



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$3,383.5 billion as of the September 11 release, the most recent available on or before the point-in-time-safe cutoff. Holdings were composed of \$1,940.6 billion in Treasury notes and bonds and \$1,291.5 billion in agency mortgage-backed securities, with the balance in other domestic securities. The portfolio grew by \$6.3 billion relative to the prior release of September 4, reflecting the ongoing pace of purchase activity. The staff noted that these figures cover SOMA securities holdings only — total size, composition, and the week-over-week change — and do not encompass the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists; the discussion accordingly abstracted from those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that inflation remained well below the Committee's longer-run objective. Core PCE inflation was running at 1.07 percent on a twelve-month basis, nearly a full percentage point under the 2 percent target. The Employment Cost Index stood at 119.0, and the Beige Book material offered no indication of building cost pressure: contacts across the reporting district generally did not complain of higher input prices and did not report raising their own prices significantly, with the majority noting no change in either input or sale prices from the prior quarter. Retail and tourism contacts described steady prices alongside comparable-store sales increases in the 4 to 5 percent range.

Labor market and activity readings pointed to continued but subdued progress. The unemployment rate was 7.3 percent, well above the 5.5 percent estimated natural rate, leaving a sizable gap. Initial jobless claims were 323,000. The Chicago Fed National Activity Index was -0.15, consistent with growth running somewhat below trend. Beige Book contacts characterized activity as expanding at a modest pace, with most reporting low-to-moderate single-digit year-on-year growth and hiring described as subdued outside fast-growing technology firms; one rapidly growing medical device maker was adding headcount at a 15 percent annualized rate, but this was an exception rather than the norm. Contacts reported no major cyclical layoffs. Sequestration had not yet produced direct effects on firms with major government business, but contacts anticipated future weakness, including a possible drag on travel-industry revenues later in the year tied to cuts in government travel budgets.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly accommodative and calm. The financial stress index stood at 0.075, a very low reading indicating no evident systemic strain, and the VIX at 13.82 signaled subdued market volatility. The Baa corporate spread was 2.61, a contained level consistent with credit markets



functioning normally and no unusual widening in borrowing costs. The Treasury yield curve was steeply positive, with the 10-year/2-year spread at 2.46, showing no inversion and no recession signal from the term structure. The 3-month T-bill spread relative to the current policy rate was -0.105, sitting slightly below the current target range and suggesting that markets were not pricing a near-term policy move. The staff also noted the Beige Book observation that higher interest rates had already begun to reshape real estate activity — putting upward pressure on commercial capitalization rates while 'nudging' some residential buyers into the market in anticipation of further rate increases.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment emphasized that the estimated neutral real rate, r^* , was -0.5 percent — a deeply negative figure implying that the current 0 to 0.25 percent target range was less accommodative in real terms than a comparison against a normal neutral rate would suggest. Against this backdrop, the reference-rule outputs diverged sharply. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points, driven principally by the large unemployment gap, while the First-Difference rule pointed to 0 basis points. The staff read this divergence as reflecting the difference between level-based prescriptions, which mechanically call for closing the gap between actual policy and a presumed-normal neutral setting, and a change-based prescription that responds to the direction of incoming momentum.

On momentum, the staff noted that inflation momentum was negative at -0.075, indicating that the undershoot relative to target was tending to widen rather than stabilize, while unemployment momentum was flat at 0.0, showing no acceleration in labor-market improvement. Taken together, these figures implied little near-term impetus toward the conditions that would justify tightening: with price pressures softening and labor progress neither accelerating nor deteriorating, the likely path of conditions was one of continued below-target inflation and gradual, incomplete labor-market healing. The optimal policy engine's loss-minimizing recommendation of 0 basis points was consistent with this reading, and the staff characterized the reference rules as reliable while noting that the 75-basis-point prescriptions rested on assumptions the negative r^* and lower-bound context did not support.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants independently favored no change to the target range, and the discussion that followed largely reinforced that convergence rather than disturbing it. Participants nonetheless arrived at the same conclusion from distinct vantage points, and the reasoning was substantive enough to be worth setting out. The member most attentive to inflation risk observed that his hawkish instinct was appropriately muted when core PCE was running nearly a full point below target. He stressed that this was not a case of inflation running hot; the Beige Book's



reports of steady input and output prices corroborated the low reading and pointed to no pipeline pressure, and the Employment Cost Index gave no sign of a wage-price spiral. With substantial labor slack still evident at a 7.3 percent unemployment rate, he saw no cost-push force to lean against and no basis for a hike, while a cut was neither feasible from the effective floor nor warranted with inflation below target.

The member focused on employment described a still-soft labor market — unemployment far above the natural rate, subdued hiring outside technology firms, and below-trend activity on the Chicago Fed index — and noted that everything in his mandate argued for more accommodation. He emphasized, however, that the binding constraint was mechanical rather than judgmental: with the range already at 0 to 0.25 percent, a conventional cut in the target was not available, so holding was the only vote consistent with his accommodative preference. The member attentive to financial stability grounded his position in the calm stress readings — a stress index of 0.075, a subdued VIX, and a contained Baa spread — and cautioned that an abrupt policy change could destabilize benign conditions for no compelling reason, particularly given the Beige Book evidence that markets were already sensitive to the rate path. The data-dependent member read the numbers at face value and found unanimous support for holding: inflation well short of target, unemployment above both the natural rate and the 6.5 percent threshold cited in prior guidance, and no urgency in either direction. The member most attuned to market pricing pointed to the slightly negative T-bill spread as evidence that markets expected continuity, with the steep positive yield curve ruling out any recession-driven case for easing.

When the discussion turned to the optimal-policy framework, participants engaged directly with the tension between the 75-basis-point reference-rule prescriptions and the framework's 0-basis-point recommendation. Several members treated this divergence as the heart of the decision. The common thread was that the Taylor, Balanced Approach, and ELB-adjusted rules generate a 75-basis-point signal by mechanically closing the gap implied by the unemployment shortfall, but do so on the assumption of a normal neutral rate. With r^* estimated at -0.5 percent, participants judged that a move toward 75 basis points would be considerably more restrictive than the level rules made it appear, and would risk tightening into genuine slack. The First-Difference rule's 0-basis-point reading was found most persuasive across the committee precisely because it responds to changes in conditions rather than to level gaps.

Members mapped that logic onto the momentum data. Negative inflation momentum indicated that the undershoot was worsening rather than stabilizing, which the inflation-focused member read as removing any residual case for tightening and the data-dependent member read as a reason not to push inflation further from target. Flat unemployment momentum told participants there was no



acceleration in labor improvement to justify pulling forward a move. The financial-stability member added that the Beige Book's account of rising capitalization rates and rate-sensitive housing buyers underscored how fragile calm conditions could be to an abrupt tightening — a point the employment-focused member and the market-signal member both took up, the latter noting it strengthened his case against the level rules given market pricing of continuity. Throughout, participants flagged the prior dissent's concern about accommodation-driven imbalances and treated it as worth taking seriously, but judged that the low stress index and contained spreads showed such imbalances had not yet materialized in a way that would force action. No member reported being persuaded to shift position by the rebuttal round; the various lenses reinforced rather than contested one another, and each concluded that holding at 0 to 0.25 percent was the disciplined choice given below-target, softening inflation and incomplete labor-market healing.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported maintaining the federal funds target range at 0.0 to 0.25 percent, a unanimous 5-to-0 outcome with no member favoring either a hike or a cut. On the optimal policy engine's recommendation of 0 basis points, the committee likewise reached full agreement: all five members — the inflation-focused member, the employment-focused member, the financial-stability member, the data-dependent member, and the market-signal member — endorsed the recommendation as-is, with no members declining and none expressing only partial support. The predictive decision and the optimal-side assessment thus coincided completely at 0 basis points.