



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$2,044.1 billion as of September 8, the most recent release available on or before the point-in-time-safe cutoff. The portfolio remained heavily weighted toward mortgage-backed securities, which accounted for \$1,103.2 billion of the total, alongside \$724.4 billion in Treasury notes and bonds and a comparatively small \$18.4 billion in Treasury bills. Total holdings rose by \$3.6 billion from the prior release of September 1, a modest week-over-week change consistent with the reinvestment of principal payments. The staff noted that this review covers SOMA securities holdings only — total size, composition, and the change from the prior week — and does not include the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that the economic recovery had continued but at a decelerating pace. The unemployment rate stood at 9.6 percent, well above the estimated natural rate of roughly 5.03 percent, pointing to substantial and persistent labor-market slack. Initial claims for unemployment insurance remained elevated at 451,000, offering little evidence of a meaningful pickup in hiring. The Chicago Fed National Activity Index registered -0.19, consistent with below-trend growth. On the price side, core PCE inflation was running at 1.13 percent on a twelve-month basis, well below the Committee's 2 percent objective, and the Employment Cost Index reading of 112.8 was consistent with contained labor-cost growth. M2 stood at \$8,610.9 billion.

The most recent Beige Book, prepared by the Federal Reserve Bank of San Francisco on information collected on or before August 30, characterized national activity as continuing to grow but with 'widespread signs of a deceleration' relative to preceding periods. Modest growth was the most common description of conditions, though five Districts highlighted mixed conditions or outright deceleration. Consumer spending appeared to increase on balance despite continued caution that limited nonessential purchases, and manufacturing continued to expand even as several Districts reported the pace of growth had eased. Home sales slowed further following the expiration of the homebuyer tax credit at the end of June, which in turn prompted a slowdown in construction, and demand for commercial real estate remained quite weak while showing signs of stabilization in some areas. Financial institutions reported generally stable or slightly lower loan demand along with modest improvement in credit quality. Upward price pressures were described as 'quite limited' for most final goods and services, with wage pressures similarly limited apart from higher prices for selected commodities such as grains and some industrial materials.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff reported that financial conditions were moderate and broadly stable, showing no acute stress. The financial stress index stood at 0.2139, elevated but well short of crisis levels, and the VIX at 21.56 reflected some market caution rather than disorder. The Baa corporate spread over Treasuries was 2.97, indicating credit stress that remained contained rather than widening alarmingly. The 10-year/2-year Treasury spread was steeply positive at 2.18, offering no inversion signal and implying low near-term recession risk from the shape of the curve. At the front end, the 3-month Treasury bill traded only about 1.5 basis points above the current target rate, indicating that market participants anchored their expectations around continuation of the prevailing policy stance and priced no near-term change in the target range.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral real rate and the momentum measures available for this meeting. The estimated r^* of about 1.184 implied that the neutral policy rate lay above the current setting, but with the federal funds target range already at its effective lower bound of 0.0 to 0.25 percent, no room remained to move the rate lower toward what the rules would otherwise prescribe. Inflation momentum was only marginally positive at 0.115, suggesting no building acceleration in prices and reinforcing the picture of inflation running persistently below target. Unemployment momentum at -0.1 pointed to only slight improvement in labor-market conditions, far from a pace that would close the large employment gap quickly.

Against this backdrop, all four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — returned an output of 0 basis points, and the reference rules were judged reliable for this meeting. Because the inflation shortfall of roughly 0.87 percentage point and the sizable unemployment gap would together push the rules' unconstrained prescription below zero, the effective lower bound was the binding constraint on the rate instrument. The projection thus implied that conditions were likely to remain accommodative but that further conventional support through the funds rate was not available; the loss-minimizing rate path held at the floor while the operative easing channel shifted to the existing reinvestment of maturing MBS proceeds into longer-term Treasuries.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening positions, all five participants arrived at the same conclusion — hold the target range at 0.0 to 0.25 percent — though they reached it through distinct frameworks. The participant most attentive to inflation risk noted that, despite weighting price pressures heavily and remaining cautious about easing prematurely, core PCE at 1.13 percent was well below the 2 percent target and the Beige Book confirmed a disinflationary tone through limited wage pressures and soft



final-goods prices. In that view there was simply no upside inflation to fight, and the only price-side concern was the downside disinflation trend, which did not yet warrant additional action beyond current support. A hike, this participant stressed, would tighten credit into a decelerating recovery with unemployment at 9.6 percent and no inflation justification to support it.

The participant focused on the labor market framed conditions in starker terms, describing a deeply weak employment picture: unemployment far above the natural rate, initial claims at 451,000, and a Chicago Fed index at -0.19 signaling below-trend growth, all against a Beige Book backdrop of slowing home sales and contracting construction. This participant's instinct was to ease further to support hiring, but acknowledged that with the range already at the effective lower bound, a conventional cut was not mechanically feasible. Additional accommodation, in this reading, had to come through the existing balance-sheet reinvestment rather than the funds rate — a point on mechanics that the participant found persuasive and returned to across rounds, characterizing the hold as a product of the constraint rather than comfort with the pace of recovery.

The participant attentive to financial stability emphasized that the stress and spread metrics showed no acute strain demanding emergency action: a stress index of 0.2139, a VIX of 21.56, a contained Baa spread of 2.97, and a positively sloped yield curve with no inversion. From that lens, no rate change was needed to calm markets, cutting was impossible at the floor, and hiking into a decelerating economy would risk widening spreads and destabilizing a fragile recovery. The participant weighting market signals reinforced this reading from the pricing side, treating the roughly 1.5-basis-point spread of the 3-month bill over the current rate as the single most decisive indicator that markets had fully priced continuation of the prevailing stance. The data-dependent participant summarized the common ground bluntly: both legs of the mandate pointed dovish, nothing in the data justified moving in either direction, and the most literal reading was to hold.

The rebuttal round produced no defections. Each participant confirmed that the others' arguments reinforced rather than challenged the shared conclusion, and none identified a case for either a hike or a mechanically feasible cut. When the discussion turned to the framework's optimal-policy output, participants engaged with the specific quantities directly. Several found the ELB-adjusted rule most persuasive, since it explicitly recognized that the floor prevented the negative rate the other rules' logic would otherwise imply. The inflation-focused participant, by contrast, said the Taylor rule's explicit weighting of the 0.87-percentage-point inflation shortfall carried the argument in its own right, reaching 0 basis points through price logic without needing to lean on the constraint. The centrist participant noted the unusual strength of having all four rules converge on the same value and judged reliable, describing the current stance as appropriately calibrated at the lower bound.



Across both the optimal-framework rounds and their rebuttals, participants consistently characterized the estimated r^* of about 1.184, the barely positive inflation momentum of 0.115, and the slightly negative unemployment momentum of -0.1 as pointing to the same place: policy that was already accommodative, with a neutral rate above the current setting but no room to close that distance through the funds rate. Participants generally judged that the operative channel for any further support remained the reinvestment of MBS proceeds into longer-term Treasuries, and that withdrawing support now would risk tightening conditions prematurely into a still-soft labor market and a decelerating recovery. No participant advanced a case for tightening, and the agreement between individual reasoning and the framework recommendation was read not as coincidence but as confirmation that the current stance was neither too tight nor destabilizing.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported maintaining the federal funds target range at 0.0 to 0.25 percent, a unanimous 5-0 outcome with no participant favoring a change in either direction. On the separate question of whether to endorse the policy framework's loss-minimizing recommendation of 0 basis points, the Committee was likewise in full agreement: all five members — the inflation-focused participant, the labor-market-focused participant, the financial-stability voice, the data-dependent centrist, and the market-signal participant — recorded an endorsement, with none declining and none registering only partial agreement. The Committee thus maintained the existing accommodative stance and the reinvestment of principal payments from maturing agency MBS into longer-term Treasury securities.