



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$2,033.0 billion in domestic securities as of October 27, 2010, comprising \$770.8 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$1,051.0 billion in agency mortgage-backed securities. This represented a decline of \$10.1 billion from the prior release of October 20. The composition remained heavily weighted toward agency MBS, which accounted for slightly more than half of the total portfolio, with longer-dated Treasury coupons making up the bulk of the remainder and bills a small residual. It should be noted that these figures cover SOMA securities holdings only — total size, composition, and the week-over-week change — and do not encompass repurchase or reverse-repurchase operation results, for which no point-in-time-safe data source is currently available; the discussion here is accordingly confined to the outright holdings reported by the Desk.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that national economic activity continued to expand at a modest pace. The Chicago Fed National Activity Index stood at -0.12, consistent with growth running somewhat below trend. Labor market conditions remained weak: the unemployment rate held at 9.6 percent, far above the estimated natural rate of roughly 5.02 percent, and initial claims for unemployment insurance remained elevated at 452,000, offering little sign of durable improvement in hiring. Inflation continued to run well below the 2 percent objective, with core PCE prices up 0.97 percent over the prior twelve months. The Employment Cost Index reading was consistent with the broader picture of subdued compensation pressure.

The most recent Beige Book, prepared on the basis of information collected on or before October 8, characterized activity as continuing to rise, 'albeit at a modest pace.' Manufacturing expansion was broad-based across most Districts, with production and new orders rising, though activity softened in two Districts and exports supported factory activity in several others. Consumer spending was steady to up slightly, but contacts described consumers as price-sensitive, with purchases 'mostly limited to necessities and nondiscretionary items.' Housing markets remained weak, with sales below year-ago levels in most Districts, and commercial real estate conditions were subdued. Lending activity was described as stable in most Districts. Input costs — most notably for agricultural commodities, industrial metals, and shipping — rose further, but higher costs were largely not passed through to final prices, and wage pressures were characterized as minimal.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff reported that financial conditions were broadly stable and showed no signs of acute distress. The financial stress index stood at 0.1758, a moderate reading, and the VIX at 20.71 was elevated but calm rather than indicative of market panic. Credit conditions appeared contained, with the Baa corporate spread at 3.09 — somewhat elevated but not signaling a sharp deterioration in borrowing costs. The Treasury yield curve was steeply positive, with the 10-year/2-year spread at 2.35 and no inversion, and front-end funding markets were orderly, as reflected in a 3-month T-bill spread of just 1.5 basis points relative to the current policy rate. Taken together, these indicators suggested that markets were pricing no near-term change in the target range and that credit and funding markets were functioning without strain.

STAFF ECONOMIC OUTLOOK

Staff projections were framed around the reference-rule outputs and the estimated policy parameters available for this meeting. The estimated neutral real rate (r^*) was approximately 1.111, which, given core inflation running near 1 percent, implies that the neutral nominal rate lies above the current setting of the federal funds rate — but the effective lower bound constrains the extent to which the rate tool can respond to that gap. Inflation momentum was slightly positive at 0.11 and unemployment momentum slightly negative at -0.05, pointing to broadly steady near-term dynamics rather than a rapid move in either direction.

All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — returned 0 basis points, and the reference rules were judged reliable this meeting. The consistency across specifications suggests that, once the lower bound is respected, holding the current stance is the loss-minimizing setting. The projection implied by these quantities is one of continued below-target inflation and persistently large labor-market slack that closes only gradually, with the rate tool essentially exhausted on the downside. The watchpoints flagged by the staff data were the rising input costs for metals, agricultural commodities, and shipping noted in the Beige Book, which could bear on the inflation path should pass-through to final prices eventually materialize.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants broadly agreed that the appropriate action for the federal funds target range this meeting was to hold at 0.0 to 0.25 percent, and much of the discussion centered on why that conclusion followed even from starkly different starting priorities. The member most attentive to inflation risk observed that the usual case for resisting accommodation simply did not apply, because core PCE at 0.97 percent was running at roughly half the 2 percent objective. With inflation momentum only slightly positive and the Beige Book reporting minimal wage pressures and stable final-goods prices, this participant judged there was no upside inflation threat to lean against and therefore no basis for a hike



— while emphasizing that holding, rather than easing further, was the position consistent with a cautious stance toward future imbalances.

The participant most focused on the labor market stressed the severity of the employment shortfall — unemployment at 9.6 percent against a natural rate near 5 percent, elevated initial claims at 452,000, and a Chicago Fed index at -0.12 signaling below-trend growth. This member argued that the mandate would ordinarily justify additional support and was explicit that endorsing a hold was not a claim that policy was already loose enough for the labor market; rather, the target range was at its effective lower bound, so a conventional cut was not an available lever. Any further support, in this view, would have to come through means other than the target rate, and prior guidance had signaled readiness to provide additional accommodation if needed.

The participant attentive to financial stability reviewed the stress indicators before endorsing any path and found conditions stable but fragile rather than resilient. The financial stress index at 0.1758, the VIX at 20.71, a contained Baa spread of 3.09, and a steeply positive yield curve with no inversion together indicated no acute systemic strain that would demand a defensive move. This member cautioned that a hike would tighten credit conditions abruptly against a backdrop of weak housing, subdued commercial real estate, and merely stable lending, and judged that holding at the floor preserved orderly spreads and funding markets without creating credit-market imbalances. The participant weighing market signals reinforced this read, noting that the 3-month T-bill sitting just 1.5 basis points above the current rate indicated markets had fully absorbed prior guidance and were pricing no change; the steep curve pointed to no imminent recession that would demand action below the floor.

The centrist participant drew the threads together in a literal reading of the data: below-target inflation and large slack would normally call for cuts, but with the range already at its floor and all reference rules converging at 0 basis points, holding was the consensus-supported call. In the optimal-framework discussion, participants found that this convergence was genuine rather than coincidental. Several noted that the ELB-adjusted rule's logic resonated most directly with their own reasoning, since it explicitly recognized that rates could not go below zero; the inflation-focused member found the Taylor rule persuasive because it still counseled staying at the floor even with inflation below target and slack wide. With the estimated r^* of 1.111 implying a neutral rate above the current setting, participants generally acknowledged that the rate tool was constrained and that the effective burden of any further accommodation would fall on other instruments.

In the rebuttal exchanges, no participant was moved off their directional emphasis, but the cross-references sharpened confidence in the shared conclusion. The labor-focused member reiterated concern about the employment gap while conceding the floor blocked further cuts; the



inflation-focused member restated commodity-driven input costs as a watchpoint, while acknowledging that the absence of pass-through to consumer prices meant those pressures did not justify tightening now. The financial-stability and market-signal participants each cited the other's read as reinforcing — calm funding markets and contained stress metrics on one side, market pricing consistent with a steady range on the other. The discussion thus reflected genuine differences in mandate weighting that nonetheless resolved, given the lower bound and the below-target inflation picture, into a common judgment that holding was appropriate.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate policy action, all five members supported holding the federal funds target range at 0.0 to 0.25 percent, a unanimous 5-0 outcome with no member favoring either a cut or a hike. On the deterministic optimal policy engine's recommendation of 0 basis points — supported by the Taylor, Balanced Approach, First-Difference, and ELB-adjusted rules, all judged reliable this meeting — the Committee was likewise in full agreement: all five members endorsed the recommendation as-is, with none declining and none registering only partial agreement. The inflation hawk, the labor market dove, the financial stability voice, the data-dependent centrist, and the market signal realist each endorsed the 0-basis-point recommendation, so that the predictive vote and the optimal-side outcome coincided completely.