



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data were available on or before the point-in-time-safe cutoff for this meeting, and the Committee therefore had no basis in the provided material for describing the total size, composition, or change in SOMA holdings from any prior release. This absence pertains to SOMA holdings only; it does not reflect results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists. The staff noted this gap explicitly so that the record would not be read as implying any particular level or shift in the portfolio.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized economic activity as running well above trend. Core PCE inflation stood at 1.9 percent on a year-over-year basis, just below the 2.0 percent objective. The unemployment rate was 4.1 percent, far beneath the estimated natural rate of 5.12 percent, and initial jobless claims were low at 270,000, offering no sign of labor-market softening. The Chicago Fed National Activity Index registered 0.44, consistent with growth above its longer-run pace. The federal funds rate was 5.75 percent at the time of the review.

The Beige Book, prepared before February 29, reported appreciable expansion across the twelve Districts, with most Districts describing strong growth and the remainder pointing to moderate growth or continued high activity. Retail sales expanded significantly over year-earlier levels, gains in manufacturing output were widespread, and real estate and construction remained at high levels, though slight cooling was evident in some areas. Constraints on the availability of labor and other inputs were apparent in many areas, and most Districts reported tight labor supplies and upward wage pressure for both skilled and entry-level workers. Despite this, increases in the prices of final goods and services were described as 'limited overall,' although the prices of transportation services and some industrial commodities rose noticeably. Bank loan demand was generally strong, with several Districts noting slower activity in consumer loans and residential mortgages.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as moderately tight but not distressed. The financial stress index stood at 0.2541, an elevated but non-crisis reading, and the VIX was 24.41, indicating some market anxiety without panic. The Baa corporate spread was 2.15, reflecting meaningful but contained credit costs rather than acute distress. The most notable signal came from the term structure: the 10-year/2-year spread was inverted at -0.17, and the 3-month T-bill spread relative to the current funds rate was -0.04, essentially flat. Taken together, the near-flat bill spread suggested markets viewed current policy as close to neutral over the near horizon, while the inversion flagged a



recession-risk signal that the staff highlighted for the Committee's attention.

STAFF ECONOMIC OUTLOOK

The forward-looking projection drew on the available quantitative benchmarks. With the estimated neutral rate at 3.722 percent and the current funds rate at 5.75 percent against 1.9 percent inflation, the implied real policy rate stands only modestly above neutral. Inflation momentum was slightly positive at 0.025 and unemployment momentum was 0.0, suggesting that, absent a fresh shock, price pressures were drifting upward only marginally while labor-market conditions were not deteriorating. On these readings, the near-term path of activity appeared likely to remain firm, with inflation continuing to hover near target rather than accelerating sharply.

The reference rules diverged in a way that framed the projection's central tension. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to 75 basis points of additional tightening, reflecting the wide gap between the 4.1 percent unemployment rate and the 5.12 percent natural rate. The First-Difference rule, which responds to momentum rather than levels, recommended no change, consistent with flat unemployment momentum and near-target inflation. The deterministic optimal policy engine, weighing the level-based rules against the muted momentum readings and the inverted yield curve, arrived at a recommendation of 0 basis points. The staff noted that this outcome reflected both the uncertainty attached to the elevated r^* estimate that inflates the level rules and the signal that markets already view policy as near neutral.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, all five participants independently arrived at a preference for a 25 basis point increase, though they reached that conclusion from distinct vantage points. The member most attentive to inflation risk emphasized that, while core PCE at 1.9 percent sat just below target, momentum and a labor market running well below its natural rate created a classic setup for wage-price pressure, reinforced by the Beige Book's reports of widespread labor shortages and rising transportation and industrial commodity prices. The participant focused on employment noted a striking feature of the current juncture: the ordinary case for accommodation rests on weakening jobs, but here employment was strong, claims were low, and wage pressure was building, so a modest hike was framed as protecting long-run employment against a later boom-bust correction rather than as a threat to it.

The participant most attentive to financial stability accepted the real-economy case for restraint but stressed that pace mattered more than direction, arguing that an inverted curve and a Baa spread of 2.15 counseled against any move larger than 25 basis points. The data-dependent participant read the



consensus as the most literal interpretation of the material: inflation near but not above target, no labor deterioration, and contained financial stress, all supporting one incremental step rather than a pause or a 50 basis point move. The participant weighting market signals observed that the near-flat T-bill spread implied markets had priced little beyond a modest move, and that the inversion was consistent with expectations that tightening would bite going forward. In the rebuttal round, no participant was moved off the 25 basis point position; several noted that the shared attention to the inverted curve confirmed a measured, gradual step as the prudent choice, and the final predictive vote was unanimous.

The optimal-framework discussion, conducted after the predictive vote was already final, exposed a genuine tension between the participants' predictive lean and the engine's loss-minimizing recommendation of 0 basis points. Several participants engaged directly with the divergence between the three level-based rules calling for 75 basis points and the First-Difference rule calling for none. The employment-focused member found the First-Difference logic persuasive precisely because unemployment momentum was zero: with no accelerating deterioration and inflation at target, there was no labor-side reason to add restraint that might later threaten jobs if activity turned. The financial-stability member likewise concluded that holding was defensible, arguing that tightening into an inverted curve with spreads already doing tightening work could convert a soft recession signal into genuine credit contraction, and that the level rules ignored the work the curve and credit markets were already performing.

The data-dependent participant grounded the case for holding in the uncertainty surrounding the elevated r^* estimate of 3.722, noting that the level rules assume r^* is known precisely while the First-Difference rule sidesteps that uncertainty by reading momentum, which was flat. This participant and the market-signals member both underscored that final goods price increases remained 'limited overall' in the Beige Book despite evident wage pressure, suggesting muted pass-through and implying that the level rules overweighted the labor gap relative to realized price outcomes. The market-signals member added that the near-zero T-bill spread indicated markets already treated 5.75 percent as near neutral, so that adding 25 basis points risked deepening the inversion without a corresponding inflation premium to justify it.

The inflation-focused participant did not accept the case for standing pat as fully as the others. While acknowledging the framework's math and agreeing that policy should not ease, this participant maintained that a real rate only modestly above neutral, set against a below-natural-rate labor market and strong Beige Book growth, argued that current policy was arguably still accommodative relative to fundamentals. From this view, the agreement of three level rules at 75 basis points was a strong



overheating signal, and holding invited the acceleration that positive inflation momentum already hinted at; the participant read the yield-curve inversion as market caution rather than license to under-tighten, and continued to favor a tightening step to guard against under-tightening in a hot economy.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported a 25 basis point increase, a unanimous 5-0 outcome. On the deterministic framework's recommendation of 0 basis points, four members endorsed the recommendation as-is, and one member registered a partial position, agreeing with the direction of not easing but judging that a hold undershot the appropriate degree of restraint given the tight labor market. Specifically, the labor-market, financial-stability, data-dependent, and market-signals members endorsed the 0 basis point recommendation, while the inflation-focused member took the partial stance, preferring a modest tightening step over standing pat. There were no members declining the recommendation outright.