



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Manager reported on developments in the System Open Market Account. As of the most recent release on October 22, 2014, total SOMA domestic securities holdings stood at \$4,197.9 billion, comprising \$2,344.3 billion in Treasury notes and bonds and \$1,715.4 billion in agency mortgage-backed securities. Holdings rose by \$5.9 billion from the prior release of October 15, a modest week-over-week increase consistent with the continued, if diminishing, pace of purchases. Members were reminded that this account covers SOMA securities holdings only — total size, composition, and 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; accordingly, no discussion of such operation results was incorporated into this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed the incoming information as broadly consistent with an economy expanding at a moderate pace. Core PCE inflation, measured on a year-over-year basis, stood at 1.25 percent, well below the Committee's 2 percent objective. Labor market indicators pointed to continued gradual improvement: the unemployment rate was 5.9 percent, still above the 5.5 percent estimate of its natural rate, while initial jobless claims at 264,000 remained very low. The Employment Cost Index registered 121.4, offering little evidence of a broad acceleration in wage pressures. The Chicago Fed National Activity Index at -0.21 indicated growth running slightly below its historical trend. M2 money supply measured \$11,474.1 billion.

The Beige Book material available to the staff, drawn from the Eighth District, described activity increasing at a moderate pace since the previous report. Reports of planned activity in manufacturing and services were largely positive, with several firms — including producers of construction materials, tools, consumer goods, and aviation equipment, as well as automobile and auto parts manufacturers — citing plans to add workers or expand operations; a smaller number of contacts, including a metal products manufacturer and a food manufacturer, reported planned layoffs or facility closures. Retail reports were mostly positive. Residential real estate conditions, however, remained weak: year-to-date home sales through August were down relative to the same period in 2013 across the District's metro areas — for example, 8 percent lower in Memphis and 5 percent lower in St. Louis — and single-family housing permits declined in the majority of metro areas. Commercial and industrial real estate conditions were mixed, though construction in that segment had increased, and lending activity at a sample of small and midsized District banks rose from mid-June to mid-September.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were described as calm and accommodative. The financial stress index stood at 0.084, a very low reading indicating no acute strain, and the VIX at 17.87 reflected moderate volatility rather than market turmoil. The Baa corporate spread of 2.43 was contained, suggesting borrowing costs showed no sign of systemic distress. Short-term rate pricing pointed to no expectation of an imminent policy move: the 3-month Treasury bill spread relative to the current rate was -0.105, and front-end pricing was broadly consistent with the target range being maintained. The staff noted that a 10-year/2-year yield curve spread was not available for this review. Taken together, the financial indicators portrayed conditions that were loose rather than tight, with markets not pricing tightening.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the momentum in the dual-mandate variables. With the estimated neutral real rate (r^*) at -0.5 percent, the analysis implied that a nominal policy rate held in the 0.0 to 0.25 percent range represented a stance that was genuinely accommodative but not markedly so, given how deeply negative the neutral rate was estimated to be. Inflation momentum of +0.07 was only faintly positive, indicating that core PCE would likely continue to run below the 2 percent objective for some time absent a firmer upward impulse, with no signal of acceleration toward target. Unemployment momentum of -0.1 pointed to a labor market that would continue improving gradually, consistent with the still-low level of jobless claims, though the level of the unemployment rate suggested some slack would persist before the natural rate was reached.

The four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — each returned a prescription of 0 basis points, and the rules were judged reliable for this meeting. The convergence of these otherwise distinct approaches, taken with the negative neutral rate and the subdued inflation and improving-but-incomplete labor readings, implied that the likely near-term path of conditions was one of continued moderate expansion and gradual labor market repair against a backdrop of soft inflation — an environment in which the prevailing stance appeared appropriately calibrated rather than in need of adjustment in either direction.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, all participants judged that the appropriate action was to leave the target range for the federal funds rate unchanged at 0.0 to 0.25 percent. The reasoning converged from distinct starting points. The member most attentive to inflation risk observed that core PCE at 1.25 percent was well below the 2 percent target and drifting rather than climbing, framing the central concern as undershooting rather than any threat of overshoot; with the Employment Cost Index and low jobless claims describing a firming but not overheating labor market, this member saw no inflation basis for tightening and no basis for cutting. The member focused on the labor market emphasized that



unemployment at 5.9 percent remained above the 5.5 percent natural rate, so slack persisted, but that claims at 264,000 and the Beige Book's widespread hiring plans indicated improvement rather than deterioration; with the rate already at its effective floor, this member noted there was no room to cut further to support employment and favored preserving accommodation.

The member weighing financial stability most heavily read the stress indicators first and found conditions calm — a stress index of 0.084, a VIX of 17.87, and a contained Baa spread of 2.43 — with no acute strain calling for action in either direction. This member reiterated a standing caution that prior discussion had flagged leveraged lending and stretched valuations as risks worth monitoring, and argued that a premature hike could destabilize already-stretched credit markets without addressing valuations; the appropriate response was vigilance in monitoring rather than a rate move. The member oriented toward market signals pointed to the 3-month Treasury bill spread of -0.105 and short-end pricing as evidence that markets expected the range to hold, adding that the wind-down of asset purchases concerned that program and not the funds rate target itself. The data-dependent centrist offered the most literal consensus reading: dual-mandate gaps on both sides — soft inflation and lingering slack — argued for patience, with no data supporting a hike and no deterioration justifying a cut from the floor.

In the second round, no participant was moved to revise. Each noted that the others' arguments reinforced rather than challenged their own conclusion, and the discussion settled on a common picture of soft inflation, lingering but improving slack, calm markets, and a rate already at the effective lower bound.

Turning to the framework's optimal-policy assessment, participants examined the loss-minimizing recommendation of 0 basis points and the underlying inputs. Several found the negative estimated neutral rate of -0.5 percent clarifying: it implied that holding at 0.0 to 0.25 percent was genuinely accommodative given how low neutral had fallen, so the current stance was not overly loose. Different members were persuaded most by different reference rules — the inflation-focused and centrist members cited the Taylor rule's logic of below-target inflation plus a positive unemployment gap, the labor-focused member found the Balanced Approach rule's heavier weight on the employment gap most congenial even as it still printed 0 basis points, and both the stability-minded and market-oriented members were drawn to the ELB-adjusted rule as speaking directly to the binding lower bound. All noted the convergence of the four rules, judged reliable this meeting, as lending confidence that the hold was robust.

In the final round of rebuttal, participants confirmed rather than altered their emphases. The inflation-focused member reiterated that with inflation momentum at only +0.07 and no wage-driven



surge evident in the Employment Cost Index, there was no tightening justification today, though inflation would need to return toward 2 percent before accommodation was removed. The labor-focused member stressed that unemployment momentum of -0.1 and low claims signaled steady improvement, so any caution against restrictiveness was not triggered, while holding at the floor remained maximally supportive of employment. The financial stability voice restated the valuation caveat as a case for watchfulness in guidance rather than a rate move, noting that market pricing offered no validation for earlier normalization. The market-signal member made the same point from the front end, observing that the negative Treasury bill spread pointed to continuity with perhaps a mild easing bias. No participant identified a reason to diverge from the framework's recommendation.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported leaving the target range for the federal funds rate unchanged at 0.0 to 0.25 percent, a unanimous 5-to-0 outcome with no member favoring a change. On the framework's loss-minimizing 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 centrist, and the market-signal member — endorsed the recommendation as-is, with none declining and none registering a partial reservation on magnitude or timing. The two votes were therefore fully aligned.