



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that total System Open Market Account domestic securities holdings stood at \$3,812.4 billion as of January 22, 2014, the most recent release available. Of this total, Treasury notes and bonds accounted for \$2,125.4 billion and agency mortgage-backed securities for \$1,539.5 billion. Holdings rose by \$24.8 billion from the prior release of January 15, reflecting continued portfolio growth over the intervening week. It was noted that these figures cover SOMA securities holdings only — total size, composition, and the week-over-week change — and do not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists; the staff therefore confined its report on open market operations to the holdings data described above.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data as generally consistent with continued moderate expansion. The unemployment rate stood at 6.7 percent, still above the estimated natural rate of 5.5 percent, pointing to remaining slack in the labor market. Initial jobless claims of 326,000 were characterized as moderate and not indicative of any acute deterioration. The Chicago Fed National Activity Index registered 0.6, consistent with growth running somewhat above trend. On the price side, core PCE inflation was running at 0.86 percent on a year-over-year basis, well below the 2 percent objective, and the Employment Cost Index reading of 119.5 was noted as part of the compensation and cost picture. The M2 money supply measured \$10,986.3 billion.

The Beige Book material for the Eighth District described economic activity as having grown at a moderate pace since the prior report. Reports of planned manufacturing and services activity were largely positive, with several manufacturing firms — spanning automobile, primary metal, oilfield equipment, medical device, and railroad tie production, among others — reporting plans to add workers, expand operations, or open new facilities, though one aluminum products firm reported plans to close a plant and lay off workers. Service-sector hiring and expansion plans were reported across health care, information technology, telecommunications, and related industries. Retail reports were mixed: contacts in the Louisville area noted 2013 sales 'mostly flat to slightly higher' than 2012, while St. Louis contacts noted that Black Friday sales came in below expectations. Residential real estate conditions continued to improve, with November year-to-date home sales up 16 percent in Louisville, 17 percent in Little Rock, 8 percent in Memphis, and 5 percent in St. Louis relative to the same period in 2012; commercial and industrial real estate conditions also improved. Total lending at a sample of small and midsized District banks was largely unchanged from mid-September to mid-December.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as notably calm. The financial stress index registered 0.018, an extremely low reading consistent with the absence of funding-market strain, and the VIX stood at 12.84, indicating very subdued expected volatility. The Baa corporate spread over Treasuries of 2.3 was described as modest, pointing to benign credit conditions and easy corporate borrowing. The 10-year/2-year Treasury spread of 2.43 was comfortably positive, showing no inversion and no near-term recession signal from the curve. The 3-month T-bill spread relative to the current policy rate was slightly negative at -0.085, consistent with market pricing that anticipated no near-term change in the policy rate. Taken together, the staff judged that these indicators pointed to loose and stable financial conditions.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available. The estimated neutral real rate (r^*) of -0.5 percent implied that the neutral policy setting was deeply negative — well below the level that the standard reference rules would mechanically prescribe. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to roughly 75 basis points, reflecting their response to the sizable unemployment gap. The First-Difference rule, which responds to momentum rather than to static gaps, returned 0 basis points. The reference rules were assessed as reliable, but the loss-minimizing calculation discounted the 75-basis-point prescriptions given the negative neutral rate and the current proximity to the effective lower bound.

Momentum measures reinforced a cautious projection. Inflation momentum was negative at -0.045, indicating that price pressures were still drifting lower and away from the 2 percent objective rather than firming toward it. Unemployment momentum was -0.15, consistent with a gradual improvement in labor-market conditions rather than a stall or reversal. Read together, these figures implied a path in which slack recedes only slowly while inflation remains persistently below target for some time. On this basis the staff projection was that maintaining the current stance would keep policy appropriately accommodative, with the balance of considerations — a negative r^* , soft inflation momentum, and the lower-bound constraint — pointing toward continuity rather than adjustment in the period ahead.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive discussion, all five participants judged that no change to the 0.0 to 0.25 percent target range was warranted, though they arrived at that conclusion from distinct vantage points. The participant most attentive to inflation risk emphasized that, despite that focus, the risk in the current environment was unambiguously to the downside: with core PCE at 0.86 percent, less than half the 2 percent objective, there was no upside pressure to lean against, and undershooting inflation was itself a genuine concern. This participant observed that a cut was not viable given the range already sat at the



effective floor, and that benign readings on stress, volatility, and credit spreads gave no cause for extraordinary action.

The participant focused on the labor market reasoned similarly, stressing that unemployment at 6.7 percent remained well above the 5.5 percent natural rate and that this slack argued for maintaining accommodation. Yet, checking for signs of acute deterioration, this participant noted that jobless claims of 326,000 were moderate, the activity index was positive, and the Beige Book documented widespread hiring and expansion plans — no emergency easing was called for, and in any case the lower bound left no room for a conventional cut. The participant attentive to financial stability underscored that stress at 0.018, a VIX of 12.84, and a Baa spread of 2.3 all signaled calm markets with no systemic tension, while the participant tracking market signals pointed to the slightly negative T-bill spread and the steeply positive yield curve as confirmation that markets priced neither a near-term hike nor distress requiring a cut. The balanced, data-dependent participant read the two mandate gaps as pointing the same direction — both toward sustained accommodation — and characterized the resulting consensus as genuine and grounded rather than manufactured. In the rebuttal round, no participant was moved to revise; each found the others' arguments reinforcing rather than challenging their own.

When the discussion turned to the framework's loss-minimizing recommendation of 0 basis points, participants engaged directly with the tension between the level-based reference rules and the change-based rule. Several noted that the Taylor, Balanced Approach, and ELB-adjusted rules all pointed to roughly 75 basis points, but that these prescriptions responded mechanically to the unemployment gap while assuming a higher neutral rate than the estimated r^* of -0.5 percent could support. On this reading, the 75-basis-point outputs overstated the appropriate degree of tightening. The First-Difference rule's output of 0 basis points was widely regarded as the more persuasive guide, precisely because it responded to momentum and respected the lower-bound context.

The inflation-focused participant made the distinctive point that the case for holding rested, in that member's seat, not on employment considerations but on avoiding the entrenchment of sub-target inflation: with momentum at -0.045 and prices still drifting lower, a preemptive hike risked pushing inflation further from target. The labor-market participant emphasized that unemployment momentum of -0.15 indicated gradual healing rather than deterioration, so the trigger for easing was absent, and that holding at the floor was itself the maximally accommodative stance available. The financial-stability participant added a cautionary note that an abrupt move toward 75 basis points could jolt the prevailing low-volatility complacency and provoke a sharp repricing of spreads against a backdrop of undershooting inflation — a preemptive shock the data did not justify. The market-signal



participant found this warning sharpened the case for staying put, and the balanced participant reiterated that a literal reading of both mandate gaps, tempered by the deeply negative neutral rate, converged on the same disciplined outcome.

Across both the rebuttal on the optimal case and the earlier predictive rounds, participants consistently characterized the current range as accommodative rather than restrictive and framed patient holding as the appropriate posture while labor slack persists and inflation runs below target. Prior guidance that the 0.0 to 0.25 percent range would remain appropriate well past unemployment falling below 6.5 percent was viewed as plainly still binding at 6.7 percent with inflation undershooting. No participant advanced an argument for a move in either direction, and none was persuaded to change position over the course of the deliberation.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported holding the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous tally of 5 to 0 for no change (0 basis points). On the deterministic policy engine's recommendation of 0 basis points, the Committee was likewise in full agreement: all five members endorsed the recommendation as-is, with none declining and none registering partial agreement. The inflation-focused, labor-market, financial-stability, data-dependent, and market-signal participants each voted to endorse, so that the predictive outcome and the optimal-side outcome coincided completely.