



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$7,977.6 billion as of the October 27 release, the most recent report on or before the point-in-time cutoff. The portfolio was composed of \$4,725.7 billion in Treasury notes and bonds, \$326.0 billion in Treasury bills, and \$2,518.4 billion in agency mortgage-backed securities. Relative to the prior release of October 20, total holdings declined by \$5.3 billion. The manager noted that these figures describe SOMA holdings only — total size, composition, and the week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists; those operations are therefore outside the scope of this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation stood at 3.47 percent on a twelve-month basis, well above the Committee's 2 percent objective. The unemployment rate was 4.8 percent, somewhat above the estimated natural rate of 4.45 percent, leaving a modest gap. Initial jobless claims registered 290,000, a level the staff characterized as moderate and consistent with continued, if uneven, labor market repair. The Chicago Fed National Activity Index at -0.13 pointed to growth running slightly below its historical trend, and the Employment Cost Index reading of 144.7 was consistent with the broad wage pressures described in anecdotal reports. M2 stood at \$20,982.9 billion.

The Beige Book described economic activity as growing at a modest to moderate rate across most Districts, with several noting that the pace of growth had slowed, constrained by supply chain disruptions, labor shortages, and uncertainty around the Delta variant. Consumer spending rose in a majority of Districts, though auto sales were widely reported as declining on low inventories and rising prices. Manufacturing and freight grew moderately to robustly. Employment increased at a modest to moderate rate, with demand for workers high but labor growth dampened by a low supply of workers; firms cited child-care issues, vaccine mandates, and COVID-related absences, and many raised starting wages, offered signing and retention bonuses, or increased automation. The majority of Districts reported robust wage growth, and most reported significantly elevated prices fueled by rising demand. Near-term outlooks remained positive overall, though some Districts expressed more cautious optimism than in prior months.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were generally calm and accommodative. The financial stress index at 0.092 sat at a low level, and the VIX at 16.98 indicated subdued expected volatility. The Baa corporate spread of 1.71 was tight, pointing to healthy credit access and no evident borrowing-cost distress. The Treasury yield



curve remained positively sloped, with the 10-year/2-year spread at 1.04 and no sign of inversion; the 3-month T-bill spread relative to the current policy rate was marginally negative at -0.065, which the staff read as consistent with markets pricing essentially no imminent change in the policy rate. Taken together, these readings suggested markets were neither signaling acute stress that would call for accommodation nor pricing near-term tightening.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the momentum in the two mandate variables. With r^* estimated at -0.342, the neutral real rate was very low, yet the current target range of 0.0 to 0.25 percent combined with core inflation of 3.47 percent implied deeply negative real policy rates and a stance well on the accommodative side of neutral. Inflation momentum was positive at 0.32, indicating price pressures still firming, while unemployment momentum was negative at -0.3, indicating joblessness continuing to fall. The combination pointed to conditions in which the inflation gap was widening even as the employment gap narrowed.

The four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — each independently pointed to a policy rate of 75 basis points, and the framework judged the rules reliable this meeting. That convergence, together with the loss-function inputs, implied that a stance materially tighter than the prevailing target range would be consistent with the prescriptions of standard policy rules. The staff projection thus described a configuration in which the momentum in inflation and unemployment, and the distance between the current rate and rule-implied levels, together suggested accommodation was likely to prove greater than warranted if these conditions persisted, absent an offsetting deterioration in growth or a materialization of the Delta and supply-chain downside risks noted in the Beige Book.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their assessment of current conditions, participants generally judged that the appropriate near-term action was to maintain the target range at 0.0 to 0.25 percent. The member most focused on inflation emphasized that core PCE at 3.47 percent stood far above the 2 percent objective and that the Beige Book's reports of robust wage growth and significantly elevated prices challenged the view that inflation would prove entirely transitory. Even so, this participant judged a rate increase premature at this meeting, noting that asset purchases were ongoing and that prior guidance had tied any liftoff to reaching maximum employment — a condition not yet met with unemployment at 4.8 percent against a 4.45 percent natural rate and participation still lagging. On this reading, holding was the floor, with any reduction in accommodation appropriately beginning through the pace of purchases rather than the funds rate.



The participant most attentive to labor market conditions observed that, while unemployment remained above the natural rate and slack had not fully closed, the labor market was improving rather than deteriorating: claims at 290,000 were moderate, and the Beige Book described employment growth constrained by worker supply rather than weak demand. With the rate already at its effective floor, a cut was neither feasible nor warranted, and holding preserved accommodation for employment while inflation ran hot. The financial stability participant stressed that every relevant indicator — the stress index at 0.092, the VIX at 16.98, the Baa spread at 1.71, and a positively sloped curve — pointed to calm rather than fragility, so that a hold posed no destabilization risk while no acute stress demanded a defensive move. The data-dependent participant read the indicators at face value and found no single measure supporting a change in either direction, while the participant weighting market signals noted that the 3-month T-bill spread at -0.065 indicated markets were not pricing an imminent hike. All five participants converged on a hold as the predictive judgment.

The discussion then turned to the framework's optimal-policy recommendation of 75 basis points, which each of the four reference rules independently produced and which the framework judged reliable. Here the tenor of the conversation shifted markedly. The inflation-focused participant endorsed the recommendation without qualification, arguing that with core inflation well above target, positive inflation momentum, and a nearly closed employment gap, tolerating above-target inflation to protect a small labor shortfall was an unfavorable trade; the deeply negative r^* of -0.342 combined with elevated inflation was, in this member's view, a policy error that the rules correctly flagged. The other participants agreed that the direction was right — that current policy was meaningfully more accommodative than conditions warranted — while parting company on magnitude.

Several participants who accepted the tightening direction nonetheless resisted the full 75-basis-point step. The labor-focused participant acknowledged that the usual trigger for defending accommodation, rising unemployment, was absent — unemployment momentum was -0.3 and claims were low — but pointed to below-pre-pandemic participation and lingering Delta and supply-chain risks as reasons for a smaller, more measured first move to protect the recovery in contact-intensive sectors. The financial stability participant, though persuaded that low stress removed the usual barrier to tightening and that prolonged floor-level rates risked inflating asset and credit valuations, cautioned that an abrupt 75-basis-point jump from the floor could provoke disorderly repricing given that short-term markets priced essentially no imminent move. The data-dependent participant noted that the Beige Book's slowing growth, cautious optimism, and the slightly below-trend CFNAI reading of -0.13 did not describe an overheating economy demanding a jumbo step. The market-signals participant made the parallel point that market pricing of no near-term hike argued the magnitude, not the direction, was wrong for now.



The exchange thus separated two questions that participants treated distinctly: whether accommodation had become excessive relative to the mandate, on which a broad view formed that it had, and how quickly to remove it, on which the calm-but-cautious tone of financial markets, the softening growth signals, and the still-incomplete labor recovery counseled gradualism for most members. The gap between the predictive hold and the rule-implied 75 basis points was read by participants as a measure of accumulated accommodation, with the disagreement centered on how abruptly that gap should be closed.

COMMITTEE POLICY ACTIONS

In the predictive vote on the near-term policy action, the Committee unanimously favored maintaining the target range at 0.0 to 0.25 percent, a tally of 5 to 0. On the framework's optimal recommendation of 75 basis points, one participant — the member weighting inflation risk most heavily — endorsed the recommendation as-is, and the remaining four participants — the labor-market, financial-stability, data-dependent, and market-signals members — registered partial agreement, supporting the direction of removing accommodation while judging the 75-basis-point magnitude too large or too abrupt for this meeting. No participant declined the recommendation outright.