



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$2,625.2 billion in domestic securities as of October 26, 2011, the most recent release available on or before the point-in-time cutoff. The portfolio comprised \$1,582.2 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$849.3 billion in agency mortgage-backed securities. Total holdings declined by \$5.1 billion from the prior release of October 19. The staff noted that this accounting covers SOMA holdings only — total size, composition, and the week-over-week change — and does not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists; the operational details of those facilities were therefore outside the scope of this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 1.55 percent on a twelve-month basis, below the Committee's 2 percent objective. The unemployment rate remained at 9.1 percent, far above the 5.2 percent figure taken as an estimate of its natural rate, indicating substantial and persistent slack in the labor market. Initial claims for unemployment insurance were elevated at 403,000, and the Chicago Fed National Activity Index registered -0.22, consistent with below-trend growth. The Employment Cost Index was reported at 115.6 and M2 money supply at \$9,578.1 billion. The federal funds target range remained at 0.0 to 0.25 percent.

Beige Book material for the Fourth District described economic activity as increasing slowly over the past six weeks. Manufacturers reported stable production but a small decline in new orders and backlogs; energy output changed little, and freight transport volume trended slightly higher. Retail sales rose slightly while new-car purchases were mixed, with district auto production having risen significantly in August as 2012 model production began and supply disruptions from Japan abated, though gains were limited to domestic nameplates. Home builders were increasingly turning to multi-family development, and nonresidential contractors struggled to rebuild backlogs. Business credit demand continued to improve slowly, whereas consumer loan demand was generally weak. Notably, the pace of hiring seen earlier in the third quarter had diminished, especially in manufacturing and energy, with staffing firms reporting fewer new openings concentrated in technical and healthcare occupations. Wage pressures were characterized as contained, and prices for materials used by manufacturers and building contractors were fairly stable or fell slightly, though several manufacturers announced modest price increases to take effect early in the fourth quarter. Most contacts expected near-term weakening in demand, but not to levels seen in the last recession, and capacity utilization remained below normal at most factories.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as elevated but short of crisis levels. The financial stress index stood at 0.267, described as moderate rather than acute. The VIX registered 29.86, reflecting lingering market anxiety attributed to global strains. The Baa corporate spread of 3.1 percentage points indicated meaningful but not severe credit-cost strain on borrowers. The 10-year/2-year Treasury spread was steeply positive at 1.95, providing no imminent recession signal from the shape of the curve. The 3-month Treasury bill spread relative to the current policy rate was -0.105, which the staff read as consistent with no market expectation of near-term tightening and, in part, with flight-to-safety demand for short-dated government paper.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and momentum measures available for this meeting. The estimated real neutral rate (r^*) was 0.381, a very low figure implying that the current policy stance sits only modestly below neutral and leaving little conventional room either to add accommodation or to justify tightening. Inflation momentum was measured at 0.305 — positive but modest, and consistent with core inflation running below the 2 percent objective rather than accelerating toward or through it. Unemployment momentum was 0.0, indicating no improving trend in the labor market to offset the large level gap between the 9.1 percent unemployment rate and its 5.2 percent estimated natural rate.

The reference-rule outputs reinforced this picture. The Taylor rule, Balanced Approach rule, First-Difference rule, and ELB-adjusted rule each returned 0 basis points, and the reference rules were judged reliable for this meeting. The ELB-adjusted rule in particular reflected that unconstrained formulations would call for deeper accommodation given the size of the employment gap and sub-target inflation, but that the effective lower bound binds. Taken together, the low neutral rate, weak inflation momentum, absent unemployment momentum, and unanimous rule agreement projected a continuation of soft, below-trend conditions with no near-term impetus toward either a firming or a further conventional easing of the policy rate.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants converged on the view that the federal funds target range was already at its effective lower bound and that neither a conventional cut nor a rate increase was warranted by the incoming data. The participant most attentive to inflation risk observed that core PCE at 1.55 percent sat below, not above, the 2 percent objective, and that the Beige Book confirmed contained wage pressures and stable-to-falling input prices. On this reading, the usual instinct to lean against inflation was simply not triggered; with no broad-based price impulse to resist and the rate already at the floor, holding was the consistent choice. This participant nonetheless voiced



continuing wariness about over-accommodation from tools deployed at the prior meeting and indicated a disposition to resist adding fresh stimulus.

The participant focused on labor-market conditions emphasized that unemployment at 9.1 percent stood nearly four points above the 5.2 percent natural rate, a gap that dominated that member's thinking. The Beige Book's reports of diminished hiring, fewer job openings in manufacturing and energy, elevated initial claims of 403,000, and a Chicago Fed index of -0.22 were cited as evidence of a stalling rather than recovering labor market. Because inflation was running below target with contained wage pressures, this participant judged that inflation posed no constraint on the desire to support employment more aggressively. The binding difficulty, this member acknowledged, was arithmetic: with the target range at the floor, no further conventional cut was feasible, and further support would have to run through balance-sheet tools already in place rather than the policy rate.

The participant most attentive to financial stability began from the stress indicators, characterizing the financial stress index at 0.267, the VIX near 30, and the Baa spread of 3.1 as signaling elevated but not acute conditions. The steeply positive 10-year/2-year curve and the slightly negative 3-month bill spread were read as showing markets pricing continued accommodation rather than an imminent recession or a near-term move. This member argued that with conditions fragile, stability was best preserved by steadiness — that surprising markets with a move would be counterproductive — and stressed that major easing had been enacted only one meeting earlier, so it was premature to layer on additional action before those tools had time to work through credit channels. The data-dependent participant, taking indicators at face value, noted that both mandate legs pointed the same direction: below-target inflation and deep slack both argued for maintaining accommodation, not tightening, while the floor foreclosed a further cut. The participant oriented toward market signals concurred, citing the negative bill spread and steady curve as an efficient market expectation of no change.

As participants turned to the framework's loss-minimizing recommendation, the discussion reinforced rather than reopened these positions. All four reference rules returning 0 basis points, the reliability flag, and the very low estimated r^* of 0.381 were taken as confirming that the stance was appropriately neutral-at-the-floor. Several participants remarked that the framework's 0-basis-point recommendation matched their own predictive judgments — that agreement, in their view, revealed a coherent stance rather than a coincidence. The labor-focused participant found the ELB-adjusted rule most persuasive, describing it as the arithmetic recognition that unconstrained rules wanted deeper accommodation but the floor bound at zero; that member reiterated a preference for more easing that it could not deliver through the rate. The inflation-focused participant found the Taylor rule's balancing of the inflation shortfall against the employment gap most compelling in landing cleanly at the floor.



In the concluding exchange, no participant was moved to revise. The inflation-focused member reaffirmed that subdued price data and modest inflation momentum of 0.305 left no case to hike, while the floor left no case to cut. The labor-focused member reaffirmed that deep slack justified more support in principle but could not be pursued below zero. The financial-stability member reiterated that steadiness, not a move, best served fragile markets, and the centrist and market-signal members restated that the data, the rules, and market pricing all pointed to the same conclusion. Participants generally judged that letting the previously deployed balance-sheet measures work while monitoring the incoming data and stress indicators was the prudent course.

COMMITTEE POLICY ACTIONS

In the predictive phase, all five participants supported maintaining the federal funds target range at 0.0 to 0.25 percent, yielding a unanimous vote of 0 basis points (5 members in favor, none opposed). On the 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 participant, the data-dependent participant, and the market-signal participant — endorsed the recommendation as-is, with none declining and none registering partial agreement. The two phases were therefore fully aligned, reflecting a unanimous decision to hold the target range steady this meeting.