



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$2,594.1 billion in domestic securities as of February 29, 2012, the most recent release available as of the point-in-time-safe cutoff. Composition consisted of \$1,565.2 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$840.8 billion in agency mortgage-backed securities. Total holdings declined by \$7.2 billion from the prior release of February 22, 2012. The manager 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 securities portfolio itself.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 1.6 percent on a year-over-year basis, below the Committee's 2.0 percent objective. The unemployment rate was 8.3 percent, well above the estimated 5.5 percent natural rate, indicating that substantial slack remained in the labor market. Initial jobless claims came in at 351,000, an improvement from earlier readings but still consistent with a labor market that was healing only gradually. The Chicago Fed National Activity Index registered 0.22, a modestly positive reading suggestive of growth somewhat above trend. The Employment Cost Index was reported at 116.3, and broad money as measured by M2 stood at \$9,765.4 billion.

The Beige Book indicated that economic activity rose at a somewhat faster pace in the Philadelphia and Atlanta Districts, while the New York District noted a somewhat slower pace of expansion, and several other Districts reported that activity expanded or improved in most sectors. Manufacturing continued to expand across all twelve Districts, with many reporting gains in new orders, shipments, or production and several noting increased capital spending, especially in auto-related industries. Consumer spending reports were generally positive apart from seasonal items, and residential real estate conditions improved somewhat in most Districts, with several reports of increased home sales and some of increased construction. Banking conditions generally improved. Hiring increased slightly across several Districts, and contacts in a variety of industries reported difficulty finding skilled workers. Wage pressures were characterized as generally contained and prices of final goods as stable, though contacts in some Districts anticipated passing rising input prices through to consumer prices.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as broadly calm. The financial stress index stood at 0.162, a low reading indicating no acute systemic distress, and the VIX at 20.87 reflected moderate rather than elevated volatility. The Baa corporate spread over Treasuries was 3.1 percentage points, showing a



contained but not fully normalized credit-risk premium. The 10-year/2-year Treasury yield curve spread was positively sloped at 1.66 percentage points, giving no signal of an imminent recession, while the 3-month Treasury bill spread relative to the current policy rate was -0.055 percentage point, consistent with short rates pinned near the effective lower bound and with markets pricing no near-term change in policy. The staff noted that the global financial strains flagged at the prior meeting appeared to be easing in light of these readings and the improvement in banking conditions reported across Districts.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral real rate and the momentum in the key macroeconomic variables. The estimated r^* was 0.111 percent, a very low figure implying that a neutral policy setting lay only marginally above the current target range; there was therefore little scope to move the policy rate higher without departing from a neutral stance, and no conventional room to move it lower given proximity to the effective lower bound. Inflation momentum was slightly negative at -0.06, consistent with price pressures that were subdued and not accelerating, while unemployment momentum was -0.3, pointing to a gradual narrowing of the still-wide employment gap.

Taken together, these figures projected a path in which conditions improved only slowly from a starting point of below-target inflation and a large unemployment shortfall. The reference-rule outputs reinforced this reading: the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule each prescribed no change, and the rules were judged reliable for this meeting. With the neutral rate near zero and both inflation and unemployment momentum modest, the staff projection implied continuity in the policy stance rather than any near-term impetus toward tightening or, given the lower bound, meaningful further conventional easing.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all participants favored maintaining the current target range of 0.0 to 0.25 percent. The member most attentive to inflation risk observed that core PCE at 1.6 percent left no current case for tightening, with wage pressures contained and no sign in the Employment Cost Index or jobless claims of an emerging wage-cost spiral. This member flagged the Beige Book note that contacts in some Districts anticipated passing rising input prices through to consumers as a latent upside risk worth monitoring, but stressed that it was an anticipation rather than a realized trend. At the same time, the large gap between the 8.3 percent unemployment rate and the 5.5 percent natural rate, together with subdued inflation and low financial stress, offered no basis to break from the existing stance in either direction.



The member most focused on employment emphasized that the shortfall of unemployment relative to its natural rate reflected massive labor-market slack and argued for maximum accommodation. The decisive practical constraint, in this member's view, was the effective lower bound: with the target range already at 0.0 to 0.25 percent, conventional cuts were exhausted and no unconventional tool was on the table in the material before the Committee. This member noted that the direction of travel mattered — initial claims at 351,000 had improved, hiring had increased slightly across several Districts, and the Chicago Fed National Activity Index at 0.22 was positive — describing a labor market that was weak but gradually improving rather than deteriorating. On that reading, the trigger for more aggressive easing was absent, and holding at the current range alongside the maturity extension program represented the most accommodative feasible stance.

The participant attentive to financial stability drew attention to the low stress index of 0.162, the moderate VIX, and the contained Baa spread of 3.1 percentage points, none of which signaled credit-market seizure. The positively sloped yield curve gave no recession signal, and the Beige Book's report of improving banking conditions and firming real estate suggested that accommodation was transmitting constructively into credit markets. This member cautioned that a disorderly change in policy could risk re-widening spreads and undoing the banking recovery, and judged that the global strains cited at the prior meeting, while easing, still warranted caution against removing support. The data-dependent centrist and the market-signal member reached the same conclusion by their own routes: the centrist read the indicators literally as neither weak enough to justify easing nor strong enough to justify tightening, while the market-signal member pointed to the negative 3-month T-bill spread and the flat near-term path implied by market pricing as confirmation that no change was expected or warranted.

When the discussion turned to the framework's loss-minimizing recommendation, participants found their predictive judgments reinforced. The estimated r^* of 0.111 percent, negative inflation momentum of -0.06, and unemployment momentum of -0.3 were read as confirming a stance that was appropriately neutral-to-accommodative given below-target inflation and a still-wide employment gap. Several participants singled out the rule they found most persuasive: the inflation-focused member and the centrist pointed to the Taylor rule's anchoring on the inflation deviation, the employment-focused member and the market-signal member to the ELB-adjusted rule's confirmation that no further conventional cut was available, and the stability voice likewise emphasized the lower-bound logic. The convergence of all four reference rules at zero, judged reliable this meeting, was taken as strong support for holding.



In the concluding exchange, no participant was moved to revise. The inflation-focused member reiterated that below-target inflation removed the case for a hike while the lower bound removed the case for a cut, and restated a caution against any further dovish drift given the latent input-price pass-through risk — a risk other participants acknowledged as worth watching but not yet present in the hard data or priced into short rates. The employment-focused member reaffirmed that gradual healing, not backsliding, characterized the labor market, so the appropriate course was to sustain rather than reverse accommodation. Participants generally judged that markets, the reference rules, and the macroeconomic data all pointed to a flat near-term path, and that holding the current range preserved the conditions allowing spreads to narrow and the recovery to build.

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. On the deterministic optimal policy engine's recommendation of no change, the Committee's recorded stance was likewise unanimous: all five members — the inflation-focused member, the employment-focused member, the financial-stability member, the data-dependent centrist, and the market-signal member — endorsed the recommendation as-is, with no members declining and none registering partial agreement. The predictive judgment and the optimal-framework outcome were thus in full agreement.