



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$4,233.3 billion in domestic securities as of the January 21, 2015 release, the most recent report available on or before the point-in-time-safe cutoff. Of that total, Treasury notes and bonds accounted for \$2,346.7 billion and agency mortgage-backed securities for \$1,750.5 billion. The portfolio contracted slightly relative to the prior release of January 14, 2015, a change of -\$2.3 billion. The manager noted that this account summary describes SOMA holdings only — total size, composition, and week-over-week change — and does not encompass repo or reverse-repo operation results, for which no confirmed point-in-time-safe data source currently exists; accordingly, no figures on temporary open market operations were presented.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that inflation remained soft. Core PCE inflation stood at 1.24 percent on a year-over-year basis, well below the Committee's 2 percent objective. The Employment Cost Index reading of 122.2 was consistent with wage gains that continued at a modest pace. Beige Book contacts in the reporting district described overall price and wage inflation as modest through the mid-November to late-December period, with input costs generally stable. Some cost pressures were localized — widespread increases in construction materials, higher shipping costs tied to shortages of truck drivers even as fuel prices fell, and supply-driven gains in wholesale produce and meat — but pass-through to retail prices was generally minimal. Offsetting forces were also evident: oil price declines lowered costs in energy-intensive aluminum production, agricultural commodity prices such as grains were flat to lower, and vigorous online competition weighed on selected retail clothing prices. Labor shortages boosted wages for truck drivers, aerospace engineers, and construction trades, though several contacts reported wage increases roughly matching local price inflation, and some noted that rising employee medical insurance premiums offset wage and salary gains.

The staff characterized labor market and activity indicators as consistent with continued, moderate improvement. The unemployment rate was 5.6 percent, close to the estimated natural rate of 5.49 percent, indicating that labor slack had narrowed considerably. Initial jobless claims at 316,000 remained low and stable. The Chicago Fed National Activity Index at 0.73 pointed to above-trend growth. Beige Book contacts reported that economic activity continued to improve moderately, with retail sales growing moderately and holiday spending running higher than in recent years, notably so in some areas. Contacts attributed stronger holiday sales to improving employment conditions and lower gasoline prices, and many expressed optimism that these factors would continue to support consumer spending in 2015. Manufacturing activity picked up, real estate advanced mainly through commercial construction, agricultural conditions were mixed, and lending activity was mixed.



STAFF REVIEW OF THE FINANCIAL SITUATION

The staff reported that financial conditions were calm and broadly accommodative. The financial stress index at 0.087 was very low, indicating well-functioning funding markets without systemic strain. The VIX at 18.85 was moderate, consistent with a normal, non-panicked level of equity volatility. The Baa corporate spread of 2.61 was contained, suggesting credit remained available without alarming borrowing costs. The 10-year/2-year Treasury spread of 1.34 was positively sloped, with no inversion signaling recession risk from the yield curve. The 3-month Treasury bill spread relative to the current policy rate was -0.095, a small negative reading consistent with short rates sitting near the effective floor and with market expectations of no imminent change in the policy rate rather than with any funding stress. The staff also noted that market-based measures of inflation compensation had been declining, per the prior meeting's notes.

STAFF ECONOMIC OUTLOOK

The staff outlook pointed to a continuation of the prevailing configuration — moderate growth, a labor market drifting closer to its estimated normal, and inflation lagging the objective — rather than to any near-term inflection. The estimated neutral real rate (r^*) of -0.5 percent implied that the current 0 to 0.25 percent target range remained accommodative even at its floor, and that policy was not exerting restraint on activity. Unemployment momentum of -0.15 indicated that joblessness was still falling, so the small remaining gap between the 5.6 percent unemployment rate and the 5.49 percent natural rate was expected to continue narrowing. Inflation momentum of 0.035 was essentially flat, offering no signal that core PCE was accelerating back toward 2 percent in the near term; the projection therefore embedded a persistent, if gradually closing, inflation shortfall.

The reference rules reinforced this reading. The Taylor rule, Balanced Approach rule, First-Difference rule, and ELB-adjusted rule each returned 0 basis points, and the rules were judged reliable for this meeting. With the neutral real rate negative and the policy rate pinned at the lower bound, the ELB-adjusted rule in particular indicated that the current stance was already delivering as much accommodation as conventional policy could supply. Taken together, these forward-looking quantities implied a likely path in which conditions heal further and slack continues to close, while inflation only slowly firms — a configuration in which holding the range steady was the loss-minimizing course and in which the balance of risks tilted toward continued undershooting of the inflation objective rather than toward overheating.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK



Participants generally judged that no change in the target range was warranted at this meeting, and their reasoning converged from distinct starting points. The member most attentive to inflation risk emphasized that his usual bias toward tightening simply did not apply when the deviation from target ran on the downside. With core PCE at 1.24 percent, declining market-based inflation compensation, oil price declines pushing prices down broadly, and the Beige Book describing only modest wage gains, he saw the live risk as inflation being too low, not too high. He observed that although the labor market was firming — unemployment near the natural rate, claims low, activity above trend — hiking into soft realized inflation and softening expectations would risk eroding credibility on the 2 percent goal from the below-target side. A cut, he added, was off the table with rates already at the floor and activity improving moderately.

The member focused on employment reached the same conclusion by examining the labor data for any sign of deterioration and finding none. Unemployment at 5.6 percent near the 5.49 percent natural rate, stable claims at 316,000, and a Chicago Fed activity index of 0.73 all pointed to a strengthening rather than weakening labor market, so his usual inclination toward easing was not triggered. He stressed a practical constraint as well: with the range already at 0 to 0.25 percent, there was essentially no room to cut, and no employment threat that would call for one. At the same time, soft inflation and only modest wage growth gave no case for tightening that might jeopardize the labor recovery. The member attentive to financial stability confirmed that conditions were benign — a stress index of 0.087, a moderate VIX, a contained Baa spread of 2.61, and a positively sloped curve at 1.34 — with the small negative front-end T-bill spread reflecting expectations of no imminent move rather than funding strain. From his lens, hiking into a calm-but-soft-inflation environment risked disrupting orderly conditions without compensating benefit.

The data-dependent member weighed inflation and employment at face value and found all evidence pointing the same direction: soft inflation well below target, a firm-but-not-overheating labor market near the natural rate, calm financial conditions, and no recession signal. He read the consensus literally as holding while remaining patient as inflation data developed. The member who weights market-implied pricing most heavily anchored on the 3-month T-bill spread of -0.095, arguing that if a January move were priced in, that spread would be positive; its negative reading signaled that markets expected the range to hold. He noted that the inflation-focused member's decision not to push for a hike removed the one committee voice that might otherwise have argued for tightening, leaving nothing to challenge the market's 'stay put' reading. Across the predictive rounds, no member was persuaded to revise, and all five arrived independently at holding the range.



Turning to the framework's loss-minimizing recommendation, participants found that the optimal case reinforced rather than altered their predictive judgments. Several centered on the estimated neutral real rate of -0.5 percent, which meant the current range remained accommodative even at the floor and gave no reason to raise rates. The inflation-focused member found the Taylor rule logic most persuasive — with inflation below target and unemployment near natural, it prescribed no hike — while the employment- and stability-focused members leaned on the ELB-adjusted rule, which recognized that policy was pinned at the effective lower bound and already maximally supportive. The data-dependent member described the Balanced Approach logic as netting the near-closed unemployment gap against the roughly 0.76 percentage point inflation shortfall to a result of zero. Inflation momentum of 0.035 and unemployment momentum of -0.15 were cited as confirming a picture of gradually healing labor conditions alongside persistently weak price pressure.

In the final rebuttal round, no participant was moved from a hold. The inflation-focused member reiterated that the asymmetric risk was entrenched below-target inflation, not overheating, and that the Employment Cost Index showed no wage-push threat despite unemployment near the natural rate. The employment- and stability-focused members reaffirmed that the effective lower bound and benign credit conditions together forced no action in either direction. The market-focused member noted that the convergence of market pricing, the reliable reference rules, and his own vote strengthened his confidence that the stance was correctly calibrated; while he acknowledged both the hawkish argument that improvement warranted sooner moves and the dovish concern about inflation credibility, he judged that markets were not pricing a hike and that holding preserved optionality without forcing a premature signal. Participants generally concluded that maintaining the current range was appropriately accommodative while inflation lagged the objective.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported maintaining the target range at 0.0 to 0.25 percent, a unanimous outcome of +0 basis points (5 members for no change). On the framework's deterministic recommendation of 0 basis points, the Committee was likewise in full agreement: all five members — the inflation-focused member, the employment-focused member, the financial-stability member, the data-dependent member, and the market-signal member — endorsed the recommendation as-is, with no members declining and none registering only partial agreement. The predictive judgment and the optimal-side outcome thus coincided completely in favor of holding the range steady.