



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available on or before the cutoff for this meeting, and the Committee was therefore unable to review the total size, composition, or change from the prior release of SOMA holdings. Accordingly, this section reports no figures on portfolio holdings. Members should further note that this discussion covers SOMA holdings only; it does not encompass the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists. The absence of these data was noted for the record.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed indicators pointing to a soft but not deteriorating economy. The unemployment rate stood at 6.0 percent, roughly a full percentage point above the estimated natural rate of 5.05 percent, and initial jobless claims registered 402,000, remaining elevated. Core PCE inflation on a year-over-year basis was 1.44 percent, below the 2.0 percent objective. The Chicago Fed National Activity Index at 0.39 was positive, consistent with growth near trend rather than contraction. The federal funds rate stood at 1.25 percent. The Employment Cost Index reading was 91.2 and M2 was reported at \$5,815.5 billion.

The Beige Book, prepared on information collected before January 7, characterized growth as subdued from mid-November through early January, with little change relative to the prior survey. Most Districts described activity as 'sluggish,' 'soft,' or 'subdued,' with the weakest report from Dallas, where activity 'remained anemic.' New York, Philadelphia, and Cleveland were more favorable, each noting signs of improvement. Consumer spending reports were consistently weak, with holiday sales flat or down in nominal terms, though automobile sales surged at year-end on favorable incentives. Manufacturers expanded production somewhat, with gains in defense-related and biomedical products. Home sales and residential construction remained at high levels but slowed a bit in some areas, while an overhang of commercial real estate persisted. Bank lending continued to expand in most Districts, driven by consumer and real estate borrowing. Labor demand was mostly flat, and increases in compensation and final prices were held down by competitive supply conditions.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as elevated in uncertainty but short of acute stress. The VIX stood at 29.01, signaling meaningful market anxiety without indicating panic, and the composite financial stress index at 0.1479 was moderate. The Baa corporate spread of 3.33 percentage points reflected a still-notable cost of borrowing for lower-rated issuers. The 10-year/2-year Treasury yield curve spread was 2.29 percentage points, a steeply positive slope carrying no inversion signal. The



3-month Treasury bill yielded 10 basis points below the current federal funds rate, a slight negative spread suggesting markets leaned toward a mild easing bias rather than any priced-in tightening. Taken together, the staff noted that credit was continuing to flow, consistent with the Beige Book report of expanding bank lending, even as front-end pricing and volatility measures pointed to residual softness and caution.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available. With the estimated neutral rate (r^*) at 3.082 percent, the current 1.25 percent funds rate stands well below neutral, implying an accommodative stance on a level basis; the Taylor, Balanced Approach, and ELB-adjusted reference rules each pointed to 75 basis points, consistent with that reading of the level gap. Working in the opposite direction, inflation momentum was negative at -0.325 , indicating continued drift of inflation further below target rather than any building pressure, while unemployment momentum was recorded at zero. The First-Difference rule, which responds to the change in conditions rather than the level, pointed to -25 basis points.

Integrating these elements, the deterministic loss-minimizing recommendation was -50 basis points, reflecting the combined weight of a wide unemployment gap and the disinflationary momentum. The projection thus embeds a genuine tension: level-based rules would imply the current rate is below neutral and argue against further ease, whereas the momentum of inflation and the depth of labor-market slack pull the loss calculation toward additional accommodation. The reference rules were assessed as reliable. The likely path of conditions implied by these figures is one of persistent slack and below-target inflation absent a policy response, with no near-term signal of overheating.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants generally judged that conditions were soft but not sharply deteriorating, and four of the five favored holding the funds rate at 1.25 percent, with one favoring a 25 basis point cut. Several members observed that core PCE at 1.44 percent sat below the 2.0 percent objective, so that no case for tightening was present, while the positive Chicago Fed index of 0.39 and the steeply positive yield curve argued that the economy was not collapsing into recession. The member most attentive to inflation risk emphasized that this was disinflation territory rather than an inflation threat, and that although there was no case to hike, caution against premature easing counseled a hold; cutting while there was no deflationary emergency, this member argued, risked fueling inflation once recovery firmed, and the already-low rate left limited room.



The member weighting employment most heavily dissented in favor of easing, pointing to unemployment nearly a full point above the natural rate, elevated jobless claims of 402,000, and the Beige Book's report of 'mostly flat' labor demand and 'consistently weak' consumer spending. With inflation well below target, this member saw room to insure against labor weakness through a modest, well-communicated 25 basis point move, which was characterized as insurance rather than panic; the greater risk to confidence, in this view, was letting labor weakness fester. Other participants engaged this case directly. The member focused on financial stability judged it coherent on employment grounds but not persuasive from a stability lens: with the stress index moderate, credit still expanding, and no self-reinforcing funding strain, cutting absent an acute crisis risked signaling alarm and could itself add volatility, while preserving ammunition was the more prudent posture. The member weighting market signals noted the T-bill spread was only 10 basis points below the funds rate and that markets were not pricing a cut at this meeting, so that acting more dovishly than expected could add rather than reduce volatility. The data-dependent member concluded that the dove's case was legitimate but did not present the collapse that would compel a move, and favored holding to assess.

When the discussion turned to the framework's -50 basis point recommendation, participants worked to reconcile it with their predictive holds. Several noted the striking divergence between the reference rules pointing to 75 basis points and the loss-minimizing output of -50. The member attentive to inflation read the gap as revealing that the loss function heavily weights the employment gap over the inflation shortfall; while accepting the framework's math, this member personally favored holding to guard against reigniting inflation and, if pressed toward easing, strongly resisted the -50 magnitude given that policy already looked accommodative relative to r^* near 3.08. The employment-focused member, by contrast, endorsed the -50 call outright, arguing the level-based rules leaned on an r^* estimate that ignored the fragile real economy and would keep policy far too tight given weak spending and flat hiring.

The remaining members converged on the easing direction while questioning the magnitude. The financial-stability member discounted the level rules as ignoring financial fragility and endorsed preemptive easing against tail risk, but judged that with only moderate stress and no acute credit event a full 50 basis points risked overshooting, preferring proportionality to the stress signals. The data-dependent member found both mandate legs pointing the same way and the direction to ease well-supported, but treated the choice between -25 and -50 as genuinely uncertain from the data alone; given elevated VIX and a reluctance to speculate, a smaller incremental step seemed the most defensible literal reading. The market-signal member likewise held that the negative T-bill spread implied markets were pricing something closer to a modest cut, aligning with the First-Difference rule's -25, and that a full -50 ran ahead of the market-implied path even as the easing direction was correct.



Across the exchange, no member was moved from the fundamentals of their view: the inflation-focused member remained unpersuaded to add stimulus, the employment-focused member if anything grew more convinced, and the other three settled on agreeing with the direction of ease while resisting its full size.

COMMITTEE POLICY ACTIONS

On the predictive question of the policy action at this meeting, the Committee's final vote was to hold the federal funds rate at 1.25 percent, by a tally of four members favoring no change and one member favoring a 25 basis point cut. On the separate question of the deterministic framework's -50 basis point recommendation, the Committee did not reach full agreement: one member (the labor-market dove) endorsed the recommendation as-is, one member (the inflation hawk) declined to support it, and three members (the financial-stability voice, the data-dependent centrist, and the market-signal realist) gave partial support, agreeing with the direction of easing but not with the full magnitude or timing.