



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data was available on or before the point-in-time-safe cutoff for this meeting. As a result, the Committee could not review the total size, composition, or change from the prior release of SOMA holdings. It should be noted that this section pertains to SOMA holdings only and does not cover the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized incoming activity data as consistent with growth running somewhat below trend. The Chicago Fed National Activity Index stood at -0.87, a reading the staff associated with below-trend expansion. Labor-market indicators showed modest softening at the margin: the unemployment rate was 5.6 percent, above the estimated natural rate of 5.32 percent, and initial jobless claims were elevated at 415,000. Core PCE inflation on a twelve-month basis was 2.01 percent, essentially at the 2.0 percent objective. M2 stood at \$3,777.5 billion.

The Beige Book, released January 17, 1996, provided commentary on current conditions across the twelve Federal Reserve Districts. The available material consisted of the summary front matter and District table of contents; no additional narrative detail from individual District reports was available for staff summary at this point. Taken together with the activity and labor readings, the staff review presented a picture of an economy expanding below trend, with inflation anchored near target and no indication of overheating in the labor data.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were described as broadly calm. The financial stress index registered 0.0672, a low reading, and equity-market volatility as measured by the VIX was subdued at 12.54. Credit conditions appeared healthy, with the Baa corporate spread at 1.83, a level the staff regarded as moderate and not indicative of meaningful stress. The Treasury term structure remained positively sloped, with the 10-year/2-year spread at 0.55, so the yield curve gave no inversion signal. Notably, the 3-month Treasury bill traded 0.53 percentage point below the current 5.5 percent funds rate, a configuration the staff read as consistent with market participants anticipating some near-term easing. In sum, the financial backdrop combined benign volatility and contained credit spreads with a bill-market signal pointing toward expected accommodation.

STAFF ECONOMIC OUTLOOK



The staff outlook drew on the reference-rule framework and the estimated neutral rate. With r^* estimated at 2.71 percent and inflation near 2 percent, a neutral nominal rate in the neighborhood of the high-4-percent range would imply that the current 5.5 percent funds rate is only modestly above neutral. Consistent with that arithmetic, the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to 75 basis points of tightening, reflecting inflation close to target alongside an unemployment rate below the estimated natural rate. These level-based rules, judged reliable in the framework output, thus implied that policy might be somewhat accommodative rather than restrictive.

Against that, the momentum-based reading pointed to no change. Inflation momentum was slightly negative at -0.005 and unemployment momentum was flat at 0.0, and on that basis the First-Difference rule recommended 0 basis points. The loss-minimizing recommendation likewise settled on 0 basis points, effectively balancing the tightening signal from the level rules against the absence of momentum in either inflation or unemployment and against the softness evident in real-activity indicators such as the below-trend activity index and elevated claims. The projection implied by these quantities is one of conditions holding near a broadly neutral stance, with no strong internal pressure toward either a further move up or down absent a change in the momentum readings or the emergence of financial stress.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In the predictive round, four of the five participants favored a 25 basis point reduction in the funds rate, while one favored no change. Those inclined toward easing pointed to a consistent cluster of soft real-side readings: the Chicago Fed activity index at -0.87 signaling below-trend growth, initial claims elevated at 415,000, and unemployment at 5.6 percent above the 5.32 percent natural rate. The member most focused on labor risk framed the case as insurance against building slack, judging the risks skewed toward employment weakening and arguing that with inflation essentially at target there was ample room to support demand. The member weighting market signals most heavily treated the 3-month bill's 53 basis point discount to the funds rate as the decisive indicator, reading it as embedded expectations of a near-term cut of roughly that size. The financial-stability-oriented member and the data-dependent member arrived at the same conclusion from their own vantage points, the former emphasizing that benign stress readings made a modest cut safe to implement in orderly conditions, and the latter describing a 25 basis point move as the most literal reading of below-trend activity paired with contained inflation.

The dissenting participant, whose priority was inflation discipline, resisted the easing case throughout. This participant stressed that core PCE at 2.01 percent was not below target but exactly at it, so



characterizing inflation as giving 'room' to ease overstated the cushion available. With the prior meeting already having delivered a cut and that easing not yet fully propagated, a second consecutive reduction was seen as risking over-easing precisely when slack was limited. The participant also cautioned that treating market pricing as a mandate could institutionalize a dovish drift eroding credibility, and noted that the calm stress, subdued volatility, positive curve, and moderate credit spreads together removed any case for insurance easing on financial-stability grounds. In rebuttal, the easing-inclined participants largely held their ground, though several acknowledged the force of the at-target inflation point; the labor-focused member conceded that holding preserved optionality even while maintaining a dovish tilt.

When the discussion turned to the framework's optimal recommendation of no change, the balance of views shifted noticeably. Participants engaged directly with the divergence between the level-based rules, all pointing to 75 basis points of tightening, and the First-Difference and loss-minimizing outputs, both pointing to a hold. The inflation-focused participant found the hold most persuasive, observing that three of four reliable rules judged policy too loose rather than too tight, which reinforced the argument against further easing. Other participants gravitated to the First-Difference logic on its own terms: with inflation momentum at -0.005 and unemployment momentum flat, there was nothing pushing policy to move in either direction, and changing course would add risk without clear benefit.

Several participants explicitly reconciled their predictive easing votes with an endorsement of the hold. The market-signal member reasoned that the bill-market discount likely reflected last meeting's cut being digested and projected forward rather than fresh demand for accommodation, and that markets appeared to be running ahead of fundamentals. The financial-stability member reiterated that absent credit-spread widening or rising stress, further easing was not stability-justified, and that cutting again into calm markets with inflation at target carried its own risk to inflation expectations. The data-dependent member characterized the current stance as roughly neutral-to-slightly-restrictive but not far enough from neutral to compel action, with the prior cut having already addressed the earlier favorable inflation surprise. The labor-focused participant remained the least comfortable with standing pat, accepting the hold's direction as reasonable given flat momentum and a benign backdrop but continuing to tilt toward easing, and emphasizing that a hold this meeting preserved the option to cut later should claims keep climbing and activity stay negative.

Across both the predictive and optimal discussions, participants generally agreed that the economy was expanding below trend with inflation anchored near target, that financial conditions were calm, and that no acute stress demanded action in either direction. The genuine disagreement concerned emphasis: whether the soft activity and labor leads warranted a follow-up easing now, or whether



at-target inflation, flat momentum, and the prior cut still propagating counseled patience and a reassessment at a later meeting.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely policy action, the Committee split four to one in favor of a 25 basis point reduction in the target funds rate, with one participant favoring no change. On the framework's optimal recommendation of holding the rate unchanged (0 basis points), the Committee's recorded stance was four endorsements and one partial. The inflation-focused participant, the financial-stability participant, the data-dependent participant, and the market-signal participant all endorsed the recommendation as-is. The labor-market-focused participant registered a partial stance, agreeing with the direction of holding but not fully endorsing standing pat given continued concern that employment risk was building; there were no outright objections to the recommendation.