



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, so the Committee was unable to review total SOMA size, its composition across security types, or any change from a prior release. This section reflects that absence rather than a judgment that holdings were unchanged. It should also be noted that this review concerns SOMA holdings only; it does not encompass the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source is currently available. Members were therefore advised to treat the open market operations portion of this review as incomplete for the current period.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that a majority of Federal Reserve districts noted some signs of improvement in economic conditions in January and early February. Several districts — Boston, Philadelphia, Richmond, Atlanta, Minneapolis, and San Francisco — described a pickup in activity, while Chicago cited a more positive tone. Kansas City and St. Louis characterized activity as weak but with some bright spots, Cleveland saw conditions as neither improved nor deteriorated relative to late last year, New York reported mixed signals, and Dallas noted continued weak activity. Manufacturing was generally described as weak across most districts, though selected industries in some areas showed more positive results. Retail sales improved modestly in a majority of districts relative to the end of last year. Residential real estate markets were generally stronger than commercial markets, and reports on demand for bank loans were mixed. The Chicago Fed National Activity Index stood at -0.03, consistent with growth roughly at trend.

On the labor and price side, the staff noted that the unemployment rate was 5.5 percent, above the estimated natural rate of 5.07 percent, and that initial jobless claims stood at 399,000. The Beige Book described labor markets as continuing to be slack in most districts, with many contacts citing suspended bonuses, frozen wages, or skipped annual salary increases; however, contacts at temporary employment firms in several districts suggested employment was bottoming out, with new hires in short supply in selected occupations. Wage and price pressures were described as 'subdued' to 'largely nonexistent,' though rising health insurance costs were mentioned in many districts, and Dallas reported upward pressure on services prices. Core PCE inflation was 0.91 percent on a year-over-year basis, well below the 2.0 percent target. The current federal funds rate stood at 1.75 percent, and M2 was reported at \$5,469.2 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff characterized financial conditions as calm and free of acute strain. The financial stress index stood at 0.1533, a low reading, and the VIX at 19.59 was moderate and well below levels associated with market crisis. The Baa corporate spread over Treasuries was 2.78, a contained level not signaling credit distress or a widening of borrowing costs. The 10-year/2-year Treasury yield curve spread was strongly positive at 1.76, showing no inversion and thus no recession signal from the term structure. At the front end, the 3-month Treasury bill traded only 6 basis points above the current 1.75 percent funds rate, indicating that markets were not pricing a near-term change in policy; if anything, the small positive premium hinted at eventual tightening rather than easing. Taken together, the financial data pointed to well-anchored expectations and stable credit conditions.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities embedded in the reference-rule framework. The neutral rate (r^*) used in the level-based rules was estimated at 3.641, a relatively high figure that mechanically pushed the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule toward a prescription of 75 basis points — that is, toward tightening from the current 1.75 percent stance. These rules anchor on the level of the funds rate relative to that neutral estimate and on current output and inflation gaps.

The momentum-based reading pointed in the opposite direction. Inflation momentum was slightly negative at -0.035, implying that price pressures were still weakening rather than building, consistent with core PCE running well below target. Unemployment momentum was positive at +0.45, implying that the jobless rate was still rising rather than stabilizing. The First-Difference rule, which responds to the direction of change rather than to level gaps, therefore prescribed -75 basis points. The loss-minimizing recommendation of the framework blended these opposing signals and landed at -50 basis points, weighting the deteriorating momentum in inflation and unemployment against the level-based rules' hawkishness. The reference rules were flagged as reliable. The projection implied by these figures is one of continued disinflation drift and persistent, still-rising labor slack unless activity firms materially — a configuration under which current policy may be modestly tighter than a loss-minimizing setting would suggest, even as calm financial conditions reduce any urgency to act.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, all five participants independently arrived at a hold at the current 1.75 percent rate, though they reached that conclusion from distinct vantage points. The member most attentive to inflation risk observed that core PCE at 0.91 percent was well below the 2.0 percent target and that the Beige Book described price pressures as 'subdued' to 'largely nonexistent,' leaving no inflation threat to preempt with a hike; at the same time, with prices this soft, no cut was warranted



against a stabilizing economy. The participant focused on labor emphasized that unemployment at 5.5 percent remained above the 5.07 percent natural rate and that claims near 399,000 were still elevated, but judged that temp-firm reports of a bottoming labor market and a majority of districts improving had weakened the case for further easing. A further cut, this participant noted, risked overshooting when activity was stabilizing.

The member weighing financial stability found the credit and stress data unambiguous — a low stress index at 0.1533, a moderate VIX at 19.59, a contained Baa spread at 2.78, and a steeply positive yield curve at 1.76 — and cautioned that cutting could signal an alarm the credit data did not support, while hiking would tighten conditions prematurely against a fragile recovery. The data-dependent member read the literal balance of the data as an improving-but-fragile economy with subdued prices and slack-but-bottoming labor, supporting a pause. The participant most attentive to market pricing pointed to the 3-month T-bill sitting only 6 basis points above the current rate as concrete evidence that no near-term move was priced, adding that the slight premium, if anything, leaned toward eventual tightening. In the rebuttal round, no participant was moved from a hold; the convergence, several noted, only reinforced their individual reasoning.

The tenor of the discussion shifted markedly once participants turned to the framework's loss-minimizing recommendation of -50 basis points. Here the below-target inflation reading and its negative momentum (-0.035), together with rising unemployment momentum (+0.45), took on greater weight. The labor-focused member endorsed the cut outright, judging that still-rising joblessness and elevated claims argued for preemptive insurance and that the low financial-stability cost of easing removed any reason to withhold support for employment. The financial-stability member likewise endorsed the -50, reasoning that easing carried essentially no destabilizing cost given tight spreads, low stress, and no bubble signals, so that the framework's protection against undershooting inflation could be taken up at no cost to the mandate this member weighted most heavily.

The remaining three participants agreed with the direction of easing but not its magnitude. The inflation-focused member acknowledged candidly that with core PCE less than half of target and disinflation the live threat, the usual hawkish caution against cutting simply did not bind; the divergence between a hold and the framework's cut, this member observed, measured how much inflation vigilance costs in a low-inflation regime. Still, citing tentative Beige Book improvement and temp-firm hints of a labor bottom, this participant favored a smaller 25-basis-point step. The data-dependent member reached a parallel conclusion, judging that both mandate legs pointed toward easing but that calm markets and nascent recovery made a full 50 basis points an overshoot. The market-focused



member stressed that the flat T-bill spread priced no cut at all and that a full -50 would outrun market signals; this participant accepted the easing direction but preferred a smaller, market-consistent step or waiting for confirmation.

Across both rounds, participants generally agreed that the level-based rules' 75-basis-point prescriptions rested on a high neutral-rate estimate of 3.641 that the soft incoming data and CFNAI of -0.03 did not corroborate, and several found the First-Difference rule's momentum logic the more persuasive guide to current conditions. The genuine disagreement was one of degree rather than direction: whether the clear disinflation and labor-slack risks warranted a full 50-basis-point response now, or whether calm financial conditions and tentative signs of recovery counseled a smaller move or continued patience.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action at this meeting, the Committee voted unanimously to hold the federal funds rate at 1.75 percent, with all five members supporting no change (a tally of five for +0 basis points). On the separate question of the framework's loss-minimizing recommendation of -50 basis points, the Committee did not reach full agreement: two members — the participant focused on labor-market conditions and the participant focused on financial stability — endorsed the recommendation as-is, while the remaining three — the inflation-focused member, the data-dependent member, and the market-focused member — recorded a partial stance, agreeing with the direction of easing but not with the full 50-basis-point magnitude. No member declined the recommendation's direction outright. The recorded optimal-side tally was thus two endorse, three partial, and zero decline.