



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that System Open Market Account holdings of domestic securities totaled \$670.0 billion as of the March 3 release, essentially unchanged from the prior release on February 25, a change of roughly \$0.1 billion. The portfolio remained concentrated in Treasury securities, with notes and bonds accounting for \$409.8 billion and Treasury bills for \$246.2 billion. The near-flat week-over-week movement was consistent with the maintenance of an accommodative operating stance without any material shift in the size or composition of the portfolio. Members were reminded that this review covers SOMA outright holdings only — total size, composition, and the change from the prior release — and does not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available; discussion was therefore confined to the outright holdings data on hand.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that the expansion continued through the opening months of the year. According to information gathered by the District Banks, activity was described as moderate across a broad set of Districts — Boston, Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, and Kansas City — as firm in Minneapolis and sound in San Francisco, and as showing signs of accelerating in New York, Richmond, and Dallas. Consumer spending rose in most Districts, with gains in general merchandise sales in January and February in all Districts except St. Louis, which reported a slight decline; motor vehicle sales, by contrast, slowed in most Districts. Service-sector activity and manufacturing output both continued to rise, the latter in all Districts except Cleveland, where it held steady. Housing demand remained strong while commercial real estate markets stayed generally soft. The Chicago Fed National Activity Index stood at 0.55, consistent with growth somewhat above trend.

On the price and labor side, the data pointed to still-subdued inflation alongside a labor market that was healing only gradually. Core PCE inflation was running at 0.86 percent on a year-over-year basis, well under half the 2 percent objective. The unemployment rate was 5.6 percent, above the estimated natural rate of 5.04 percent, and initial jobless claims stood at 344,000. The Beige Book characterized employment as growing only slowly in most Districts and wages and salaries as increasing slightly, though employers reported substantial increases in employee health-care costs. Most Reserve Banks reported retail prices as level or modestly higher, but reports from manufacturers and other businesses indicated more noticeable increases in commodity prices, with the largest gains in steel, lumber and other building materials; shipping charges had also risen recently.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff reported that financial conditions remained calm and broadly accommodative. The financial stress index stood at a very low 0.0558, and the VIX at 16.6 pointed to subdued equity-market volatility and stable risk sentiment. The Baa corporate spread of 2.3 percentage points indicated moderate, unstrained credit conditions, with no evidence of widening. The Treasury yield curve was steeply positive, with a 10-year/2-year spread of 2.22 percentage points and no sign of inversion — a configuration not consistent with heightened near-term recession risk. The 3-month T-bill spread against the current funds rate was slightly negative at -0.06, suggesting that market participants anticipated no imminent tightening and, if anything, a whisper of an easing bias. Bank lending was reported to be growing moderately.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the momentum measures for inflation and unemployment. With the estimated neutral real rate (r^*) at roughly 2.18 percent and the nominal funds rate at 1.0 percent against core inflation of 0.86 percent, the real policy rate was near zero — accommodative relative to neutral, but by a smaller margin than the level of the funds rate alone might suggest. Inflation momentum was estimated at -0.24 and unemployment momentum at -0.2, implying that price pressures were still decelerating rather than stabilizing near target, while labor-market slack was closing only slowly. Taken together, these quantities pointed toward a continued undershoot of the inflation objective absent a change in stance.

The reference rules gave a notably split reading. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points of tightening, reflecting an economy expanding at or above trend and a positive output gap. The First-Difference rule, which responds to the direction of change in inflation and slack rather than to the level of inflation relative to target, prescribed -50 basis points. The level-based rules were understood to embed an inflation reading nearer target than the 0.86 percent actually observed, so their tightening signal likely overstated realized price pressure. The framework's loss-minimizing output, with the reference rules judged reliable, was -50 basis points, aligning with the First-Difference logic — an implication that, on pure loss-minimization, the persistent inflation shortfall and residual slack argued for additional accommodation rather than restraint.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants converged unanimously on holding the funds rate at 1.0 percent, though they arrived there from distinct starting frameworks. The member most attentive to inflation risk began from the Beige Book's flags on rising steel, lumber, building-material and shipping costs, together with reports of more noticeable commodity-price increases from manufacturers. That member judged these to be early pipeline warning signs worth watching but not yet a present threat,



noting that core PCE at 0.86 percent showed no pass-through and that retail prices remained only level to modestly higher. With growth broadly moderate-to-accelerating and the funds rate already very accommodative, this participant saw neither a case for hiking into contained inflation nor any justification for cutting.

The participant most focused on employment emphasized that unemployment at 5.6 percent remained above the 5.04 percent natural rate and that the Beige Book described job growth as slow in most Districts — precisely the conditions under which easing to support employment would normally be considered. On reflection, however, this member observed that the labor market was improving slowly rather than deteriorating, that jobless claims at 344,000 were elevated but not sharply rising, and that a positive CFNAI and a steep, non-inverted curve gave no recession signal. A further cut into an expanding economy with rates already at 1.0 percent, the member concluded, risked appearing as an emergency response to a non-emergency. The financial-stability member reinforced this, pointing to the very low stress index, benign VIX and moderate Baa spread as evidence that a surprise move could unsettle otherwise healthy credit conditions, while the market-signal member noted that the -0.06 T-bill spread showed markets already pricing no hike. The data-dependent centrist summarized the literal reading shared across the table: low inflation plus labor slack plus moderate expansion equaled hold.

The optimal-framework discussion opened a genuine and instructive gap between that predictive consensus and the loss-minimizing recommendation of -50 basis points. Several participants worked carefully through why the framework favored easing despite an expanding economy. The negative inflation momentum of -0.24 and the sub-target core reading meant, in the words of the reasoning offered, that policy at 1.0 percent might already be marginally restrictive relative to what conditions justified — the undershoot persisting despite loose policy being the very reason the framework wanted more support. The First-Difference rule, keyed to trajectory rather than level, was widely judged the most persuasive of the reference rules, since the Taylor-family prescriptions of 75 basis points rested on an inflation premise that the 0.86 percent reading contradicted. The financial-stability member added a distinctive argument: entrenched sub-1-percent inflation was itself a stability risk, raising real debt burdens and impairing credit, so easing into calm markets carried little downside.

Even the inflation-focused member accepted the direction of the framework's call, reasoning that fighting phantom inflation while prices were falling risked entrenching a below-target undershoot — though that member continued to weigh the commodity-cost pipeline as the one factor that could reverse the disinflation narrative. In the rebuttal round, the disagreement crystallized around magnitude rather than direction. The labor-market member and the centrist endorsed the full



50-basis-point step as the loss-minimizing choice, the centrist stressing that a full-point inflation shortfall plus slack supported easing at the stated magnitude and that moderate growth did not override that shortfall. Three members, however, resisted the size of the move. The inflation-focused member found 50 basis points aggressive given moderate-to-accelerating growth and no crisis; the financial-stability member preferred a smaller, less destabilizing step into markets that expected only marginal easing; and the market-signal member returned repeatedly to the mildly negative bill spread as whispering modest rather than aggressive easing, warning that a full cut could surprise stable pricing to the downside.

Across both the predictive and optimal discussions, participants generally agreed on the essentials: tightening was unwarranted given the inflation undershoot and residual slack, and financial conditions were benign enough that neither restraint nor emergency easing was demanded. Where they parted company was on the degree of accommodation the disinflation genuinely called for — a divergence that several members described as the space between a prudent hold and the framework's loss-minimizing cut.

COMMITTEE POLICY ACTIONS

In the predictive vote on the near-term policy decision, all five members supported holding the target federal funds rate at 1.0 percent, a unanimous 0-basis-point outcome (5 to 0). 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 labor-market dove and the data-dependent centrist — endorsed the recommendation as stated, while three members — the inflation hawk, the financial-stability voice, and the market-signal realist — offered partial support, agreeing with the easing direction implied by the disinflation and residual slack but judging the 50-basis-point magnitude larger than benign financial conditions and the mildly negative bill spread warranted. No member declined the recommendation outright.