



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$7,265.0 billion as of the most recent release on October 25, 2023. The portfolio consisted of \$4,183.8 billion in Treasury notes and bonds, \$232.8 billion in Treasury bills, and \$2,454.6 billion in agency mortgage-backed securities. Holdings declined by \$18.4 billion from the prior release of October 18. The manager noted that these figures cover SOMA holdings only — their total size, composition, and 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; accordingly, this review makes no statement about the volume or pricing of those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data showing an economy still expanding at a modest pace with a firm labor market. Core PCE inflation stood at 3.05 percent on a twelve-month basis, still well above the Committee's 2 percent objective, though the pace of increase had moderated. The unemployment rate was 3.8 percent, below the estimated natural rate of 4.42 percent, and initial jobless claims remained very low at 198,000, indicating continued labor-market tightness. The Chicago Fed National Activity Index at 0.02 pointed to activity running near its historical trend, neither clearly overheating nor contracting. The Employment Cost Index reading was 159.0, and M2 money supply stood at \$20,754.9 billion.

Beige Book reports described activity as little changed to slightly softer across Districts. Several regions noted cooling: one District reported a slight contraction, with manufacturing demand down and commercial real estate activity and lending declining, while another reported conditions softening slightly. Hiring was generally characterized as flat to moderate, and multiple Districts reported that wage pressures had eased, with firms more frequently holding wages steady after sizeable increases in prior years. Price growth was widely described as slowing, though input costs continued to press on some service providers, and businesses reported difficulty passing costs through amid softer consumer demand. Contacts in more than one District indicated that higher long-term interest rates had weakened their outlooks for the coming year. Manufacturers in one District also flagged concern about potential effects of the UAW strike.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were broadly restrictive but not disorderly. The financial stress index at 0.183 was low, and the VIX at 20.19 was moderate, consistent with markets that were not signaling acute strain. The Baa corporate spread of 1.84 percentage points was contained by historical standards, suggesting



credit markets were functioning without evident distress. At the same time, the 10-year/2-year Treasury spread was inverted at -0.13 percentage point, a configuration associated with elevated recession risk, and the 3-month T-bill yield stood 0.065 percentage point below the current target rate, an indication that money markets were not pricing further firming near term. Beige Book contacts reinforced this picture, reporting that credit conditions had tightened somewhat and that higher long-term yields were transmitting restraint into the real economy.

STAFF ECONOMIC OUTLOOK

The staff outlook pointed toward gradually cooling activity and continued, if incomplete, disinflation, conditional on policy remaining at its current setting. With the estimated neutral rate (r^*) at -0.5 percent, the prevailing target range of 5.25 to 5.50 percent implied a substantially restrictive real stance relative to core inflation of 3.05 percent, suggesting that policy was already exerting meaningful downward pressure on demand. Inflation momentum was estimated at -0.23, consistent with disinflation being underway despite the still-elevated level, while unemployment momentum was only marginally positive at 0.05, implying the labor market was near flat rather than deteriorating.

The reference-rule outputs prescribed levels above the current range: the Taylor, Balanced Approach, and ELB-adjusted rules each pointed to roughly 75 basis points of additional tightening, and the First-Difference rule to about 50 basis points. The staff noted that the level rules rely heavily on the r^* estimate and weight the inflation gap strongly, whereas the First-Difference rule, keyed to changes rather than the static gap, produced a smaller signal that better accommodated the negative inflation momentum. Taken together, the projection was one in which lagged effects of prior firming and higher long-term yields continued to filter through, activity held near trend, and inflation drifted lower over the projection horizon absent a fresh shock — a path that the deterministic policy engine judged consistent with a loss-minimizing recommendation of 0 basis points.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants favored holding the target range at 5.25 to 5.50 percent, though they arrived there from different vantage points. The participant most focused on inflation risk emphasized that core PCE at 3.05 percent remained well above target and that the labor market, with unemployment below the natural rate and claims at 198,000, was not demanding relief. This participant weighed whether a hawkish lean and the prior median projection of 5.6 percent warranted pressing for a further hike, but concluded that softening activity across several Districts and the tightening already delivered by higher long-term yields argued against it. The preferred posture was a hold that explicitly preserved optionality for additional firming should disinflation stall.



The participant most attentive to employment risk explained that a cutting bias is triggered only by rising unemployment or clearly slowing job growth, neither of which the data showed; accordingly, a cut was not justified with inflation still elevated. This participant nonetheless emphasized firm resistance to any further hike, reading the recession signals in the inverted yield curve and the broad-based cooling in the Beige Book as forward risks to the labor market. The participant focused on financial stability observed that the stress index, VIX, and Baa spread all pointed to orderly, functioning markets with no acute distress, so nothing forced action in either direction. This participant stressed that an incremental hike layered on top of market-driven tightening — declining commercial real estate lending, tighter conditions in one District, weakened outlooks tied to higher long rates — risked overshooting into the very credit stress the participant most feared.

The participant reading the data at face value noted the tension between elevated inflation, which ruled out easing, and softening activity together with a negative T-bill spread, which argued against hiking; the most literal reading was patience. The participant weighting market-implied pricing most heavily made the point sharpest: with the 3-month bill priced below the current rate and the curve inverted, markets saw the stance at or near peak and were not pricing the additional firming implied by the prior 5.6 percent median, which this participant treated as a stale signal overridden by the live market path. Across the rebuttal round, no participant was moved off holding; several remarked that the convergence reflected a genuine balance in the data rather than mere consensus.

When discussion turned to the framework's loss-minimizing recommendation of 0 basis points, participants engaged directly with the gap between that recommendation and the reference rules, which pointed to 50 to 75 basis points of additional tightening. Several found the divergence instructive rather than contradictory. The inflation-focused participant read it as caution about lags rather than dovishness, noting that negative inflation momentum of -0.23 indicated disinflation was genuinely progressing and that the level rules did not account for firming still in the pipeline. The centrist and the market-signal participant both found the First-Difference rule's logic most persuasive, since it responds to momentum rather than the static level gap and produced a smaller signal consistent with decelerating inflation. The financial-stability participant framed the 0-basis-point outcome as reflecting an incremental hike whose stability cost now exceeded its marginal disinflation benefit, and the employment-focused participant pointed to r^* at -0.5 as confirmation that the current range was already deeply restrictive in real terms.

In the final rebuttal on the optimal case, participants reaffirmed these views without changing direction. The inflation-focused participant characterized the hold as a firmly restrictive, inflation-focused choice rather than a dovish concession, with optionality for further firming preserved if inflation reaccelerated.



The employment-focused participant reiterated that no employment emergency justified a cut but that the cooling in wages and demand, together with the recession signal in the curve, meant restriction was already sufficient, and indicated resistance to any statement language leaning toward further firming. The financial-stability participant said the centrist and dove arguments only confirmed its emphasis on pipeline tightening, and the market-signal participant concluded that market pricing and decelerating momentum both justified patience over another hike.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy action, all five participants supported maintaining the target range for the federal funds rate at 5.25 to 5.50 percent, a unanimous tally of 5 to 0 for no change (0 basis points). On the deterministic policy engine's loss-minimizing recommendation of 0 basis points, the Committee likewise reached full agreement: 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 partial agreement. Participants generally judged that the current stance was already appropriately restrictive and that patience, allowing prior firming and tighter financial conditions to continue transmitting, was preferable to further action at this meeting.