



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$2,744.2 billion as of the January 23 release, the most recent available on or before the point-in-time cutoff. The portfolio comprised \$1,609.8 billion in Treasury notes and bonds and \$983.2 billion in agency mortgage-backed securities, with the balance in other domestic holdings. Total holdings rose by \$43.3 billion from the prior release of January 16, reflecting the ongoing pace of purchases. It should be noted that these figures cover SOMA securities holdings only — total size, composition, and the 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; the staff review here is therefore confined to the holdings data itself.

STAFF REVIEW OF THE ECONOMIC SITUATION

Incoming data described an economy expanding at a modest pace with inflation running well below the Committee's longer-run objective. Core PCE inflation was 1.06 percent on a twelve-month basis, nearly a full percentage point under the 2 percent target. The unemployment rate stood at 7.8 percent, well above the staff's estimate of the natural rate of 5.44 percent, indicating substantial remaining slack in the labor market. Initial jobless claims registered 335,000, a level the staff characterized as moderate — neither deteriorating sharply nor signaling a strong acceleration in hiring. The Chicago Fed National Activity Index at 0.02 pointed to growth close to its historical trend, and the Employment Cost Index reading of 118.4, together with subdued hiring, gave little indication of building wage pressure. M2 stood at \$10,402.3 billion.

The Beige Book material for the First District reinforced this picture of modest but continued growth. Most retailers and the tourism industry reported year-over-year increases in demand, with the tourism sector setting records for hotel occupancy and revenue on the strength of corporate and international travel. Manufacturing was described as expanding at a modest pace, with seven of eleven responding firms reporting higher fourth-quarter sales than a year earlier, though in some cases the gains were quite modest. Residential real estate continued to recover, with both sales and prices in November above year-earlier levels, while commercial real estate contacts were 'somewhat downbeat,' citing slow office leasing and weaker pipelines for commercial construction. On pricing, most respondents reported holding selling prices level, attributing the stability to an absence of increases at the wholesale level. Hiring was reported to depend on demand growth, with most firms 'doing little to no hiring' even as some expanded headcounts substantially. Contacts generally expected continued modest growth in 2013 notwithstanding ongoing concerns about uncertainty.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were benign and accommodative across the indicators reviewed. The financial stress index stood at 0.045, near the low end of its range, signaling calm rather than tightening conditions. The VIX at 12.46 was exceptionally subdued, consistent with an absence of market fear and, in the staff's characterization, arguably suggestive of complacency. The Baa corporate spread over Treasuries was 2.83 percentage points — moderate and showing no sign of credit deterioration. The 10-year/2-year Treasury yield curve spread was positively sloped at 1.6 percentage points, carrying no recession signal from an inversion. The 3-month T-bill spread relative to the current policy rate was near zero at negative 0.045 percentage point, indicating smoothly functioning short-term funding markets and little expectation of a near-term change in the policy rate.

STAFF ECONOMIC OUTLOOK

The staff outlook pointed to continued modest expansion with inflation likely to remain below target for some time. The estimated neutral real rate (r^*) of negative 0.5 percent implied that the current target range of 0.0 to 0.25 percent, taken with inflation near 1 percent, was itself accommodative relative to a neutral setting that lies below zero. On this reading, unconstrained policy prescriptions would call for a rate beneath the effective lower bound; because the funds rate cannot fall below zero, the ELB-adjusted rule returned 0 basis points, and additional accommodation would necessarily operate through channels other than the funds rate.

Momentum measures suggested that the mandate gaps were closing, but only slowly. Inflation momentum was negative at negative 0.08, consistent with disinflationary rather than overheating dynamics, while unemployment momentum at negative 0.2 pointed to gradual improvement in the labor market from an elevated level. All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — returned 0 basis points, and the reference rules were flagged as reliable for this meeting. Taken together, the projection implied that conditions were unlikely to warrant a change in the funds-rate stance in the near term: neither the disinflationary trajectory nor the slow pace of labor-market healing pointed toward liftoff, and no rule prescribed tightening.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their independent opening assessments, all participants judged that the appropriate action was to leave the target range unchanged at 0.0 to 0.25 percent, though they arrived at that conclusion from distinct vantage points. The participant most focused on inflation risk emphasized that, with core PCE at 1.06 percent, there was no upside price pressure to lean against — firms were holding selling prices level, wholesale prices were flat, and neither the Employment Cost Index nor the tepid pace of hiring pointed to wage-push inflation. This participant noted that the discipline of guarding against overshoot



argues against easing, but that the rate was already pinned at the effective floor, so the constraint and the inflation view were not in tension; a hike, meanwhile, was seen as unjustifiable given inflation running near 1 percent and only modest growth.

The participant most attentive to the labor market underscored the width of the gap between the 7.8 percent unemployment rate and the 5.44 percent natural rate, describing labor conditions as far from healthy and in need of continued support. This participant observed that the Beige Book's account of 'little to no hiring' at most firms signaled fragility, though jobless claims at 335,000 and a National Activity Index near zero did not indicate acute deterioration that would demand extraordinary action. With no conventional room to cut, this participant judged that the easing preference was already expressed through the maintained asset purchases and that holding the range was the only feasible action consistent with an employment-first view.

The participant weighing financial stability scanned the stress indicators first and found them unambiguously benign — a stress index at 0.045, a VIX of 12.46, a moderate Baa spread of 2.83, a positively sloped curve, and no funding stress in short-term markets. This participant cautioned that a VIX this low might hint at complacency, but that complacency absent any spread widening was no reason to tighten and disrupt orderly conditions. The data-dependent centrist and the market-signal participant both stressed that markets were pricing no change — the near-zero T-bill spread being the clearest evidence — and that abruptly shifting course so soon after the prior meeting's launch of large-scale purchases would risk surprising markets for no offsetting benefit. Consistency with the recently established framework was seen as itself valuable.

In the rebuttal round, no participant was moved off the hold. Each noted that the others' arguments reinforced rather than challenged their own reasoning, and all returned repeatedly to two facts: inflation gave no reason to tighten, and the effective lower bound left no room to cut. When the discussion turned to the optimal-policy framework, participants engaged directly with its inputs. Several found the ELB-adjusted rule the most persuasive of the reference rules, precisely because the estimated neutral real rate of negative 0.5 percent implied that unconstrained policy would want a setting below zero; with the funds rate unable to go negative, they reasoned, holding at 0.0 to 0.25 percent was itself accommodative and the burden of any further easing fell on the ongoing purchases. Participants also read the momentum figures — inflation at negative 0.08, unemployment at negative 0.2 — as evidence of slow improvement rather than of overheating or of a downturn requiring preemptive action, a reading they saw as consistent with the positively sloped curve and the absence of any inversion.



By the close of the optimal-framework discussion, participants generally judged that the convergence of their own analysis, the market-implied path, and the unanimous 0-basis-point output of the reference rules revealed a stance that was appropriately calibrated: accommodative given the slack and below-target inflation, yet constrained at the floor. A couple of participants added that the soft real-side picture in the Beige Book — weaker commercial construction pipelines, level prices, ongoing fiscal uncertainty — made premature tightening especially inadvisable, since it could destabilize benign credit conditions with no inflation benefit to show for it.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported leaving the target range for the federal funds rate unchanged at 0.0 to 0.25 percent, a unanimous outcome of 0 basis points ($\{0: 5\}$). On the optimal-policy engine's recommendation of 0 basis points, the Committee was likewise in 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 partial support. The predictive and optimal-side outcomes were thus fully aligned.