



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$584.1 billion in domestic securities as of March 11, 2009, an increase of \$6.2 billion from the prior release of March 4. The portfolio remained overwhelmingly concentrated in Treasury securities: notes and bonds accounted for \$412.9 billion and bills for \$18.4 billion, with agency mortgage-backed securities making up the remaining \$69.0 billion. The staff noted that these figures describe SOMA securities holdings only — their total size, composition, and week-over-week change — and do not capture the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists. Accordingly, this review is limited to the outright holdings themselves and draws no inference about temporary operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed data pointing to a severe and broad-based contraction. The unemployment rate stood at 8.1 percent, more than three percentage points above the estimated natural rate of 5.05 percent, and initial claims for unemployment insurance remained elevated at 660,000. The Chicago Fed National Activity Index registered -2.35, consistent with activity running well below trend. On the price side, core PCE inflation was 1.27 percent on a year-over-year basis, below the 2.0 percent objective. The Employment Cost Index reading was 109.9, and M2 stood at \$8,244 billion.

The most recent Beige Book, prepared by the Federal Reserve Bank of San Francisco on information collected on or before February 23, reinforced this picture. Ten of the twelve Districts reported weaker conditions or outright declines, with only Philadelphia and Chicago describing their economies as having 'remained weak' rather than deteriorating further. The weakening was described as broad based, with basic food production and pharmaceuticals among the few exceptions. Consumer spending was sluggish on net, though several Districts noted modest improvement in January and February after a dismal holiday season. Manufacturing showed pronounced declines overall, residential real estate remained largely stagnant with only scattered signs of stabilization, and demand for commercial real estate weakened significantly. Banks reported further drops in business loan demand, some deterioration in credit quality, and continued tight credit availability. Upward price pressures continued to ease across a broad range of final goods and services, largely reflecting lower energy and raw-materials prices. Contacts across Districts rated the prospects for near-term improvement as poor, with a meaningful pickup not anticipated before late 2009 or early 2010.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions remained acutely strained. The financial stress index stood at 0.9432, near the top of its range, indicating severe systemic pressure. The VIX was elevated at 43.61, reflecting extreme



market volatility and fear, and the Baa corporate spread of 5.45 percentage points pointed to heavy credit stress and punishing borrowing costs for firms despite a policy rate at the floor. The 3-month T-bill spread relative to the current rate was small and positive at 0.105, consistent with short rates pinned near the effective lower bound and little market expectation of further conventional easing. The 10-year to 2-year Treasury spread was steeply positive at 1.92; the staff noted that this steepness partly reflects the floor on short rates rather than a firm signal of imminent recovery.

STAFF ECONOMIC OUTLOOK

The staff projection took as its starting point the fact that the federal funds target range was already 0.0 to 0.25 percent, at the effective lower bound. With an estimated neutral rate (r^*) of 1.676 percent against core PCE inflation of 1.27 percent, the framework implied a desired nominal policy setting below zero — that is, one the conventional rate instrument cannot deliver. This gap suggests that, judged by the usual benchmarks, the current stance is accommodative but still less supportive than conditions would otherwise call for.

The momentum readings underscored a still-deteriorating near-term path. Inflation momentum was negative at -0.305, indicating decelerating price pressures rather than any building inflation, consistent with the flagged risk of undershooting the objective. Unemployment momentum was positive at 0.55, implying joblessness was still rising rather than stabilizing. All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — returned 0 basis points, though the reference rules were judged unreliable for this meeting, and the loss-minimizing recommendation was likewise 0 basis points. Taken together, the projection pointed to continued weakness in activity and labor markets into late 2009, with price pressures subdued and the rate lever mechanically constrained by the lower bound.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants approached the decision from distinct vantage points but converged early on the reality that the conventional rate instrument was exhausted. The member most attentive to inflation risk noted that core PCE at 1.27 percent sat well below the 2.0 percent objective and that the Beige Book confirmed upward price pressures easing broadly across final goods and services. This member emphasized that the usual hawkish restraint against cutting into above-target inflation simply did not apply, since inflation was below target and, with deflation risk flagged at the prior meeting, an undershoot was itself an inflation-mandate failure. With no evidence of upside price risk, there was no case to tighten, and with the rate at the floor, no room to ease conventionally.



The member focused on the labor market stressed the enormous employment gap — unemployment at 8.1 percent against a 5.05 percent natural rate — together with initial claims of 660,000 and positive unemployment momentum of 0.55, all of which pointed to a labor market still deteriorating rather than stabilizing. This member argued for maximum accommodation but acknowledged the binding constraint: the target range was already at 0.0 to 0.25 percent, and pushing it into negative territory risked destabilizing money markets. The member emphasized that the gap between what unconstrained rules would want and what the floor permits showed policy was, for labor conditions, effectively still too tight, and that any additional support would therefore have to come through channels other than the policy rate.

The member most concerned with financial stability described conditions as acutely fragile — a stress index near its maximum at 0.9432, a VIX of 43.61, and a Baa spread of 5.45 — and cautioned that a surprise move in either direction would amplify volatility in already fragile markets. Cutting was impossible at the floor and hiking amid this credit distress was untenable, so holding steady was the stabilizing choice. The data-dependent member read every indicator at face value and reached the same conclusion, noting the unanimous 0-basis-point output across the reference rules while cautioning that these rules had been judged unreliable this meeting; the member leaned instead on the ELB reality and the loss function. The member weighting market signals observed that the small positive T-bill spread of 0.105 showed markets had already priced the floor, and that the steep 10-year to 2-year spread of 1.92 signaled expectations of eventual recovery rather than imminent tightening.

In the optimal-framework rounds, participants generally judged the ELB-adjusted rule's logic the most persuasive of the four, precisely because it acknowledged the zero-bound constraint the others did not. Several observed that the estimated r^* of 1.676 against inflation of 1.27 percent implied a desired nominal rate below zero, so that the framework's 0-basis-point recommendation was mechanically constrained rather than a signal of a fully appropriate stance. A recurring theme was that agreement on holding did not reflect complacency: the constraint was the floor, not the Committee's will, and members repeatedly returned to the point that further accommodation would have to be delivered outside the rate tool. No participant was moved from an initial position by the rebuttals; if anything, each round reinforced the shared reading. A couple of participants noted that the only genuinely open question concerned whether additional balance-sheet or credit action was warranted — a matter the target range itself cannot address.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported no change to the federal funds target range, leaving it at 0.0 to 0.25 percent, a unanimous 5-to-0 outcome. On the deterministic optimal policy engine's



recommendation of 0 basis points, the Committee was likewise in full agreement: all five members — the inflation-focused member, the labor-market member, the financial-stability member, the data-dependent member, and the market-signal member — endorsed the recommendation as-is, with none declining and none registering only partial agreement. The predictive and optimal-side outcomes thus fully coincided in maintaining the target range at 0.0 to 0.25 percent.