



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The manager reported that System Open Market Account holdings of domestic securities totaled \$6,574.0 billion as of September 11, essentially unchanged from the prior release on September 4, a net increase of \$0.1 billion. The composition remained heavily weighted toward Treasury notes and bonds, which stood at \$3,726.6 billion, with Treasury bills at \$195.3 billion and agency mortgage-backed securities at \$2,291.7 billion. The near-flat week-over-week change indicated that the balance sheet was little altered over the period. Members were reminded that this review covers SOMA securities holdings only — total size, composition, and the change from the prior release — and does not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists; accordingly, no characterization of those operations is offered here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review indicated that inflation had continued to moderate toward the Committee's objective, with core PCE inflation running at 2.18 percent on a twelve-month basis. Labor market conditions had eased over the intermeeting period: the unemployment rate stood at 4.2 percent, a touch below the estimated natural rate of 4.41 percent, while initial claims for unemployment insurance remained contained at 227,000. The Chicago Fed National Activity Index at -0.34 was consistent with growth running somewhat below trend, and the Employment Cost Index reading of 165.5 accompanied reports of a slowing pace of wage gains. M2 stood at \$21,054.4 billion.

The most recent Beige Book pointed to a broad-based softening. Economic activity grew only slightly in three Districts, while the number of Districts reporting flat or declining activity rose to nine, up from five in the prior period. Employment was generally flat to up slightly, with isolated reports of firms filling only necessary positions, trimming hours and shifts, or reducing headcounts through attrition, though accounts of layoffs remained rare. Employers were described as more selective in hiring, and candidates faced longer times to secure a job. On balance, wages rose at a modest pace, with skilled tradespeople and unionized workers still commanding stronger increases. Consumer spending ticked down in most Districts after holding steady previously, manufacturing activity declined in most Districts, and reports on residential and commercial real estate were mixed, with most Districts indicating softer home sales. Contacts generally expected activity to remain stable or improve somewhat, though those in three Districts anticipated slight declines.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm over the intermeeting period. The financial stress index stood at 0.1289, a low reading, and the VIX at 17.69 was benign, giving no indication of market



strain. Credit markets showed no distress: the Baa corporate spread over Treasuries was 1.74, a tight and healthy level. Term structure signals were notable. The 10-year/2-year Treasury spread stood at just 0.03, barely positive after a prolonged inversion, while the 3-month Treasury bill yielded 0.525 percentage point below the current federal funds target rate — a spread whose sign indicated that funding markets were pricing near-term policy easing. The current target range remained 5.25 to 5.50 percent, above the FOMC's last median projected fed funds rate of 5.1 percent.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment emphasized that the current stance of policy appeared meaningfully restrictive relative to neutral. The estimated neutral real rate was negative, at -0.342 , which, set against a nominal target range of 5.25 to 5.50 percent and inflation near target, implied a real policy rate well above neutral. Consistent with this, three of the four reference rules — the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule — each prescribed a reduction of 75 basis points, while the First-Difference rule, which places weight on the pace of change rather than the level of gaps, prescribed no change. The reference rules were assessed as reliable in the current configuration.

The momentum readings tempered the case for aggressive front-loading. Inflation momentum was low at 0.07, indicating that the disinflation trend was essentially flat rather than reaccelerating, while unemployment momentum at 0.15 pointed to a gradual upward drift in the unemployment rate rather than a sharp deterioration. Taken together, these quantities suggested a projected environment in which policy could begin normalizing toward a lower path without the level gaps demanding an outsized single move. The framework's loss-minimizing output, at -25 basis points, sat between the aggressive level-gap rules and the cautious First-Difference prescription, reflecting a projected path of gradual normalization that acknowledges genuine restrictiveness while the containment of momentum on both mandates argues against a rapid descent.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants agreed that the disinflation process had made substantial progress, with core PCE inflation at 2.18 percent now within striking distance of the 2 percent objective. One participant whose foremost concern was inflation risk noted that with the twelve-month rate still above target, caution remained warranted, but acknowledged that the underlying momentum was nearly flat and that the Beige Book confirmed waning pricing power, modest wage growth, and softening demand across the nine Districts reporting flat or declining activity. Several participants observed that long-term expectations remained well anchored, which reduced the risk that beginning to ease would reignite price pressures. A participant focused on employment characterized the inflation battle as largely won, freeing attention



toward the labor mandate, while others were more measured, cautioning that with inflation not yet at 2 percent it was premature to declare the objective achieved.

On the labor market, participants generally judged that conditions had cooled but had not deteriorated abruptly. A participant emphasizing employment risk pointed to the unemployment rate at 4.2 percent, its upward drift as captured by unemployment momentum of 0.15, and Beige Book reports of frozen hiring, reduced hours and shifts, and lengthening job searches, arguing that the composition of hiring weakness was as telling as the rare incidence of layoffs. Other participants noted that the unemployment rate remained near, and by one reading just below, the estimated natural rate of 4.41 percent, that initial claims at 227,000 were contained, and that layoffs remained rare — describing the process as orderly rebalancing rather than a collapse. A couple of participants remarked that this gradual character argued against an emergency-sized response while still supporting the start of normalization.

There was extended discussion of the appropriate magnitude of an initial move. Early in the deliberation, three participants leaned toward a 50 basis point cut. A participant weighting market-implied pricing most heavily stressed that the 3-month Treasury bill sitting 0.525 percentage point below the current range, together with the 2s10s spread having un-inverted to 0.03, pointed toward markets anticipating more than a token quarter-point step at the outset. A participant attentive to financial stability had also opened at 50 basis points on the logic of heading off credit-market stress, and a participant focused on employment had been drawn to a larger move given rising labor risk. On reflection, however, most of these participants revised toward a smaller step. The financial stability participant reconsidered, noting that the stress index at 0.1289, the VIX at 17.69, and the Baa spread at 1.74 revealed no stress building to head off, and that an outsized front-loaded cut could itself be read as a signal of alarm and destabilize the very conditions it aimed to protect. The employment-focused participant concluded that the absence of financial stress, contained claims, and rare layoffs did not yet justify a jumbo opening move. A participant taking market pricing at face value cautioned that reading a specific 50 basis point increment out of the T-bill spread was speculation beyond what the number literally supported — a spread of that magnitude was consistent with the beginning of an easing cycle rather than a mandate for a single large cut. One participant continued to favor 50 basis points, holding that the size of the T-bill spread and the un-inversion pointed beyond a quarter point and that calm markets permitted a decisive but non-disruptive opening move.

In turning to the optimal-policy framework, participants engaged directly with the divergence between the reference rules and the recommended action. Several noted that the Taylor, Balanced Approach, and ELB-adjusted rules each prescribing 75 basis points, together with an estimated neutral real rate of



-0.342, confirmed that the current 5.25 to 5.50 percent range — set above the last median projection of 5.1 percent — was genuinely restrictive. The participant most concerned with inflation said the 75 basis point prescriptions were alarming and distrusted their speed, favoring the direction of the Balanced Approach logic but not its pace, and viewed the First-Difference rule's zero-change reading as reflecting a caution against overreacting to level gaps when momentum was contained. Others found the First-Difference rule too passive given softening demand and the too-tight funding spread. Participants broadly converged on the view that the framework's 25 basis point recommendation threaded these rules — meaningful relief without a destabilizing shock — and preserved optionality to accelerate if labor data weakened or to pause if inflation stalled above 2 percent.

Summing up, participants generally judged that a quarter-point reduction represented a prudent first step: it began normalization in line with near-target inflation and a cooling labor market while retaining caution appropriate to inflation still modestly above objective and to calm financial conditions that created no urgency for aggressive action. A number of participants emphasized that the gap between the deep cuts implied by the level-based rules and the measured cut adopted underscored that policy would remain restrictive even after the move, leaving ample room for subsequent action to be guided by incoming data.

COMMITTEE POLICY ACTIONS

In the predictive assessment of the likely policy decision, the Committee's final vote was for a 25 basis point reduction, moving the target range to 5.00 to 5.25 percent, with four members favoring 25 basis points and one member favoring 50 basis points. On the optimal-policy framework's recommendation of a 25 basis point cut, all five members endorsed the recommendation as-is: the inflation hawk, the labor market dove, the financial stability voice, the data-dependent centrist, and the market signal realist each recorded an endorsement, with none declining and none registering only partial agreement. The framework recommendation, the deterministic engine output, and the majority predictive vote thus all aligned on a measured first step of 25 basis points.