



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$6,194.9 billion as of September 10, unchanged from the prior release on September 3. The composition remained weighted toward longer-dated Treasury securities, with Treasury notes and bonds accounting for \$3,572.1 billion and Treasury bills for \$195.5 billion; agency mortgage-backed securities made up the balance at \$2,094.9 billion. The manager noted that this review covers SOMA securities holdings only — total size, composition, and the week-over-week change — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available. Accordingly, no characterization of money-market operations beyond the reported holdings is offered here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 2.45 percent on a twelve-month basis, still above the Committee's 2.0 percent objective but by a modest margin. The unemployment rate was 4.3 percent, essentially equal to the estimated natural rate of 4.32 percent, indicating a labor market close to balance rather than one exhibiting meaningful slack. Initial jobless claims at 237,000 were consistent with a contained, gradual pace of separations. The Chicago Fed National Activity Index at -0.19 pointed to somewhat below-trend growth, and the Employment Cost Index and M2 readings were reviewed without indication of abrupt change. The current federal funds target range was 4.25 to 4.50 percent, above the Committee's own most recent median projected rate of 3.9 percent.

The Beige Book characterized overall economic activity as expanding only slightly, with consumer spending flat and employment down slightly. Wages and prices were reported to have increased modestly, and home sales rose moderately from a year earlier. Tariff-related uncertainty was a recurring theme, weighing on the outlook for consumer spending in particular. Price signals were two-sided across Districts: New York reported selling prices accelerating and input prices rising strongly; Philadelphia noted inflation expectations 'higher still' alongside tariff and federal budget stress; and Cleveland described cost growth as robust even as selling-price increases were more modest. Several Districts — including Atlanta and Richmond — reported steady employment and moderating or moderate wage pressures, while Chicago and Philadelphia noted broadening expectations for future growth. On balance the picture was one of soft real activity accompanied by persistent, tariff-linked cost pressure.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as calm and orderly. The financial stress index at 0.1371 was low, and the VIX at 15.35 indicated subdued equity volatility. The Baa corporate spread at 1.75 was



moderate, showing no meaningful widening or sign of credit-market distress. The 10-year/2-year Treasury spread was positively sloped at 0.5, offering no acute recession signal from the yield curve. The 3-month T-bill yield sat 0.425 below the current target-range midpoint, a spread the staff read as consistent with market expectations of near-term easing. Taken together, the indicators pointed to markets that were not signaling systemic strain and appeared to have priced in a modest reduction in the policy rate rather than an aggressive move.

STAFF ECONOMIC OUTLOOK

The staff projection drew on the real forward-looking quantities available. The estimated neutral real rate (r^*) was very low, near 0.099, which implies that the current 4.25 to 4.50 percent target range is meaningfully restrictive in real terms. Both inflation and unemployment momentum readings were slightly negative — -0.055 and -0.05, respectively — suggesting that price pressures were easing gently and that labor-market softening, while present, was gradual rather than abrupt. These momentum figures, if sustained, point toward conditions drifting modestly further from full-employment tension and toward slowly cooling inflation, though a single reading does not confirm that tariff pass-through has run its course.

The reference rules spanned a wide range and did not converge on a single prescription. The Taylor, Balanced Approach, and ELB-adjusted rules each pointed to -75 basis points, reflecting the low neutral rate and the negative momentum readings, while the First-Difference rule — which responds to changes rather than levels — pointed to +25 basis points, reflecting inflation still above target. The optimal-policy engine, treating the reference rules as reliable, reconciled these opposing signals into a loss-minimizing recommendation of 0 basis points. The staff characterized this as a hold that balances the aggressive level-based easing signals against still-above-target inflation and calm financial conditions, with the breadth of the rule dispersion itself underscoring the sensitivity of the restrictiveness calculation to the low r^* estimate.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening positions, four of the five participants favored a 25 basis point reduction in the target range, while one favored holding. Those inclined toward a cut emphasized that unemployment at 4.3 percent had reached the estimated natural rate of 4.32 percent, so that the labor market had moved from having slack to being merely balanced and was now showing early signs of softening. They pointed to the Beige Book's report that employment was down slightly nationally, to flat consumer spending, and to the Chicago Fed index at -0.19 as evidence of fading momentum. Several also noted that the current range sat well above the Committee's own prior median projection of 3.9 percent, implying policy was restrictive, and that the 3-month T-bill spread of -0.425 indicated markets



had already priced a near-term move. Participants weighing financial and market signals stressed that low stress readings — the stress index at 0.1371, the VIX at 15.35, and a contained Baa spread at 1.75 — argued for a measured single step rather than any larger, emergency-sized action, and that holding when markets had priced a cut risked a disruptive repricing.

The participant favoring a hold placed primary weight on inflation risk. With core PCE at 2.45 percent still meaningfully above the 2.0 percent objective, this participant argued that the Beige Book directly undercut the view that tariff effects were merely one-time price-level shifts, citing accelerating selling prices in New York, inflation expectations described as 'higher still' in Philadelphia, and robust cost growth in Cleveland. In this view, being at the natural rate reflected balance rather than deterioration, and with no crisis in the financial data and a positively sloped yield curve, there was no case for preemptive easing that might cement above-target inflation or unanchor expectations. In the rebuttal round, this participant acknowledged that four of five members leaned toward a cut and that such an outcome was the likely committee result, but was not persuaded to revise, judging the labor softening real but marginal. The members favoring a cut were likewise unmoved toward a larger 50 basis point move, uniformly citing the absence of stress as reason to keep any step measured.

When the discussion turned to the framework's loss-minimizing recommendation of 0 basis points, the balance of views shifted. The participant most focused on inflation found the hold closely aligned with a price-stability-first temperament, distrusting the -75 basis point rule outputs on the grounds that they assumed inflation was contained and downplayed tariff persistence, and finding the First-Difference rule's +25 basis points the closest match to a cautious reading. The financial-stability-focused participant endorsed the hold, reasoning that with stress this low there was no emergency demanding defensive easing, and that abrupt large cuts could themselves destabilize expectations; waiting one meeting was judged to cost little. The data-dependent participant endorsed the hold as well, observing that both mandate gaps were small — unemployment at the natural rate and inflation roughly 0.45 percentage point above target — so that the stance was near neutral and only fine-tuning was warranted, and that the two-sided Beige Book picture of soft growth alongside repeated tariff price acceleration supported patience over the rules' aggressive easing signal.

Two participants agreed with the direction implied by holding but not with its full application at this meeting. The participant most attentive to the labor market accepted that the divergence from the framework was small and that the next move was likely to be a cut, but continued to prefer a 25 basis point reduction now, arguing that with slack already gone and three of four reference rules calling for easing, it was worth getting ahead of softening before it accelerated; this participant indicated that further labor deterioration would make a cut compelling at the following meeting. The market-focused



participant similarly agreed against deep cuts but held that the embedded T-bill signal pointed to a modest step now rather than patience, viewing a 25 basis point move as the reading most consistent with aggregated market information. Both framed their difference as one of magnitude and timing rather than direction, and both conceded the current stance was only slightly restrictive relative to neutral, so that the case between a small cut and a hold was genuinely close.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely policy action, the Committee recorded a 4-to-1 split in favor of a 25 basis point reduction in the target range, with one participant favoring no change (recorded as -25 bps: 4, 0 bps: 1). On the separate question of the optimal-policy framework's recommendation of 0 basis points — a hold at the current 4.25 to 4.50 percent range — three participants endorsed the recommendation as-is (the inflation-focused, financial-stability, and data-dependent participants), and two participants gave partial support, agreeing with the direction but not the magnitude or timing (the labor-market and market-signal participants, each preferring a modest 25 basis point cut this meeting). No participant declined the recommendation outright.