



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The manager reported on the System Open Market Account, noting that total domestic securities holdings stood at \$4,200.5 billion as of the release dated October 26, 2016. Holdings were composed of \$2,334.8 billion in Treasury notes and bonds and \$1,735.8 billion in agency mortgage-backed securities. This represented a decline of \$14.9 billion from the prior release dated October 19. It was noted that this account covers the size and composition of SOMA securities holdings only; it does not cover the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists, and the discussion was therefore confined to the holdings figures above.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that the economy continued to expand at a modest pace. Core PCE inflation on a twelve-month basis was 1.48 percent, remaining below the Committee's 2 percent longer-run objective. The unemployment rate stood at 5.0 percent, slightly above the estimated natural rate of 4.8 percent, while initial claims for unemployment insurance were low at 260,000, consistent with continued firmness in labor conditions. The Chicago Fed National Activity Index registered -0.14, pointing to growth running modestly below its historical trend. The Employment Cost Index reading of 126.7 and other wage measures were consistent with only moderate compensation growth.

The Beige Book material, drawn from the First District, described economic activity as continuing to increase, mostly at a modest to moderate pace. Manufacturers and residential real estate contacts reported more consistently positive results, while retail and commercial real estate contacts described mixed conditions. A larger share of manufacturing and retail contacts than in prior reports mentioned raising wages moderately to attract and retain employees, and labor markets in some areas were described as more competitive. Contacts generally characterized their own prices and those of their suppliers as relatively stable, though median single-family home sale prices rose year-over-year across all six New England states. Outlooks were positive on the whole, but contacts in several sectors cited the upcoming presidential election as a source of near-term uncertainty that was delaying some business decisions.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and accommodative. The financial stress index stood at 0.105, a very low reading, and the VIX at 14.24 indicated subdued expected volatility. The Baa corporate spread of 2.61 was moderate and gave no indication of credit-market strain. The 10-year/2-year Treasury yield curve spread was positive at 0.93, showing no inversion and thus no



term-structure signal of recession. The 3-month Treasury bill spread relative to the current policy rate was -0.035 , sitting just below the current range midpoint, suggesting that markets were not pricing an imminent policy tightening. Taken together, these readings pointed to benign and stable financial conditions with no evident funding or systemic pressures.

STAFF ECONOMIC OUTLOOK

The staff projection took as its starting point an estimated neutral real rate (r^*) of -0.5 percent, which implies that the current target range of $1/4$ to $1/2$ percent may be modestly restrictive in real terms rather than as accommodative as the nominal setting alone would suggest. Inflation momentum was slightly negative at -0.005 , indicating no upward drift toward the 2 percent objective over the projection horizon, while unemployment momentum was positive at 0.1 , suggesting that labor market slack was, if anything, edging wider rather than closing. Combined with the below-trend growth signal in the activity index, these quantities pointed to a path in which inflation remained short of target and the small employment gap failed to narrow absent a policy adjustment.

The reference rules considered by the staff were mutually consistent this cycle. The Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule each prescribed a 25 basis point reduction, and the rules were judged reliable given the calm financial backdrop that was not distorting their inputs. The convergence of all four rules on the same prescription, together with the deeply negative r^* and the sub-target inflation reading, implied that the loss-minimizing setting lay modestly below the current range. The staff outlook therefore described a configuration in which prevailing policy sat slightly above the level the reference framework would identify as optimal, with easing rather than tightening being the direction the rules favored.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion of the likely policy decision, participants converged on holding the target range at $1/4$ to $1/2$ percent. Several emphasized that core PCE inflation at 1.48 percent remained meaningfully below the 2 percent objective, which the prior statement had identified as a key constraint on tightening, and that this soft inflation reading argued against forcing a move now. A couple of participants noted that the prior meeting had seen three dissents favoring an immediate hike and that the earlier statement had described the case for tightening as having strengthened, so a hike was clearly on the table even if the data did not compel one this meeting.

Participants attentive to labor conditions observed that unemployment at 5.0 percent, near the 4.8 percent natural rate, together with low initial claims, described a firm but not overheating labor market, with no sign of rising joblessness or slowing job growth that would justify easing and no clear



overheating that would demand tightening. The participant most focused on inflation risk acknowledged that Beige Book reports of moderate wage increases to attract and retain workers, rising home prices across the New England states, and a tightening labor market constituted genuine, if nascent, inflation signals worth watching, but stressed that with inflation running below target and no upward momentum there was no above-target inflation to defend against at this meeting. Participants attentive to financial conditions and to market signals reinforced the case for patience, pointing to the low stress index, subdued VIX, moderate credit spreads, a non-inverted yield curve, and a 3-month bill spread just below the current midpoint that indicated markets were not pricing an imminent tightening. Many participants also weighed the Beige Book's explicit reference to the upcoming presidential election delaying business decisions, judging that with the meeting one week ahead of that event, waiting for further evidence was the prudent course. On this basis all five participants held to their view that the appropriate action was to leave the range unchanged.

The Committee then turned to the deterministic optimal-policy framework, which recommended a 25 basis point reduction, a prescription on which all four reference rules agreed and which was judged reliable this cycle. Participants engaged seriously with the gap between their predictive hold and this easing recommendation. The participant focused on inflation reasoned that his usual caution about cutting into elevated inflation simply did not bind, since inflation was running roughly half a point below target with essentially flat momentum and only moderate wage growth in the Beige Book and ECI; with r^* at -0.5 implying that current policy was tighter than it appeared, he concluded that the framework's cut was the right direction even as his own vote reflected institutional caution and the prior meeting's hawkish dissents.

The participant weighting labor conditions most heavily found the optimal case strengthened by the positive unemployment momentum of 0.1 and the below-trend activity index reading, which he read as early softening he did not wish to let harden, and he singled out the Balanced Approach rule, which weights the employment gap heavily, as pointing clearly toward easing. The participant focused on financial stability noted the tension that conditions were already easy, so a cut felt unnecessary from a stress standpoint, but reasoned through the ELB-adjusted logic that with a deeply negative r^* current real policy was modestly restrictive and that low stress, contained spreads, and the mildly easing-tilted bill pricing meant a cut carried little destabilizing downside. The market-focused participant and the centrist both took the four-rule convergence and the negative bill spread as strong, mutually reinforcing evidence that markets embedded no demand for tightening and that a cut would carry no inflation-expectations penalty. Across the rebuttal round, participants generally judged that their predictive hold reflected gradualism, institutional caution, and the prior tilt toward eventual hikes, while the framework's -25 basis point recommendation reflected the loss-minimizing correction of a stance



sitting modestly above neutral given the persistent inflation shortfall and non-closing slack. Several emphasized that a single 25 basis point step was a measured correction rather than an overreach.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely policy decision, all five participants supported leaving the target range for the federal funds rate unchanged at 1/4 to 1/2 percent, a unanimous 5-0 outcome. On the separate question of the deterministic framework's recommendation of a 25 basis point reduction, all five participants endorsed the recommendation as-is, with none declining and none supporting only the direction while dissenting on magnitude or timing. The optimal-side tally was therefore a full 5-0 endorsement of the -25 basis point recommendation, even as each participant's predictive vote reflected the more gradualist stance discussed above.