



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$735.0 billion in domestic securities as of the October 19 release, the most recent data available on or before the point-in-time-safe cutoff. Of that total, Treasury notes and bonds accounted for \$444.9 billion and Treasury bills for \$270.1 billion. Holdings rose by \$0.3 billion from the prior release of October 12, a modest change consistent with routine portfolio maintenance. It should be noted that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

Economic activity continued to expand through September, with most Districts characterizing the pace as moderate or gradual. One District reported some quickening in growth while another noted a slowdown, and conditions in the Gulf region remained affected by hurricane damage, including noticeable disruptions to activity and repairs still underway at onshore and offshore energy facilities. The Chicago Fed National Activity Index stood at 0.65, consistent with above-trend growth. Retail sales of general merchandise rose moderately in most Districts, though several Banks reported sales below plan or weak, and auto sales fell across the Districts. Retailers in many Districts noted that consumer confidence had ebbed as gasoline prices rose. Service sector activity continued to expand, manufacturing advanced in all Districts except two, and commercial real estate continued to firm. Residential real estate activity remained generally strong, but reports of easing home demand had become somewhat more common.

Labor markets showed continued firming. The unemployment rate was 5.1 percent, essentially at the estimated natural rate of 5.04 percent, and initial jobless claims stood at 324,000. The Beige Book reported that employment had been rising and that several Districts saw some tightening in labor markets. Wage increases were characterized as moderate overall, though a number of Districts noted increased upward pressure on wages and salaries in the service sectors and for some skilled occupations. On prices, core PCE inflation was 1.56 percent on a year-over-year basis, below the 2.0 percent target, while the Employment Cost Index reading was 100.1 and M2 stood at \$6,587.9 billion. All Districts reported cost increases for energy, petroleum-based products, building materials, and shipping, and several Districts indicated that these input cost increases were being passed through to retail prices.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions remained calm and accommodative. The financial stress index stood at 0.1269, a low reading indicating no aggregate market strain, and the VIX was subdued at 14.53. The Baa corporate spread over Treasuries was 1.81, a moderate level consistent with orderly credit markets and no widening borrowing-cost pressure. The 10-year/2-year Treasury spread was positive but flat at 0.2, reflecting continued flattening without inversion, while the 3-month T-bill spread relative to the current funds rate was essentially zero at 0.02, suggesting money markets were orderly and that market pricing was consistent with a continuation of the measured tightening path. With the fed funds rate at 3.75 percent, these readings pointed to financial conditions that could absorb a further modest adjustment without destabilization.

STAFF ECONOMIC OUTLOOK

The forward-looking indicators available to the staff pointed in somewhat divergent directions relative to the current stance. The estimated neutral rate (r^*) was 1.176; against a nominal funds rate of 3.75 percent and core PCE inflation of 1.56 percent, the implied real policy rate of roughly 2.2 percent sat above this neutral estimate, suggesting that policy was not accommodative and might be modestly restrictive on a level basis. Inflation momentum was mildly positive at 0.075, indicating prices were firming rather than decelerating, while unemployment momentum was slightly negative at -0.1, hinting at some potential softening in labor conditions ahead. The reference rules were judged reliable this meeting.

The reference-rule outputs clustered toward easing. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 bps, driven primarily by core inflation printing below the 2.0 percent target with the labor market near neutral. The First-Difference rule, which responds to changes rather than levels and is therefore less sensitive to the level estimate of r^* and the temporarily soft inflation reading, pointed to -25 bps. The framework's loss-minimizing recommendation was -25 bps, aligning with the more gradual First-Difference signal rather than the larger level-rule cluster. Taken together, these quantities imply a projected path in which policy is closer to neutral than a level reading of the funds rate alone would suggest, with the modest momenta arguing against an abrupt adjustment in either direction.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants converged on a continuation of the measured 25 bps tightening pace, though they arrived there from distinct vantage points. The member most focused on inflation risk emphasized that although core PCE at 1.56 percent remained below target, the Beige Book documented broad cost increases across all Districts for energy, petroleum products, building materials, and shipping, with several Districts reporting that these input costs were passing through to



retail prices. This member stressed that with unemployment essentially at the natural rate, the economy had little slack to absorb emerging wage pressures in services and skilled occupations, and argued that a forward-looking mandate should guard against building inflation risk rather than wait for realized inflation to breach target.

The member weighting labor and employment risk most heavily examined whether the data called for protective easing and concluded it did not, at least on the predictive read: unemployment showed no rising trend, jobless claims at 324,000 were moderate, and the Beige Book confirmed rising employment and tightening labor markets. With no jobs to defend, this member judged a measured continuation appropriate rather than a pause or cut. The member attentive to financial stability observed that the stress index at 0.1269, a VIX of 14.53, and a Baa spread of 1.81 all signaled calm, healthy conditions that could absorb another hike, and noted that halting abruptly would surprise markets given the near-zero T-bill spread. The data-dependent member read the numbers at face value as supporting continued gradual tightening, and the member focused on market signals emphasized that the T-bill spread pointed to a hike already priced in and that a flat but positive yield curve offered no recession signal to block continuation. In rebuttal, no member was moved off the +25 bps view.

The discussion shifted markedly when participants turned to the deterministic framework's recommendation of -25 bps and its reference-rule inputs. Several participants confronted the tension directly: the level rules pointed to -75 bps because core inflation was below target with labor near neutral, while the First-Difference rule and the framework's aggregated output pointed to a more measured -25 bps. A recurring theme was that a real policy rate of roughly 2.2 percent against an r^* estimate of 1.176 implied policy was not loose, which participants reconciled in different ways. The member weighting labor risk found the level rules resonant with an instinct to ease given below-target inflation, negative unemployment momentum, and elevated jobless claims, but judged that hurricane distortions in the data counseled against overreacting with a full -75 bps; this member endorsed -25 bps as beginning to remove restriction to protect a possibly softening labor market while respecting moderate wage growth.

The member focused on financial stability likewise endorsed -25 bps, reasoning that the calm in credit and funding markets meant no systemic constraint bound the decision in either direction, that a -75 bps cut would jar orderly markets and risk reigniting still-firm housing at a time when residential demand was already reported to be easing somewhat, and that First-Difference gradualism best respected orderly conditions. The data-dependent member reached the same conclusion, judging that below-target inflation and near-neutral labor justified a small, proportionate cut, that the modest



momenta argued against the aggressive -75 bps of the level rules, and that the framework's aggregation deserved weight given the rules were judged reliable. By contrast, the inflation-focused member declined to endorse easing: while acknowledging the framework's math and finding the First-Difference logic the only tolerable easing rationale, this member held that positive inflation momentum and building pass-through and wage pressures made cutting the wrong direction, and that a real rate only modestly above neutral did not warrant accommodation.

The member weighting market signals took an intermediate position. This member agreed the current stance was likely closer to neutral than market pricing assumed and that a modest cut was 'not crazy' given sub-target inflation, but resisted easing against clear market signals: the T-bill spread pointed to expected firming, the curve showed no recession alarm, and positive inflation momentum together with Beige Book pass-through warned that the soft core reading could reverse. This member accepted that the -25 bps step was at least modest rather than the jarring -75 bps of the level rules, but stated a true preference for a smaller-or-no step, agreeing with the direction only uneasily. Across both the predictive and optimal discussions, participants repeatedly returned to the same underlying facts — sub-target but firming inflation, a labor market essentially at neutral, calm financial conditions, and hurricane-related noise in the incoming data — even as they weighed those facts toward different conclusions.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action, all five members supported a 25 bps increase in the target rate, a unanimous 5-0 reading. On the deterministic framework's recommendation of a 25 bps reduction, the Committee did not reach full agreement: three members — the member weighting labor and employment risk, the member focused on financial stability, and the data-dependent member — endorsed the -25 bps recommendation as-is; the member weighting inflation risk declined to support it, holding that easing ran against positive inflation momentum and building cost and wage pressures; and the member weighting market signals registered a partial position, agreeing with the direction of a modest step but not with easing against market pricing that anticipated continued firming. The recorded optimal-side tally was thus three endorse, one decline, and one partial.