



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$500.9 billion as of January 21, a modest increase of \$1.1 billion from the prior release on January 14. The composition remained dominated by Treasury notes and bonds, which accounted for \$412.9 billion of the total, alongside \$18.4 billion in Treasury bills and \$6.0 billion in agency mortgage-backed securities. The staff noted that this accounting reflects SOMA holdings only — total size, composition, and week-over-week change — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available; members should therefore read these figures as a partial picture of open market activity rather than a comprehensive one.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity had continued to weaken across almost all Federal Reserve Districts since the previous reporting period, with most Districts noting reduced or low activity across a wide range of industries and only scattered exceptions. Core PCE inflation registered 1.44 percent on a twelve-month basis, below the 2.0 percent objective. The unemployment rate stood at 7.2 percent, well above the estimated natural rate of roughly 5.05 percent, and initial jobless claims came in at 591,000, consistent with continued job losses. The Chicago Fed National Activity Index at -3.04 pointed to activity running deeply below trend.

The Beige Book material reinforced the broad-based nature of the contraction. Retail sales during the holiday season were generally negative in most Districts, with a majority reporting deep discounting; contacts in the Boston and New York Districts noted some pickup after the holidays. Vehicle sales were weak or down where reported, manufacturing decreased in most Districts, and services activity generally declined, with exceptions in some sectors of the Boston, Richmond, and Chicago Districts. Residential and commercial real estate continued to worsen in most Districts, and lending conditions were described as tight or tightening in most Districts, with credit quality a concern in several. On prices, most reporting Districts noted declining input costs — the Richmond District being the exception in citing higher raw-materials prices — while wage pressures remained largely contained, with some Districts reporting pay freezes or compensation reductions.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions remained under acute strain. The financial stress index stood at 0.9864, near the top of its range, and the VIX at 46.42 reflected severe market fear. The Baa corporate spread of 5.58 percentage points indicated elevated borrowing costs and heavy credit-market stress despite a policy rate already near zero. The 3-month Treasury bill spread against the current target rate was essentially



flat at -0.015, consistent with the short end being pinned at the effective lower bound. The 10-year/2-year yield curve spread of 1.78 percentage points was comparatively steep, a configuration the staff characterized as reflecting a long end more forward-looking than the mechanically constrained front end.

STAFF ECONOMIC OUTLOOK

With the current target range at 0.0 to 0.25 percent and the estimated neutral rate (r^*) around 1.75 percent, the staff projection recognized that the nominal policy rate sits well below neutral in level terms, yet with inflation momentum negative at -0.11 and unemployment momentum positive at 0.3, the accommodation embedded in the current stance is materially offset by disinflationary drift and continued labor-market deterioration. The negative inflation momentum implies that price pressures are likely to soften further before stabilizing, while the rising unemployment momentum suggests labor conditions have not yet reached a trough. Taken together, these forward-looking quantities point to a period in which real economic slack widens rather than narrows.

The reference-rule outputs framed the path in similar terms. The Taylor rule prescribed 75 basis points, but the framework flagged the reference rules as unreliable at this juncture, reflecting that a positive prescribed rate is not literally reachable from a floor already at the effective lower bound. The Balanced Approach, First-Difference, and ELB-adjusted rules each returned 0 basis points, the ELB-adjusted rule being the one that explicitly incorporates the binding lower bound. The projection thus implied that the conventional rate lever offers little to no additional room, and that the anticipated evolution of conditions — soft inflation and a still-weakening labor market — would leave policy pressed against the floor with support increasingly reliant on channels other than the target range.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their opening assessments, all five participants independently arrived at holding the target range at 0.0 to 0.25 percent, and the discussion that followed was less about the direction of policy than about why the conventional rate tool was exhausted and what that implied. The member most attentive to inflation risk observed that core PCE at 1.44 percent sits below the 2.0 percent objective and is falling, with the Beige Book's declining input prices, contained wages, pay freezes, and deep holiday discounting all pointing to disinflation rather than building price pressure. On that reading there was simply no upside inflation threat to lean against, and a hike was seen as unjustifiable amid unemployment at 7.2 percent and activity at -3.04 on the Chicago Fed index.

The member most focused on the labor market described the data as unambiguous — unemployment far above the 5.05 percent natural rate, claims at 591,000 signaling continued layoffs, and broad



weakening confirmed by the Beige Book. This participant emphasized that every instinct pointed toward aggressive easing, but that the binding constraint was mechanical rather than judgmental: with the range already at the floor, the target could not be lowered without pushing into negative territory. The financial-stability participant made the complementary point that a 25-basis-point cut from the current range would risk destabilizing money markets — precisely the sort of harm most to be avoided given a stress index at 0.9864, a VIX of 46.42, and a Baa spread of 5.58. From that lens, cutting would be counterproductive, and the appropriate response to acute credit strain lay in sustained liquidity and credit facilities rather than a further target reduction.

The member weighting market pricing most heavily reinforced this conclusion from the signals themselves. The 3-month Treasury bill spread of -0.015 against the current range indicated the front end was already pinned essentially at zero, so markets were neither expecting nor pricing a further conventional cut. The steep 10-year/2-year spread of 1.78 was read not as room for front-end easing but as consistent with expectations of eventual recovery, the short end being mechanically constrained. The data-dependent member, disclaiming any lean, took the most literal consensus reading: with the range at the floor and unanimous agreement, holding was the warranted outcome. Across the rebuttal round, no participant proposed a feasible easing alternative, and each found the others' arguments reinforcing rather than contradicting.

Turning to the framework's loss-minimizing recommendation of 0 basis points, participants engaged directly with the divergence among the reference rules. Several noted that the Taylor rule's 75-basis-point prescription ignored the effective lower bound and was, in any case, flagged unreliable at this juncture; the ELB-adjusted rule, which respects the binding floor, was singled out as most persuasive, with the Balanced Approach and First-Difference rules converging on the same 0-basis-point result. Participants observed that the estimated r^* of roughly 1.75 percent alongside negative inflation momentum suggested policy was not truly loose in real terms despite the low nominal rate — but that this made no operational difference, since a cut below zero was not available. The labor-focused participant stressed that holding must not be read as any implied tightening, and that support for employment would have to come through liquidity tools; the financial-stability participant framed the balance-sheet and credit facilities as where policy was actually doing the heavy lifting, citing the prior Term Auction Facility operation as an example of liquidity provision addressing the 0.9864 stress reading directly.

By the close of the discussion, the convergence was understood by participants to reflect a genuinely binding constraint rather than a discretionary choice. The inflation lens found no price pressure to counter, the employment and centrist lenses found overwhelming weakness but no room below zero,



the financial-stability lens found a cut potentially destabilizing, and the market-pricing lens found the floor already fully aggregated into short-term rates. All five agreed that holding at the current range was the coherent call and that the real margin of policy adjustment now lay off the rate dimension.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous 5-0 outcome with no member favoring a cut or a hike. On the framework's loss-minimizing recommendation of 0 basis points, the Committee likewise reached full agreement: all five members — the inflation hawk, the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist — endorsed the recommendation as-is, with none declining and none registering a partial (direction-but-not-magnitude) reservation. The two votes were thus fully aligned, reflecting the shared judgment that conventional rate room was exhausted at the effective lower bound and that holding the current range was the appropriate action.