



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The manager reported on the System Open Market Account, whose total domestic securities holdings stood at \$4,224.1 billion as of the October 25 release. Of this, Treasury notes and bonds accounted for \$2,322.6 billion and agency mortgage-backed securities for \$1,770.6 billion. The total represented a decline of \$7.3 billion from the prior release on October 18, a modest reduction consistent with a gradual, orderly evolution of the balance sheet. It should be noted that this account covers SOMA holdings only — their total size, composition, and week-over-week change — and does not reflect the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source is presently available; the manager's report is therefore confined to the securities holdings themselves.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that economic activity had continued to expand. According to the Beige Book, activity had grown at a modest to moderate pace since August, with contacts in manufacturing, retailing, and software and IT services reporting continued year-over-year revenue increases and business respondents remaining upbeat about the outlook. Reports across Districts were broadly consistent with this characterization: several described moderate expansion, while others noted growth at a more modest rate. Labor markets were widely described as tight, with hiring picking up in some Districts after a summer slowdown. Wage pressures were generally characterized as modest or subdued, though a few Districts reported that pressures had broadened. Input price pressures were noted to have outpaced selling price pressures in several Districts, and some price increases were attributed in part to supply chain disruptions stemming from the recent hurricanes. The Chicago Fed National Activity Index stood at 0.17, consistent with growth somewhat above trend.

On the labor side, the unemployment rate was 4.2 percent, below the estimated natural rate of 4.74 percent, and initial jobless claims were low at 222,000. The Employment Cost Index reading was 129.7. Against this backdrop of a tight labor market, inflation remained soft: core PCE prices rose 1.07 percent over the prior twelve months, well below the Committee's 2 percent objective. The staff noted that hurricane-related effects on prices and activity in the affected Districts were generally regarded as temporary. M2 money supply stood at \$13,701.2 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and accommodative. The financial stress index was 0.027, near the bottom of its range, and the VIX stood at 11.23, an unusually low level of implied volatility. Credit markets showed no sign of strain: the Baa corporate spread was 1.92, historically tight,



indicating ample credit availability and low borrowing costs. The Treasury yield curve remained positively sloped, with the 10-year to 2-year spread at 0.83, offering no near-term recession signal, though the spread was modest enough to warrant attention. At the front end, the 3-month Treasury bill spread relative to the current target was slightly negative at -0.025, suggesting money markets were not pricing an imminent move in the policy rate. On balance, the staff saw no evidence of funding stress or market fragility.

STAFF ECONOMIC OUTLOOK

The staff's outlook drew on several forward-looking quantities. The estimated neutral real rate (r^*) was -0.5, implying that the current target range of 1.0 to 1.25 percent may be modestly restrictive relative to neutral. Inflation momentum was estimated at -0.1, indicating that the shortfall of core PCE inflation below the 2 percent objective was drifting lower rather than converging toward target on its own. Unemployment momentum was estimated at +0.05, consistent with a labor market that was roughly stable rather than deteriorating or accelerating.

Taken together, these readings suggested that the configuration of a tight labor market alongside persistently soft inflation was unusual and unlikely to resolve quickly absent a policy adjustment. The reference rules, judged reliable in the current environment, pointed uniformly toward easing: the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each implied roughly -75 basis points, driven principally by the inflation shortfall and low estimated neutral rate, while the First-Difference rule implied -50 basis points. The loss-minimizing framework tempered these mechanical prescriptions to a single step of -25 basis points, reflecting the offsetting pull of below-natural unemployment and the case for gradualism. The projection implied that, absent action, real policy would remain somewhat above neutral and the inflation undershoot could become more entrenched.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion of the likely policy decision, participants divided on whether a modest rate increase or a hold was the more probable near-term outcome. Three participants initially leaned toward a 25 basis point increase, with two favoring no change. Those inclined toward a hike emphasized labor market tightness — unemployment at 4.2 percent below the 4.74 percent estimated natural rate, low jobless claims at 222,000, and reports of tight labor markets and, in some Districts, broadening wage pressures. One participant weighting inflation risk most heavily argued that such tightness posed a genuine forward inflation risk warranting a preemptive move along the gradual path implied by the Committee's earlier median projection of 1.4 percent. A participant focused on financial stability observed that conditions were exceptionally benign — a stress index of 0.027, a VIX of 11.23, and a tight Baa spread of 1.92 — leaving ample cushion to absorb a modest move, and cautioned that an extended



period of low volatility could encourage complacency, making a calm period the appropriate time to normalize gradually.

Participants favoring no change stressed that core PCE inflation at 1.07 percent was nearly a full point below the 2 percent objective, arguing that tightening into soft inflation would risk unnecessary restraint. One participant attending most closely to labor conditions noted that easing was warranted only when unemployment was rising or job growth slowing — neither of which was present — but likewise saw no case for a hike while inflation ran soft, and judged that a patient hold best preserved labor-market momentum. A participant weighting market signals pointed to the slightly negative 3-month Treasury bill spread of -0.025 as evidence that markets were not pricing an imminent move, and to the positive but flattening 10-year to 2-year spread of 0.83 as a caution against further tightening; in this view the next step, if any, was more likely at a later meeting. The data-dependent participant favored the most literal reading of the incoming data, noting that wage pressures across most Districts were described as modest or subdued and that hurricane effects were seen as transitory, and concluded that nothing had changed materially enough to force a move. On balance, several who leaned toward a hike conceded that soft inflation reduced urgency and that they would not strongly oppose a hold.

When the discussion turned to the loss-minimizing framework, participants engaged directly with its recommendation of a 25 basis point cut, which diverged from the predictive vote. Here the emphasis shifted from what the Committee was likely to do to what the data implied was optimal. Participants observed that the estimated neutral rate of -0.5 suggested current policy was modestly restrictive, that inflation momentum of -0.1 indicated the shortfall was not self-correcting, and that the reference rules pointed uniformly toward easing. The participant most attuned to inflation risk reasoned that hawkish caution is triggered by inflation above target — not the case here — and recognized a symmetric risk that chronic undershooting could erode the 2 percent anchor as surely as overshooting; on that basis a small cut better served the inflation objective.

Other participants reached the same conclusion from their own vantage points. The labor-focused participant argued that a persistent undershoot risked embedding low inflation expectations that could ultimately undermine durable employment, and that with unemployment momentum only slightly positive there was room to insure the expansion. The financial-stability participant emphasized that the tranquil credit and volatility backdrop made a modest cut low-risk — there was no stress to relieve, but equally no fragility a move would inflame — and favored a single moderated step over aggressive easing given hurricane-distorted price readings. The market-signal participant distinguished between market pricing, which aggregates expectations of what the Committee will do, and the loss-minimizing



optimum, noting that the negative front-end spread even hinted at a mild easing tilt already embedded. Participants generally agreed that the tempering of the roughly -75 basis point rule prescriptions to a single -25 basis point step appropriately balanced the inflation shortfall against a tight labor market and the Committee's preference for gradualism.

In reconciling their predictive hold with the framework's cut, participants generally characterized the gap as revealing that current policy was quietly somewhat tighter than optimal — a stance reflecting institutional caution mid-normalization and prior guidance emphasizing gradual increases, rather than a judgment that the data called for restraint. A couple of participants remained wary of overreacting to any single quarter's inflation print given hurricane noise, but none identified a stability, credit, or recession consideration that argued against the direction of a modest easing.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely near-term policy decision, the Committee's forecast was for no change to the current target range of 1.0 to 1.25 percent, by a tally of three participants for a hold and two for a 25 basis point increase. Separately, on the loss-minimizing framework's recommendation of a 25 basis point reduction, all five participants — 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 only partial agreement. Participants thus judged that, while the Committee would most likely hold pending further data, the data taken at face value pointed toward a modest easing better aligned with the persistent inflation shortfall and a below-neutral estimated real rate.