markets already pricing continued normalization and only mildly closing slack, the priced-in quarter-point is the more defensible path. Participants across both camps nonetheless agreed that the economy was near a balanced point, and that the disagreement was one of timing and magnitude rather than fundamental direction.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action at this meeting, the Committee was unanimous: all five members voted for a 25-basis-point increase in the target federal funds rate, a tally of 5 to 0. On the separate question of the deterministic framework's loss-minimizing recommendation of a hold at 0 basis points, the Committee did not reach full agreement. Two members — the participant focused on the labor market and the participant focused on financial stability — endorsed the recommendation as-is. The remaining three — the inflation-focused member, the data-dependent member, and the market-signal member — registered partial agreement, concurring with the framework's direction of restraint over easing but favoring a measured quarter-point firming this meeting rather than a hold. No member declined the recommendation outright.