



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$1,564.3 billion as of September 16, up \$63.9 billion from the prior release on September 9. The composition remained concentrated in longer-dated Treasury securities and agency mortgage-backed securities: Treasury notes and bonds accounted for \$691.1 billion, agency MBS for \$685.1 billion, and Treasury bills for a comparatively small \$18.4 billion. The week-over-week increase reflected continued expansion of the account. The staff noted that these figures cover SOMA securities holdings only — total size, composition, and change from the prior week — and do not encompass the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source is currently available; discussion here is accordingly limited to the holdings data itself.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that measures of real activity continued to point to stabilization rather than robust recovery. The Chicago Fed National Activity Index registered -0.21, consistent with growth still running somewhat below trend. Labor market conditions remained weak: the unemployment rate stood at 9.7%, far above the estimated natural rate of 5.04%, and initial jobless claims were still elevated at roughly 550,000. On the price side, core PCE inflation was running at 1.07% on a year-over-year basis, well below the 2.0% objective, indicating subdued underlying price pressures. The Employment Cost Index reading of 110.7 showed no evident acceleration in labor compensation. M2 stood at \$8,297.7 billion.

The most recent Beige Book, prepared before the end of August, described economic activity as continuing to stabilize across the twelve Districts in July and August. Dallas reported that activity had firmed, while several Districts — including Boston, Cleveland, Philadelphia, Richmond, and San Francisco — noted signs of improvement; others characterized conditions as stable or stabilizing, and St. Louis observed that the pace of decline appeared to be moderating. Retail sales were generally flat, with retailers keeping inventories tightly aligned to low sales, and the 'cash-for-clunkers' program was widely credited with boosting traffic and prompting increases or planned increases in automobile-related production in several Districts. Most regions reported some improvement in residential real estate, though downward pressure on home prices persisted in most Districts. Commercial real estate demand remained weak and nonresidential construction continued to decline. Loan demand was described as weak and credit standards as still tight, and labor market conditions were reported as weak across all Districts, even as the overall outlook among business contacts was characterized as cautiously positive.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as healing but not yet fully normalized. The financial stress index stood at 0.3507, elevated relative to a calm baseline but well off crisis peaks. The VIX at 23.69 indicated meaningful residual volatility without the panic readings seen earlier. The Baa corporate spread of 2.91 showed that credit costs for lower-grade borrowers remained wide, a sign of lingering stress in private borrowing conditions. The 10-year/2-year Treasury spread was steeply positive at 2.47, with no inversion, consistent with market expectations of eventual recovery. Short-term money markets remained pinned near the current target: the 3-month T-bill spread relative to the current rate was essentially flat at 0.015, indicating that markets priced no near-term move away from the 0.0% to 0.25% range.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the momentum of key variables. The estimate of r^* used in the policy analysis was 1.593, and the reference rules that key off level gaps — the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule — each prescribed roughly 75 basis points, reflecting the combination of a positive neutral rate with large gaps in both inflation and unemployment. Because the current target range of 0.0% to 0.25% already sits near the effective lower bound, these level-based prescriptions point upward rather than downward; they describe a policy stance that mechanical rules regard as accommodative relative to a distant equilibrium, not a case for imminent tightening given the state of the real economy.

The momentum readings temper that level-based signal. Inflation momentum was negative at -0.185, indicating that price pressures were decelerating rather than building, while unemployment momentum was 0.5, suggesting that joblessness was still tending to rise rather than stabilize. Taken together, these imply that conditions were not yet improving decisively and that the disinflationary drift left no near-term impetus toward higher rates. Consistent with this, the change-based First-Difference rule returned 0 basis points. The deterministic policy engine, weighing these inputs with the reference rules judged reliable, arrived at a loss-minimizing recommendation of 0 basis points — the divergence between the 75 basis point level rules and the 0 basis point outcome being attributable to the lower-bound constraint and the softening momentum.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants approached the meeting from distinct vantage points but converged early on the assessment that the current target range should be maintained. The member most attentive to inflation risk observed that, for this meeting, the usual concern was simply absent: core PCE at 1.07% sat nearly a full point below the 2.0% objective, and there was no wage-push signal, with the Employment Cost Index showing no acceleration and slack described as enormous. This participant



emphasized that a hike would require an actual or clearly incipient inflation threat, which the data did not present, while a cut was infeasible at the floor and unwarranted given that stress readings were off crisis levels. The member noted, however, that vigilance would return if slack narrowed and inflation momentum turned positive.

The participant most focused on the labor market underscored the severity of the employment shortfall — unemployment at 9.7% against a 5.04% natural rate, a gap of some 4.6 points, with initial claims still around 550,000 and labor conditions weak across all twelve Districts. This member stressed that additional accommodation could not come through conventional cuts at the effective lower bound, and that holding the range was therefore the maximally accommodative feasible stance, supported by the ongoing Treasury purchase program winding down through October and by continued extended-low-rate guidance. The participant attentive to financial stability read credit spreads and funding markets first, judging that a financial stress index of 0.3507, a VIX near 24, and a Baa spread of 2.91 signaled healing but not health. With loan demand weak and credit standards still tight, this member argued that the transmission channel remained impaired and that premature tightening posed the greater, asymmetric risk of reversing tentative stabilization.

The participant weighting market-implied signals noted that the flat 3-month T-bill spread of 0.015 indicated markets priced no near-term move, while the steeply positive 10-year/2-year spread of 2.47 was interpreted as the market performing its own easing — carrying accommodation at the long end while short rates stayed pinned. In this reading, markets were neither fighting the current stance nor demanding additional stimulus. The data-dependent member, reading the indicators at face value, found genuine unanimity in the predictive round: no inflation pressure to hike against, deep labor slack, a floor that precluded meaningful cuts, and a Beige Book that described only stabilization and a cautiously positive outlook rather than a recovery warranting a change.

When discussion turned to the framework's loss-minimizing recommendation, participants engaged directly with the divergence between the reference rules and the recommended action. Several observed that the Taylor, Balanced Approach, and ELB-adjusted rules each prescribed roughly 75 basis points, driven by the positive r^* of 1.593 and the large gaps, but that these level-based prescriptions overshoot when policy is pinned near the lower bound. The First-Difference rule's 0 basis point output, keyed to momentum rather than distant equilibrium, was the prescription participants found most persuasive given negative inflation momentum of -0.185 and rising unemployment momentum of 0.5. The inflation-focused member characterized the alignment of an inflation hawk with a hold recommendation as a rare full agreement, revealing that the current stance was already appropriately positioned; the labor and stability members read the same divergence as confirmation that the balance



sheet and guidance, not the policy rate, were the active tools.

Across both the predictive and optimal-framework rounds, no participant was moved from a hold. Each characterized the recommendation as consistent with their own primary lens — inflation risk, labor slack, financial fragility, market pricing, or a literal reading of the data — and each treated the 75 basis point level-rule outputs as a mechanical artifact already discounted by the lower-bound reality and by markets. Participants generally judged that with inflation subdued and decelerating, slack enormous, and credit conditions still fragile, holding the range preserved the extended-low-rate posture on which the recovery was relying.

COMMITTEE POLICY ACTIONS

In the predictive round, all five participants supported maintaining the target range for the federal funds rate at 0.0% to 0.25%, a unanimous outcome of five votes for no change. On the framework's loss-minimizing recommendation of 0 basis points, the Committee likewise reached full agreement: all five members — the inflation hawk, the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist — endorsed the recommendation as-is, with no members declining and none registering partial agreement. Both the predictive vote and the optimal-side stance thus aligned on holding the current range unchanged.