



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Manager reported on holdings in the System Open Market Account. As of September 14, 2011, total SOMA domestic securities holdings stood at \$2,644.2 billion, comprising \$1,564.3 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$884.9 billion in agency mortgage-backed securities. This represented an increase of \$3.4 billion from the prior release of September 7. Members were reminded that this account summary reflects SOMA securities holdings only — total size, composition, and the week-over-week change — and does not cover the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source is currently available; accordingly, the discussion of open market operations was confined to the securities portfolio itself.

STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation stood at 1.45 percent on a twelve-month basis, running below the 2.0 percent objective. The unemployment rate remained elevated at 9.1 percent, far above the 5.2 percent estimated natural rate, and initial jobless claims registered 414,000, at a level that staff associate with continued labor-market stress. The Chicago Fed National Activity Index at -0.06 pointed to growth running slightly below trend. The Employment Cost Index was reported at 115.1 and M2 money supply at \$9,313.7 billion.

The most recent Beige Book described a softening tone across much of the country. Economic activity expanded more slowly in the Chicago District and slowed in Richmond, while conditions in Boston and Philadelphia were characterized as mixed, with Philadelphia noting activity was somewhat weaker overall. Several Districts reported that recent stock market volatility and increased economic uncertainty had led many contacts to downgrade or become more cautious about their near-term outlooks. Consumer spending increased slightly in most Districts, though non-auto retail sales were flat or down in several. Manufacturing conditions were mixed, with the pace of activity slowing in many Districts. Residential real estate remained weak overall, and most Districts characterized commercial real estate and construction as weak or little changed. Loan demand was stable to slightly weaker with lending standards largely unchanged. On prices, the report noted that price pressures edged lower, although input costs continued to rise in some industries; labor markets were generally stable, and wage pressures were generally minimal outside of some upward movement for skilled positions.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions reflected elevated volatility and a degree of investor caution. The VIX stood at 34.6, and the financial stress index registered 0.207 — moderate in level but consistent with the volatility-driven wariness described by Beige Book contacts. The Baa corporate spread of 3.3



percentage points indicated meaningful, though not extreme, credit-cost strain for lower-grade issuers. The 3-month Treasury bill spread relative to the current policy rate was negative at -0.115 , suggesting flight-to-safety demand for short-term Treasuries and market pricing at or slightly below the current policy floor. The 10-year/2-year Treasury yield curve spread remained positively sloped at 1.84 percentage points, an indication that market participants were not pricing an imminent recession even amid the elevated stress readings.

STAFF ECONOMIC OUTLOOK

Staff projections drew on the estimated neutral rate and the reference-rule framework. The estimated neutral real rate (r^*) was low, at 0.495, implying limited scope for the policy rate to rise even were conditions to move toward neutral. Inflation momentum was estimated at 0.265 and unemployment momentum at 0.2 — figures consistent with inflation running soft and slack receding only gradually. With core PCE below the 2.0 percent objective and a wide unemployment gap, the near-term trajectory pointed toward continued below-target inflation and persistently elevated unemployment rather than any emerging overheating.

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 framework judged the reference rules reliable for this meeting. The Taylor and Balanced Approach formulations, given below-target inflation combined with a large unemployment gap, would imply a policy rate below zero, truncated at the effective lower bound; the ELB-adjusted rule captured that truncation directly. Taken together, the projected path was one in which the funds rate stance remains pinned at the floor, with the low r^* leaving little room above the current setting and the momentum readings offering no signal of a self-sustaining acceleration in either prices or employment over the projection horizon.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants generally agreed that the data offered no case for tightening and, given the current setting of the target range, no feasible room for a conventional cut. The member most focused on inflation risk observed that core PCE at 1.45 percent was running below the 2.0 percent objective, and that the Beige Book's reports of price pressures edging lower and minimal wage pressure left nothing to lean against. This member emphasized that a hawkish tilt finds its justification only when inflation risk is present, and it was simply not present this meeting; with rates already at the effective lower bound, cutting was equally unwarranted, so holding was the unobjectionable outcome.



The member most attentive to the labor market described the 9.1 percent unemployment rate against a 5.2 percent natural rate as a severe and painful gap, with initial claims at 414,000 and the Chicago Fed index at -0.06 confirming that no meaningful healing was underway. This member expressed a genuine desire for maximum accommodation to support employment, but stressed that the instrument was constrained rather than the intent absent: with the target range already at 0.0 to 0.25 percent, there was no conventional room to move lower. Several participants noted that core PCE below target removed any inflation barrier to accommodation, reinforcing this dovish read even as the floor bound the response.

The participant focused on financial stability began from the stress indicators, noting the VIX at 34.6 as a sign of acute market fear and a fragile risk environment, the financial stress index at 0.207 as moderate but consistent with real tension, and the Baa spread of 3.3 as evidence of meaningful credit-cost strain. This member pointed to Beige Book contacts downgrading outlooks specifically on account of stock market volatility and uncertainty, and argued that in such a fragile setting any tightening would risk destabilizing already-nervous conditions. The member attentive to market signals concurred, citing the negative 3-month bill spread of -0.115 as evidence that markets were pricing the floor rather than any liftoff, and the positively sloped 10-year/2-year curve at 1.84 as tempering urgency for dramatic action in either direction. Both stressed that continued accommodation, not a change in the rate itself, was what the stress readings warranted.

The data-dependent participant favored the most literal reading of the evidence: both mandate legs — below-target inflation and a wide unemployment gap — pointed away from tightening, while the effective lower bound foreclosed a conventional cut, leaving a clean hold. In moving from their predictive positions to an assessment of the framework's recommendation, participants found that the reference rules reinforced their independently reached conclusions. Several found the ELB-adjusted rule most persuasive given that the floor binds directly, while the inflation-focused member found the Taylor logic most compelling — below-target inflation plus a large slack signal yielding no room to tighten. The low r^* estimate of 0.495 was cited repeatedly as confirmation that the neutral rate leaves little scope above the current stance.

Across both the predictive rounds and the discussion of the optimal framework, no participant argued for a move in either direction on the rate instrument. Participants generally acknowledged that the more accommodation-minded members would prefer additional support through non-rate means, but agreed this concern bears on other tools rather than on the target range itself. A couple of participants recalled that the prior guidance had been extended and included three dissents concerned about the specificity of that commitment rather than the level of rates, and judged that this history implied no



pressure within the Committee to tighten. The convergence of the mandate signals, the market pricing, and the unanimous reference-rule outputs was read as indicating that the current stance is appropriately accommodative — the endorsement reflecting a binding constraint at the floor as much as any comfort with prevailing conditions.

COMMITTEE POLICY ACTIONS

In the predictive round, all five members independently arrived at a recommendation of no change, holding the target range for the federal funds rate at 0.0 to 0.25 percent, for a final predictive tally of 5 to 0 in favor of a hold. On the framework's recommendation of 0 basis points, the Committee was likewise in full agreement: all five members — the inflation-focused member, the labor-market-focused member, the financial-stability member, the data-dependent member, and the market-signals member — endorsed the recommendation as-is, with none declining and none registering partial agreement. The optimal-side outcome was therefore unanimous, consistent with the predictive vote and with all four reference rules, which returned 0 basis points.