



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$708.8 billion in domestic securities as of March 5, 2008, comprising \$470.0 billion in Treasury notes and bonds and \$200.4 billion in Treasury bills. The account was unchanged from the prior release of February 27, 2008, showing no net change over the intervening week. Participants noted that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists; accordingly, the discussion of open market operations was limited to the outright holdings reported here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that the pace of economic growth had slowed since the start of the year. The Chicago Fed National Activity Index stood at -0.79, consistent with activity running meaningfully below trend. The March Beige Book, based on information collected on or before February 25, indicated that two-thirds of Districts cited softening or weakening in business activity, with the remainder describing subdued, slow, or modest growth. Retail spending was generally downbeat, with the majority of Districts characterizing sales as below plan, though tourism generally continued to expand. Manufacturing was said to be sluggish or slowing in about half the Districts, and services activity appeared to be slowing in several. Residential real estate markets remained weak across the board, while reports on commercial real estate were mixed but on balance also pointed to slowing. Most Districts reporting on banking cited tight or tightening credit standards and stable or weaker loan demand.

On the labor and price fronts, the unemployment rate was 4.8 percent, still below the estimated natural rate of 5.05 percent, while initial jobless claims came in at 348,000. Core PCE inflation was 1.94 percent on a twelve-month basis, just below the 2.0 percent objective, and the Employment Cost Index registered 107.6. The Beige Book noted upward pressure on prices from rising materials and energy costs in nearly all District reports, though Philadelphia observed that input and output price increases had recently become less prevalent and San Francisco reported that pressures were limited for products other than food and energy. Wage and salary pressures were generally described as modest, as hiring slowed in various sectors and labor markets loosened somewhat in many Districts.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as tight and anxious. The financial stress index stood at 0.5643, an elevated reading, and the VIX was 26.36, reflecting continued market volatility. The Baa corporate spread of 3.39 percentage points pointed to meaningful borrowing-cost stress in corporate



credit markets, consistent with the Beige Book's reports of broadly tightening bank credit standards. The 3-month Treasury bill was trading well below the current 3.0 percent funds rate, with a spread of -1.58 percentage points, implying that markets anticipated substantial further easing. In contrast, the 10-year/2-year Treasury spread was steeply positive at +1.86 percentage points, an un-inverted slope consistent with expectations of aggressive front-end cuts working through the economy over time.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the available estimates of underlying conditions. With the neutral real rate (r^*) estimated at 1.744 percent, the current 3.0 percent nominal funds rate — implying a real rate on the order of roughly 1 percent — sits below neutral, indicating that policy is already modestly accommodative rather than restrictive. Inflation momentum was positive at 0.145, suggesting that price pressures, particularly the materials- and energy-driven pressures flagged across Districts, were not yet abating and could become more embedded if left unaddressed. Unemployment momentum of 0.15 pointed to some softening in the labor market ahead, though from a starting point still below the estimated natural rate.

The reference rules gave a divided reading and were flagged as unreliable for this meeting. The Taylor rule and the First-Difference rule each pointed to a modest -25 basis point adjustment, while the Balanced Approach rule and the ELB-adjusted rule called for -75 basis points. Given the unreliability flag and the spread across rules, the loss-minimizing framework arrived at a recommendation of 0 basis points — more conservative than any single rule. Taken together, these quantities imply a projected path in which the accommodation already in place continues to transmit through the economy with a lag, while live inflation pressure and only modestly soft activity argue against front-loading additional easing before existing cuts have worked through.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, participants confronted an economy sending mixed but broadly worrying signals: contained inflation near the 2.0 percent objective alongside meaningful financial stress and clearly below-trend growth. Four of the five members opened at a 75 basis point cut. The member most focused on labor markets emphasized that jobless claims and the Beige Book's reports of slowed hiring and looser labor markets warranted preemptive easing before unemployment turned up in earnest, arguing that with core PCE essentially at target and wage pressures modest, there was ample room to act. The member attentive to financial stability pointed to the elevated stress index, the Baa spread of 3.39, and broadly tightening bank credit standards as evidence of a constricting credit channel that decisive easing could relieve. The member weighting market signals most heavily read the -1.58 Treasury bill spread as a strong market vote for a large cut, well beyond 25 basis points, and the



data-dependent member converged on the same conclusion from a literal reading of the softening growth data.

The inflation-focused member alone opened more cautiously, initially favoring a minimal cut. This member acknowledged the genuine financial and growth stress the others documented but weighted heavily the Beige Book's warning of upward price pressure from materials and energy in nearly all Districts, viewing a 75 basis point move as risking entrenchment of inflation expectations. In the predictive rebuttal, this member revised from 25 basis points to a mid-sized cut as a compromise — acknowledging the acuteness of credit tightening while declining to go all the way to 75, on the view that chasing market-implied pricing risked making the easing bias self-reinforcing. The other four held firmly at 75 basis points, and the predictive vote closed at that magnitude, with the single more cautious preference the lone divergence.

The character of the deliberation shifted materially when participants turned to the optimal-policy framework, whose loss-minimizing output was a hold at the current 3.0 percent rate. Several members observed that this recommendation diverged sharply from their own predictive votes — a gap they read as separating what the Committee would likely do under market pressure from what fundamentals alone justified. With r^* estimated at 1.744 percent, participants generally recognized that the 3.0 percent rate is already below neutral in real terms, meaning that policy is accommodative rather than restrictive. The positive inflation momentum of 0.145, combined with the broad materials- and energy-price pressure in the Beige Book, gave several members pause about pushing real rates further into negative territory. The unreliability of the reference rules led participants to discount the two rules calling for -75 basis points, and to give more weight to the Taylor and First-Difference rules, both of which pointed only to a modest -25.

A recurring theme was that the cumulative easing already delivered was still transmitting through the system with a lag, so that a hold would let prior cuts work while preserving room to act should stress escalate. The member focused on financial stability found the steeply positive, un-inverted 10-year/2-year curve genuinely persuasive on this point, reading it as a signal that prior easing was already working and that near-term systemic-dysfunction risk had eased; this member also stressed that cutting too aggressively could itself signal panic and destabilize fragile markets. The member weighting market signals noted the tension within the market data itself — front-end pricing screaming for cuts while the curve slope counseled patience — and concluded that market-implied easing overstated the fundamental case. The inflation-focused member found the hold fully consistent with price-stability vigilance, and the data-dependent member judged that with both mandate variables near balance, a conservative hold best reflected the uncertainty of unreliable rules.



The member most concerned with labor risk was the least persuaded to stand entirely pat. This member accepted that labor data had not yet broken down — unemployment remained below the natural rate, claims were elevated but not spiking, and wages were soft — and agreed the -75 predictive vote had run ahead of the actual labor evidence. But this member continued to worry that waiting for the labor market to crack would be too late, and that the building demand and credit stress warranted some insurance. This member indicated a preference for a measured -25 basis points, matching the Taylor and First-Difference rules, as a hedge against labor risk that stopped short of overshooting on inflation — agreeing with the direction of restraint from -75 but not with a complete hold.

COMMITTEE POLICY ACTIONS

On the predictive question of the likely policy action, the Committee's final vote was for a 75 basis point cut, with four members favoring -75 basis points and one member favoring a smaller cut. On the optimal-policy framework's recommendation of a hold at 0 basis points, the Committee recorded four endorsements and one partial concurrence, with no member declining: the inflation-focused member, the financial-stability member, the data-dependent member, and the market-signal member all endorsed the recommendation as-is, while the labor-focused member partially concurred — agreeing with the direction of restraint relative to an aggressive cut but preferring a modest -25 basis point move rather than a full hold.