



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$3,552.7 billion as of the most recent release dated October 23, comprising \$2,004.3 billion in Treasury notes and bonds and \$1,400.7 billion in agency mortgage-backed securities. This represented an increase of \$23.3 billion from the prior release dated October 16, consistent with ongoing purchases across both asset classes. The staff noted that this account 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 is currently available; nothing in this review should therefore be read as characterizing short-term operating balances.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that measured inflation remained well below the Committee's longer-run objective. Core PCE inflation stood at 0.97 percent on a twelve-month basis, roughly half of the 2 percent target. Labor market conditions showed continued slack: the unemployment rate was 7.2 percent, some 1.7 percentage points above the 5.5 percent estimate of its natural rate, and initial claims for unemployment insurance were 358,000, a level the staff characterized as still somewhat elevated. Broader activity readings pointed to steady but unremarkable growth, with the Chicago Fed National Activity Index at 0.14 — near its trend value — and the Employment Cost Index reported at 119.0. M2 stood at \$10,818.7 billion.

The Beige Book material, drawn from the Eighth District, described economic activity as growing at a moderate pace since the previous report. Reports of planned activity in manufacturing and services were positive, with several manufacturing firms indicating plans to add workers, expand operations, or open new facilities — in automobile parts, consumer products, machinery, steel, chemicals, and plastics, among others — while a smaller number, including firms in pharmaceuticals, shoes, food, and aircraft, reported planned layoffs. Retail contacts were mostly positive, citing new investment projects, store and restaurant openings, and higher foot traffic. Residential and commercial real estate conditions continued to improve, with year-to-date home sales through August up 17 percent in Louisville, 19 percent in Little Rock, 10 percent in Memphis, and 8 percent in St. Louis relative to the same period in 2012, and single-family housing permits rising in most District metro areas. The staff noted one offsetting detail: total lending at a sample of small and midsized District banks decreased from mid-June to mid-September.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were calm and accommodative across the measures the staff reviewed. The financial stress index stood at 0.051, a very low reading indicating no systemic strain, and the VIX at 13.42 pointed to subdued expected volatility. Credit conditions showed no acute distress, with the Baa corporate spread at 2.67 — a moderate level. The Treasury yield curve was steeply positive, with a 10-year/2-year spread of 2.2, giving no signal of near-term recession, and the 3-month T-bill spread relative to the current target rate was slightly negative at -0.085, consistent with an anchored front end and market pricing that embedded no expectation of a near-term policy move. The staff flagged, as at the prior meeting, that rising mortgage rates could act as a source of restraint on the recovery if sustained, though no acute tightening was evident in the current data.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking review emphasized quantities bearing on the likely path of policy and activity. The estimated neutral real rate (r^*) was -0.5 percent, a deeply negative value implying that the equilibrium stance of policy is itself very low; on that reading, maintaining the target range at 0.0 to 0.25 percent is considerably closer to neutral than conventional level-based prescriptions would suggest. Inflation momentum was estimated at 0.15 and unemployment momentum at -0.15, both small in magnitude — signaling gradual improvement in the labor market and only slight upward drift in prices, with no indication of overheating in either direction.

The reference rules diverged sharply, and the staff read that divergence as informative in itself. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points, driven largely by the wide unemployment gap measured against a 5.5 percent natural rate. The First-Difference rule, which responds to changes in inflation and unemployment momentum rather than to absolute gap levels, prescribed 0 basis points. With r^* deeply negative, the level-based rules would overstate the appropriate degree of tightening; the loss-minimizing recommendation, at 0 basis points, aligned with the First-Difference logic. The projection thus implied continuity: conditions improving slowly, inflation likely to remain below target for some time, and no momentum-based impetus for a change in the policy rate.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants broadly agreed at the outset that the current data offered no case for moving the target range in either direction. On the inflation side, the decisive fact for several participants was that core PCE at 0.97 percent was running well below the 2 percent objective. One participant, whose emphasis is inflation risk, observed that the disciplined response to subdued inflation is not to tighten — a hike would push inflation further from target — and that with inflation this low there was simply no live upside threat to resist. That participant was equally clear that a conventional cut was not realistically on



the table given that the range already sat at its effective floor.

The participant most focused on the labor market pressed the point that unemployment at 7.2 percent remained 1.7 points above its 5.5 percent natural rate, and that initial claims near 358,000 signaled a recovery still incomplete rather than decisively healing. On the merits, this participant favored maximum accommodation; the binding constraint, acknowledged frankly, was that the target range was already at 0.0 to 0.25 percent, leaving essentially no room for a conventional cut and no crisis condition to justify emergency action below zero. Holding at the current floor, this participant concluded, was itself the accommodative choice consistent with an employment-first lens.

The participant attentive to financial stability reported calm and accommodative conditions across the board — a stress index of 0.051, a VIX of 13.42, a Baa spread of 2.67, and a steeply positive yield curve — and saw neither credit-market distress demanding rescue easing nor imbalances yet demanding tightening. This participant returned repeatedly to the standing caution that rising mortgage rates could restrain the recovery if sustained, treating it as a reason to avoid a destabilizing policy jolt rather than as a call for action now. The participant weighing market signals reinforced this reading, noting that the slightly negative 3-month T-bill spread and the absence of any inversion indicated markets were pricing continuity, with no move expected. The data-dependent participant read both legs of the mandate as pointing the same way — inflation too low, unemployment too high — and characterized the most literal reading of the evidence as a hold. Growth indicators such as the CFNAI at 0.14 and the moderate, if uneven, Beige Book reports were seen as consistent with steady progress that demanded no shift.

When the discussion turned to the optimal-policy framework, participants engaged directly with the divergence between the 75-basis-point level rules and the 0-basis-point loss-minimizing recommendation. There was wide agreement that the gap was explained by the deeply negative r^* of -0.5 percent: with the neutral rate that low, the Taylor, Balanced Approach, and ELB-adjusted rules overstated the appropriate degree of tightening, and holding at the current range was nearer to neutral than those rules implied. Participants across different lenses found the First-Difference rule's logic most persuasive under present conditions, since inflation momentum of 0.15 and unemployment momentum of -0.15 indicated only slow improvement and no impetus to move. The inflation-focused participant emphasized that the framework's agreement with a hold revealed that current policy is appropriately calibrated — no urgency to hike, no case to add accommodation. The labor-market and stability participants each drew the same conclusion from their respective vantage points, the former stressing that tightening would be hostile to an employment recovery still well short of full employment, the latter stressing that a rate move risked disturbing calm credit markets and the



improving housing sector for no offsetting gain.

In the rebuttal exchanges, no participant was moved off an initial view; rather, the arguments reinforced one another. The inflation participant reiterated that the risk here was undershooting the inflation objective, not overshooting it, and that a concern about future imbalances from prolonged accommodation was a tail risk not borne out by present data. The market-signal participant noted that no colleague had offered a pricing-based counter-signal, and that the front end continued to say hold. The centrist summarized the convergence as data-grounded rather than merely deferential, with five distinct analytical routes arriving at the same destination.

COMMITTEE POLICY ACTIONS

In the predictive round, all five members forecast maintaining the federal funds target range at 0.0 to 0.25 percent, a unanimous 0-basis-point vote (5 to 0). On the optimal-policy framework's recommendation of 0 basis points, the Committee's recorded stance was likewise unanimous: all five members — the inflation hawk, the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist — endorsed the recommendation as-is, with none declining and none registering partial agreement. Both the predictive vote and the optimal-side outcome thus fully agreed on holding the target range unchanged.