



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that System Open Market Account holdings of domestic securities totaled \$8,307.8 billion as of September 14, up \$5.5 billion from the prior release of September 7. Composition was little changed: Treasury notes and bonds accounted for \$4,863.1 billion, Treasury bills for \$318.1 billion, and agency mortgage-backed securities for \$2,709.8 billion. The staff noted that this review covers SOMA holdings only — total size, composition, and the week-over-week change — and does not encompass repurchase or reverse repurchase operation results, for which no point-in-time-safe data source currently exists; accordingly, no characterization of those operations was offered.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that inflation remained well above the Committee's longer-run objective. Core PCE inflation stood at 3.99 percent on a twelve-month basis, still close to double the 2 percent target. The labor market remained tight: the unemployment rate was 3.7 percent, below the estimated natural rate of 4.44 percent, and initial jobless claims were low at 222,000. The Chicago Fed National Activity Index registered 0.27, consistent with growth near its historical trend, and the Employment Cost Index reading was 152.1. M2 stood at \$21,709.2 billion.

The most recent Beige Book described economic activity as unchanged, on balance, since early July, with five Districts reporting slight to modest growth and five others reporting slight to modest softening. Consumer spending was steady as households continued to trade down and to shift toward food and other essentials, while auto sales remained muted amid limited inventories and elevated prices. Residential real estate weakened noticeably, with home sales falling in all twelve Districts and residential construction constrained by input shortages; commercial real estate softened, particularly demand for office space. Employment rose at a modest to moderate pace in most Districts, and although labor conditions remained tight, nearly all Districts noted some improvement in labor availability and improved worker retention. Wages grew across all Districts, but reports of a slower pace of increase and moderating salary expectations were widespread. The outlook among contacts was generally weak, with expectations for further softening of demand over the next six to twelve months.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as reflecting some anxiety but not acute distress. The financial stress index stood at 0.234, a moderate reading, and the Baa corporate spread of 2.18 percentage points was elevated but within normal cyclical ranges, with no sign of a credit-market seizure. The VIX at 26.16 indicated nervous but not panicked equity markets. The most notable signal was the inversion of the 10-year/2-year Treasury spread at -0.37 percentage point, a configuration



often associated with heightened recession risk further out. At the short end, the 3-month T-bill spread stood at 0.815 percentage point above the current policy rate, a level the staff noted was broadly consistent with market participants pricing in meaningful additional near-term tightening from the current 2.25 to 2.50 percent target range.

STAFF ECONOMIC OUTLOOK

The staff projection took as a point of departure that the current 2.25 to 2.50 percent range already sits well below the FOMC's prior median projection of 3.4 percent, implying additional firming would be needed to reach that level. At the same time, the estimated neutral rate (r^*) of -0.5 suggested that the prevailing real policy stance was already meaningfully restrictive, so that further increases would push the stance more firmly into restrictive territory. Inflation momentum was estimated at -0.23, pointing to some deceleration in price pressures even with core PCE near 4 percent, while unemployment momentum was flat at 0.0, consistent with a labor market that was tight but not yet turning.

Against this backdrop, the reference rules gave a divided reading. The Taylor rule and the First-Difference rule each pointed to a 75 basis point increase, reflecting the large inflation gap and still-tight labor market. The Balanced Approach and ELB-adjusted rules, by contrast, pointed to a 25 basis point reduction, weighting the negative r^* estimate and softening growth signals more heavily. With the reference rules judged reliable, the loss-minimizing calculation reconciled these opposing pulls at a 50 basis point increase — firm enough to continue closing the inflation gap while giving weight to the curve inversion, the negative inflation momentum, and the weak forward outlook evident in the Beige Book.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, most participants judged that a 75 basis point increase was the most likely outcome. Several grounded this view in the persistence of inflation: with core PCE at 3.99 percent, nearly double the target, and prior guidance having explicitly pointed to ongoing increases, the case for continued firm tightening was seen as strong. One participant focused on inflation risk emphasized that unemployment at 3.7 percent, below the 4.44 percent natural rate, and wage growth across all Districts left room to keep tightening without inflicting acute labor-market damage. A participant attentive to market signals observed that the 3-month T-bill spread of 0.815 percentage point was most consistent with roughly 75 basis points of near-term tightening — more than a 50 basis point step but short of 100 — and that continuity with the prior firm move argued for the same magnitude.



A participant weighting financial stability checked first for signs of systemic strain and concluded there were none decisive: the stress index at 0.234 was moderate, the Baa spread at 2.18 was elevated but not alarming, and the VIX at 26.16 reflected anxiety rather than panic. This participant flagged the -0.37 curve inversion as a genuine caution against over-tightening, but ultimately reasoned that credit was still flowing and that a downside surprise relative to what markets had priced could be read as a loss of resolve on inflation, potentially destabilizing expectations. On that logic the participant leaned to 75 basis points to preserve credibility.

One participant, weighting employment risk most heavily, dissented from the majority magnitude and favored 50 basis points. This participant took the recession-warning signals seriously — the inverted curve, the weak six-to-twelve-month outlook, and housing weakening across all twelve Districts — and worried that a 75 basis point move risked tightening abruptly into a slowing economy, the kind of overshoot that could produce future job losses. At the same time, this participant acknowledged that with core PCE near 4 percent and unemployment still below the natural rate, cutting was unjustifiable, and that no member proposed easing. The preference was thus for the smallest step that still credibly addressed inflation while leaving room to observe whether labor softening accelerated. The final predictive vote stood at four participants favoring 75 basis points and one favoring 50.

When the discussion turned to the framework's loss-minimizing recommendation of 50 basis points, the tenor of the deliberation shifted. Participants generally came to view the 50 basis point figure as a defensible reconciliation of the divided reference rules — the 75 basis point readings from the Taylor and First-Difference rules against the -25 basis point readings from the Balanced Approach and ELB-adjusted rules. Several noted that the negative inflation momentum of -0.23 suggested price pressures were cresting rather than accelerating, and that the r^* estimate of -0.5 implied the current stance was already restrictive in real terms. A couple of participants observed that the Beige Book's evidence of moderating wages and improving labor availability represented genuine, not merely speculative, signs that earlier tightening was working through the economy.

The participant focused on inflation risk characterized the disagreement as one of magnitude rather than direction, maintaining that a full 75 basis points remained warranted given fragile disinflation but accepting that 50 basis points kept policy firmly in tightening territory and continued the move toward the prior 3.4 percent median. The employment-focused participant and the financial-stability participant both endorsed 50 basis points as the more prudent step, the latter emphasizing that a fourth consecutive large move could send a destabilizing message even absent acute stress. The market-focused participant noted a tension in the data — front-end pricing demanding firming while the inversion flagged downside risk — and concluded that 50 basis points threaded that needle, while



observing that the 25 basis point gap between the predictive expectation and the optimal recommendation reflected an expected policy stance somewhat more hawkish than a pure loss-minimizing balance would dictate.

COMMITTEE POLICY ACTIONS

In the predictive vote on the most likely policy action, four participants judged a 75 basis point increase most likely and one judged a 50 basis point increase most likely, for a recorded tally of 75 basis points ({75: 4, 50: 1}). On the separate question of the framework's loss-minimizing recommendation of a 50 basis point increase, four participants endorsed the recommendation as-is — the participant weighting employment risk, the financial-stability participant, the data-dependent centrist, and the market-signal participant. The participant most focused on inflation risk registered a partial position, agreeing with the direction of continued tightening but preferring a larger step. No participant declined the recommendation, for an optimal-side outcome of four endorse, one partial, and none declining.