



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent System Open Market Account holdings data, released as of September 10, 2014. Total SOMA domestic securities holdings stood at \$4,144.0 billion, composed of \$2,326.3 billion in Treasury notes and bonds and \$1,678.3 billion in agency mortgage-backed securities. Relative to the prior release of September 3, total holdings rose by \$3.7 billion, a modest week-over-week change consistent with the gradual pace of ongoing operations. It should be noted that these figures cover SOMA holdings only — total size, composition, and the change from the prior release — and do not reflect the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available; accordingly, no representation is made here regarding those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data pointing to continued, gradual improvement in economic activity. The unemployment rate stood at 6.1 percent, above the estimated natural rate of 5.5 percent, indicating that a degree of labor market slack remained. Initial jobless claims were low and stable at 302,000, and the Chicago Fed National Activity Index registered 0.39, consistent with growth running somewhat above trend. Core PCE inflation on a year-over-year basis was 1.27 percent, well below the Committee's 2 percent objective. The Employment Cost Index reading of 121.4 and other wage measures were consistent with only modest gains in labor compensation. M2 money supply stood at \$11,422.4 billion.

The Beige Book material available to the staff, covering the Twelfth District from early July through mid-August, described activity that continued to improve moderately. Overall price inflation remained 'quite modest,' and wage pressures were 'well contained on net.' Retail sales growth ticked up, and contacts reported consumers appeared more optimistic about the recovery. Demand for business and consumer services increased moderately, manufacturing activity was mixed, and agricultural conditions were generally good. Real estate activity advanced, though growth in the residential sector slowed somewhat, and loan demand increased moderately. Wage gains were generally modest, with more pronounced increases noted in pockets such as skilled construction workers, certain technical employees in the computer industry, and entry-level positions in the financial industry; some contacts in faster-growing areas reported difficulty filling lower-skilled positions. Vigorous competition, including from online vendors, was cited as restraining retail price increases.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were assessed as calm and accommodative across the indicators reviewed. The financial stress index was 0.027, near the bottom of its range, and the VIX stood at 12.88, a very subdued level suggesting little near-term expected volatility. The Baa corporate spread of 2.25 was moderate and pointed to healthy, easily available credit with no evident funding strain. The 10-year/2-year Treasury yield curve spread of 1.96 remained comfortably positive, showing no recession signal from the term structure. The 3-month T-bill spread relative to the current rate was -0.105, consistent with short-term markets pricing no near-term change in policy. Taken together, the data indicated benign conditions with no signs of financial market disruption in either direction.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available. The estimated neutral real rate (r^*) was -0.5 percent, indicating that the equilibrium real rate remained deeply negative; on that basis, the current 0.0 to 0.25 percent target range would be expected to remain accommodative rather than restrictive relative to the mandate gaps. Inflation momentum was weakly positive at 0.065, a pace that, if sustained, implies only a very gradual drift back toward the 2 percent objective, with core PCE likely to remain below target for some time. Unemployment momentum of -0.3 was consistent with the unemployment rate continuing to decline gradually and slack closing at a measured pace rather than abruptly.

The four reference rules considered by the staff — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — each pointed to a policy setting of 0 basis points, and the framework judged the rules reliable for this meeting. With core inflation roughly 0.73 percentage point below target and unemployment about 0.6 percentage point above the natural rate, the prescriptions cohere: given a negative r^* and the effective lower bound, holding at the current range is the loss-minimizing outcome, and no basis was identified for either tightening or a further conventional move lower. On this projection, conditions would be expected to continue improving gradually, with inflation firming only slowly and the labor market healing without generating overheating pressure.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants generally judged that the incoming data provided no case for altering the target range in either direction. On the inflation side, the member most attentive to price risk observed that core PCE at 1.27 percent was undershooting, not overshooting, the 2 percent objective, so the usual bias against continued accommodation was simply not triggered. The Beige Book's characterization of 'quite modest' price inflation and 'well contained' wages reinforced this reading, and the localized wage gains noted in construction, technology, and entry-level financial



positions were viewed as pockets rather than evidence of broad-based, wage-push inflation. With inflation momentum at just 0.065, participants saw nothing to act against on inflation grounds.

The participant focused on the labor market emphasized that direction mattered as much as level. Unemployment at 6.1 percent remained above the 5.5 percent natural rate, so slack persisted, but unemployment momentum of -0.3 indicated the rate was falling, and stable initial claims of 302,000 together with a CFNAI of 0.39 showed a labor market healing rather than deteriorating. Because the trigger for easing — weakening employment — was absent, and because the range was already at the effective lower bound, this participant saw no room or reason to cut, while soft inflation removed any case for tightening that might jeopardize the ongoing recovery.

Participants attentive to financial stability and to market pricing reinforced these conclusions from their own vantage points. The stability-focused member noted that the stress index at 0.027, VIX at 12.88, a tight Baa spread of 2.25, and a positively sloped curve at 1.96 revealed no credit strain or systemic imbalance that would warrant a defensive move; the one caution raised was that ultra-low stress and a complacent VIX could, over time, breed imbalances, though none were evident today. The market-oriented participant pointed to the 3-month T-bill spread of -0.105 as evidence that markets priced no near-term move, and cautioned that a surprise hike would inject volatility into calm markets for no compelling reason. Several participants observed that a premature tightening would risk unsettling benign conditions and could interrupt the gradual normalization path continued at the prior meeting.

When the discussion turned to the framework's optimal-policy assessment, participants found that their forward-looking reasoning aligned closely with the reference-rule output. All four rules — Taylor, Balanced Approach, First-Difference, and ELB-adjusted — printed 0 basis points, and the framework judged them reliable. Individual members gravitated toward different rules as most persuasive: the inflation-focused and market-oriented participants found the Taylor logic compelling given inflation roughly 0.73 percentage point below target and unemployment about 0.6 percentage point above natural, while the labor-focused, stability-focused, and centrist participants emphasized the ELB-adjusted rule, noting that with r^* at -0.5 percent the current range was already accommodative and conventional easing was not available. The centrist participant summarized the view that both mandate gaps argued for continued accommodation while they closed gradually, with no data-grounded case for a move.

Across both the predictive discussion and the optimal-framework rebuttal, no participant was moved from an initial reading by another's argument; rather, the members described their convergence as confirming that the current stance was well calibrated. Inflation below target justified patience,



persistent but closing labor slack argued against tightening, and calm financial conditions gave no urgency to act in either direction. Participants noted they would remain watchful — for any firming of inflation toward target, for any softening in the labor data, and for any spread widening or volatility spike — but judged that none of these was present at this meeting.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate policy action, all five members supported maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous tally of 5 to 0 for no change. On the framework's loss-minimizing recommendation of 0 basis points, the Committee was also in full agreement: 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 no members declining and none registering partial agreement. The predictive and optimal-side outcomes were therefore fully consistent, both pointing to holding the current range this meeting.