



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Open Market Desk reported that total System Open Market Account (SOMA) domestic securities holdings stood at \$3,919.8 billion as of October 31, 2018, the most recent release available within the point-in-time-safe window. Holdings consisted of \$2,115.5 billion in Treasury notes and bonds, \$0.1 billion in Treasury bills, and \$1,669.0 billion in agency mortgage-backed securities. Relative to the prior release of October 24, total holdings declined by \$31.8 billion. Members were reminded that this accounting covers SOMA securities holdings only — total size, composition, and the week-over-week change — and does not extend to repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data pointing to a labor market that remained very tight. The unemployment rate stood at 3.7 percent, well below the estimated natural rate of 4.61 percent, and initial jobless claims were low at 214,000. Core PCE inflation was running at 1.61 percent on a twelve-month basis, below the Committee's 2.0 percent objective. The Chicago Fed National Activity Index at 0.17 indicated growth modestly above trend, and the Employment Cost Index registered 134.3. M2 money supply was reported at \$14,241.5 billion.

The Beige Book, prepared from District reports, characterized economic activity as expanding across the country, with most Districts reporting modest to moderate growth; a few noted slight growth while one reported robust growth led by manufacturing, retail, and nonfinancial services. Labor shortages were broadly noted and were linked to wage increases and, in some cases, to constrained growth, with difficulty finding qualified workers spanning engineers, finance and sales professionals, construction and manufacturing workers, IT professionals, and truck drivers. Some firms turned to non-wage strategies — signing bonuses, flexible schedules, and larger vacation allowances — to recruit and retain staff. Wage growth was mostly described as modest or moderate. Prices rose at a modest to moderate pace in all Districts, and manufacturers reported raising finished-goods prices out of necessity as costs of raw materials such as metals increased. Several Districts flagged rising materials and shipping costs, trade-environment uncertainty, and difficulties finding workers. Reports on real estate were mixed, with several Districts citing rising home prices and low inventories, and demand for transportation services remained strong. Hurricane Florence deterred tourism in the Carolinas and caused crop and livestock losses in affected areas.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were generally calm and accommodative. The financial stress index at 0.048 was very low, and the Baa corporate spread at 2.03 pointed to benign credit and borrowing conditions. The VIX at 19.34 was moderate — somewhat elevated relative to its calmer readings but not indicative of acute market distress. The Treasury yield curve remained positive but flat, with the 10-year/2-year spread at 0.3, showing no inversion. The 3-month Treasury bill sat 16.5 basis points above the current policy rate, consistent with markets pricing modest further tightening rather than aggressive moves. The current target range for the federal funds rate was 2.0 to 2.25 percent.

STAFF ECONOMIC OUTLOOK

The staff outlook combined the incoming data with the Committee's reference-rule framework and estimated policy parameters. Inflation momentum was estimated at a weak 0.07 and unemployment momentum at a modest 0.05, indicating little forward thrust in either direction. Against these near-flat readings, the level-based rules — the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule — each pointed to a substantially higher policy setting of roughly 75 basis points above the current range, driven largely by the wide gap between the 3.7 percent unemployment rate and the 4.61 percent natural-rate estimate. The First-Difference rule, which responds to inflation and unemployment momentum rather than to level gaps and does not require an estimate of the neutral rate, pointed instead to -25 basis points.

The staff noted that the estimated neutral real rate (r^*) used in the framework was -0.5 percent, unusually low. On that assumption, the current 2.0 to 2.25 percent nominal range, set against 1.61 percent core inflation, would already be a meaningfully restrictive stance rather than an accommodative one. Weighing the low neutral-rate estimate and the weak momentum readings against the level rules' overheating signal, the deterministic optimal-policy engine produced a loss-minimizing recommendation of -25 basis points, with reference rules assessed as reliable. The projection implied by these quantities was therefore that the tightening cycle had likely reached or slightly passed neutral, with the flattening yield curve reinforcing the caution against pushing the policy rate materially higher from here.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants converged on holding the target range at 2.0 to 2.25 percent this meeting even as their reasoning differed. The member most attentive to inflation risk observed that core PCE at 1.61 percent remained below the 2.0 percent objective, tempering the urgency to act, while the very tight labor market — unemployment at 3.7 percent against a 4.61 percent natural rate — together with the Beige Book's reports of broad labor shortages, wage increases, and firms raising finished-goods prices signaled genuine pipeline inflation pressure building ahead. This participant



characterized the meeting as a defensible pause point between scheduled moves, one that kept a tightening bias fully intact without sacrificing inflation vigilance given that realized inflation had not yet surged.

The member weighting employment risk most heavily initially leaned toward a 25 basis point increase, reasoning that none of the conditions that would trigger dovish concern — rising unemployment, slowing job growth, elevated claims — were present, with claims at 214,000 and the labor market showing no deterioration. Over the course of the discussion this participant moved to a hold, persuaded that below-target inflation gave no urgency to add restriction and that the meeting immediately followed a prior increase. The member focused on financial stability, by contrast, maintained a 25 basis point increase throughout the predictive rounds, arguing that the low stress index of 0.048, the tight Baa spread of 2.03, and a still-positive curve left no obstacle to continued gradual normalization — and that leaving policy too accommodative for too long was itself a source of instability. The data-dependent participant and the participant reading market signals both favored holding from the outset, emphasizing that the 3-month bill sat only 16.5 basis points above the current rate and that a gradual, roughly quarterly cadence pointed to the next move at the following meeting rather than this one; moving in consecutive meetings would depart from the 'gradual' path.

The framework's -25 basis point recommendation reframed the discussion in the optimal rounds. Participants noted the sharp divergence between the three level-based rules at roughly 75 basis points and the First-Difference rule at -25 basis points, and much of the debate turned on the -0.5 percent neutral-rate estimate. The employment-focused participant found the framework closer to right, reasoning that if r^* were truly negative, the current range against 1.61 percent inflation was already meaningfully restrictive — a risk to future job growth precisely when inflation was undershooting — and endorsed a modest cut as insurance, treating the earlier hold vote as a first cautious step in that direction. Several participants found the First-Difference logic persuasive on its own terms, since it responds to momentum rather than a contested neutral-rate level, and both momentum readings were only weakly positive.

Others resisted acting on that logic. The inflation-focused participant acknowledged that the flattening curve at 0.3 argued against further hikes and that below-target inflation reduced the case for tightening, but held that cutting while labor markets were this tight and pipeline pressure was building would be premature, resting as it did on a deeply uncertain r^* estimate; this participant declined the recommendation and stayed at a hold. The data-dependent participant similarly declined, stressing that at face value the indicators — low stress, tight credit spreads, low claims, modest-to-moderate growth — showed no distress and no realized inflation collapse, so a cut required assuming



restrictiveness entirely from a disputed negative neutral rate. The financial-stability participant and the market-signals participant each landed on partial agreement: both accepted the direction — that the hiking cycle should stop — but judged an actual cut premature, the former citing the absence of any widening spreads or curve inversion that would trigger easing under a stability lens, and the latter noting that the 3-month bill still sat above the range midpoint, so markets were pricing a ceiling near current levels rather than reversal.

A common thread ran through the divergence: whether framed by inflation, employment, financial stability, market pricing, or face-value data, participants broadly agreed that further tightening was no longer warranted and that policy had reached restrictive-enough territory. Where they parted company was on whether that shared judgment implied merely a pause or an active step toward easing — a distinction that turned largely on how much weight to place on the -0.5 percent neutral-rate estimate against the tight-labor and calm-credit readings visible directly in the data.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy action for this meeting, four members supported holding the target range at 2.0 to 2.25 percent and one member supported a 25 basis point increase, for a tally of four to one in favor of no change. On the separate question of the deterministic framework's -25 basis point recommendation, the Committee's recorded stances were split: one member (the labor-market-focused participant) endorsed the recommendation as-is; two members (the inflation-focused and data-dependent participants) declined it; and two members (the financial-stability and market-signals participants) gave partial agreement, supporting the direction of no further tightening but not a cut at this meeting.