



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings were available on or before the cutoff for this meeting, so the Committee is unable to report a total size, a breakdown of composition, or any change from a prior release. This absence pertains to SOMA holdings specifically; it should be understood as distinct from the results of repurchase and reverse repurchase operations, for which no point-in-time-safe data source currently exists and which are therefore not covered here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized the expansion as ongoing and, in places, gaining pace. Core PCE inflation stood at 2.25 percent on a year-over-year basis, modestly above the 2.0 percent objective. The unemployment rate was 6.4 percent, roughly a full percentage point above the estimated natural rate of 5.47 percent, indicating that meaningful labor market slack remained. Initial jobless claims at 351,000 were moderate and gave no sign of deterioration. The Chicago Fed National Activity Index at 0.07 placed overall activity near its historical trend, and the current federal funds rate was 3.0 percent.

The most recent Beige Book, prepared from information gathered before January 10, reinforced this picture. It reported that economic activity 'continued to expand with signs of acceleration in some sectors,' with consumer spending on household-related items strong during the holidays across most districts and manufacturing activity strengthening, accompanied by some improvement in manufacturing employment. Residential real estate sales and construction grew robustly in almost all districts, while commercial real estate remained generally sluggish. Loan demand increased somewhat in many districts. On prices, almost all districts reported 'little upward pressure on wages and prices,' though widespread lumber price increases and scattered labor shortages were noted, and weak conditions persisted in southern California.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were calm and accommodative across every measure available. The financial stress index registered 0.0, its lowest possible reading, and the VIX stood at 9.94, an extraordinarily low level suggestive of considerable market complacency. The Baa corporate spread of 1.86 percentage points was narrow, consistent with easy corporate borrowing conditions and no evident credit-market strain. The 10-year/2-year Treasury spread was positively sloped at 1.6 percentage points, showing no inversion or recession signal, while the 3-month T-bill spread against the current funds rate was essentially flat at -0.07, implying that money markets anticipated little imminent change in policy.

STAFF ECONOMIC OUTLOOK



The forward-looking staff assessment drew on several real quantities. The estimated neutral real rate (r^*) was low, on the order of 0.5 percent, implying that a 3.0 percent nominal funds rate against inflation near 2.25 percent leaves the real policy stance close to neutral rather than clearly restrictive. Both inflation momentum and unemployment momentum were flat at 0.0, indicating no fresh acceleration in prices and no fresh deterioration in the labor market over the projection horizon. On this reading, conditions appeared more likely to evolve gradually than to shift abruptly in either direction.

The reference rules diverged sharply. The Taylor, Balanced Approach, and ELB-adjusted rules each pointed to -75 basis points, driven principally by the wide unemployment gap relative to the estimated natural rate. The First-Difference rule, which keys off observed changes rather than level gaps, indicated 0 basis points, consistent with the flat momentum readings. The deterministic policy engine, treating the reference rules as reliable and weighting the terms above, recommended 0 basis points. The gap between the deep-cut level rules and the no-change recommendation reflects the sensitivity of the level-based rules to a low and uncertain r^* estimate, which the momentum-based projection effectively discounts. Taken together, the staff outlook implied a stance near neutral with no strong pull toward either easing or tightening in the near term.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In the predictive phase of the discussion, four of the five participants favored a 25 basis point increase, while one favored no change. Those inclined toward a hike built their case on the combination of above-target inflation, an accelerating expansion, and unusually calm markets. The participant most focused on inflation risk emphasized that core PCE at 2.25 percent sat above the 2.0 percent objective and that the Beige Book's language of activity 'continued to expand with signs of acceleration' — together with widespread lumber price increases and scattered labor shortages — represented incipient pressures worth leaning against before they could entrench. With the funds rate at 3.0 percent against roughly 2.25 percent inflation, this participant judged the real rate near zero and policy plainly accommodative into a firming economy.

The participant attentive to financial stability and the participant weighing market signals both arrived at the same 25 basis point step from different directions. The stability-minded participant argued that the very calmness of markets — stress index at 0.0, VIX under 10, Baa spread at 1.86 — provided the window to move gently now, and that deferring adjustment risked a sharper, more disruptive repricing later; a modest, gradual step was preferable to allowing accommodation to persist. The market-focused participant acknowledged that the flat T-bill spread of -0.07 implied markets expected essentially no change, a genuine counterweight, but concluded that firming activity tilted the balance toward a small preemptive move that calm markets could absorb without shock. The



data-focused participant read the same indicators at face value and treated a gentle 25 basis point normalization as the literal consensus reading. All those favoring action agreed that a larger move would risk shocking complacent markets and abruptly widening spreads.

The dissenting participant, whose mandate weights employment heavily, held at no change. This participant anchored on the roughly full percentage point of remaining slack — unemployment at 6.4 percent against a 5.47 percent natural rate — and stressed that the Beige Book itself reported 'little upward pressure on wages and prices,' with only scattered shortages and lumber prices rather than broad wage-price acceleration. Core inflation 25 basis points above target did not, in this view, constitute an emergency justifying restraint on a labor market still healing. Initial claims at 351,000 were moderate and not deteriorating, so this participant saw no case for a cut either, and concluded that holding steady best supported the ongoing recovery without adding restraint or fueling inflation.

When the discussion turned to the framework's loss-minimizing recommendation of 0 basis points, the participants converged more closely than their predictive votes had. Several found the First-Difference rule most persuasive precisely because it reacts to change rather than to a level gap resting on a fragile r^* estimate of only 0.5; with inflation and unemployment momentum both flat at 0.0, they judged there was no active reason to move from 3.0 percent. The employment-focused participant reconciled the framework's hold with a cutting instinct by observing that the trigger that would justify easing — deteriorating employment — was simply absent, while cutting into an accelerating economy risked overheating that could later cost jobs. The stability and market participants agreed that the deep-cut level rules misread a healthy economy with loose financial conditions as one needing rescue, and that easing 75 basis points into a 9.94 VIX would be the true error.

The participant most concerned with inflation continued to prefer a small hike and could not fully embrace holding, but accepted 0 basis points as a defensible, inflation-respecting compromise: it declines to add stimulus the economy does not need while not tightening prematurely against a still-elevated unemployment gap. Across the group, the recurring observation was that the modest distance between the predictive lean toward a small hike and the framework's hold — a quarter point — signaled genuine ambiguity about a stance that was near neutral, not a case for the aggressive easing the level rules implied. No participant offered a case for a move larger than 25 basis points in either direction.

COMMITTEE POLICY ACTIONS

In the predictive vote, the Committee's recorded tally was 4 members in favor of a 25 basis point increase and 1 member in favor of no change, and the final predictive stance was a 25 basis point



increase. On the framework's recommendation of 0 basis points, the recorded optimal-side outcome was 4 endorse and 1 partial, with no member declining. The labor-market-focused participant, the financial-stability participant, the data-dependent centrist, and the market-signal participant each endorsed the 0 basis point recommendation as-is, while the inflation-focused participant registered a partial position — agreeing with the direction of not easing but continuing to prefer a small tightening step rather than a hold.