



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$4,228.5 billion in domestic securities as of the March 9 release, comprising \$2,344.2 billion in Treasury notes and bonds and \$1,751.8 billion in agency mortgage-backed securities. The account was unchanged from the prior release of March 2, a week-over-week change of \$0.0 billion, indicating that holdings were being maintained at a steady level over this interval. Members were reminded that this review covers SOMA holdings only — total size, composition, and the change from the prior release — and does not extend to repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists; accordingly, no characterization of those operations is offered here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 1.33 percent on a year-over-year basis, running well below the Committee's 2 percent objective. The unemployment rate was 4.9 percent, matching the estimated natural rate, while initial jobless claims of 278,000 remained low. The Chicago Fed National Activity Index at 0.28 was consistent with growth modestly above trend. The Employment Cost Index registered 125.2, and M2 money supply stood at \$12,420.3 billion.

Regional information drawn from the most recent Beige Book indicated that economic activity in the reporting District had remained generally flat since the prior report, even as labor markets continued to tighten. Selling prices were described as little changed, though service-sector firms reported continued upward pressure on wages and other input costs. Manufacturers reported further weakening in activity, and service-sector firms noted some recent contraction. Consumer spending was steady to up slightly in early 2016 after a sluggish holiday season, with unseasonably mild January weather buoying shopper traffic while hampering sales of cold-weather merchandise; contacts generally described a more promotional environment than a year earlier. Tourism was characterized as stable at a fairly weak level, with hotel occupancy and room rates running below year-earlier figures amid softer international demand and added room supply. Residential real estate markets showed scattered signs of softening while commercial markets were little changed, and banks reported a pickup in commercial loan demand alongside further weakening in household loan demand, with little change in delinquency rates.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as broadly calm but carrying a few points of caution. The financial stress index at 0.132 was low, and the VIX at 18.34 was moderate rather than elevated, suggesting no acute market disruption. The 10-year/2-year Treasury yield curve spread was positive at



1.0, providing no inversion signal. Against this benign backdrop, the Baa corporate spread at 3.38 was somewhat wide, pointing to lingering credit-market caution consistent with the weakening in household loan demand and scattered residential softening noted in the regional review. The 3-month T-bill spread relative to the current target rate was slightly negative at -0.085, indicating that front-end pricing sat modestly below the current stance and that markets were not pricing a near-term firming of policy.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and on measures of inflation and unemployment momentum. The estimated neutral real rate (r^*) was placed at -0.5 percent, implying that neutral was quite low and that the current target range of 0.25 to 0.5 percent could be exerting some restraint on activity. Inflation momentum was estimated at only 0.085, a barely positive reading that suggested the shortfall of core PCE from the 2 percent objective was more likely to persist than to close quickly on its own. Unemployment momentum at -0.05 pointed to a labor market that was, if anything, still edging tighter rather than loosening, consistent with the 4.9 percent rate sitting at the natural rate.

Taken together, these inputs shaped a projection in which policy appeared modestly tighter than the fundamentals warranted. The reference rules were judged reliable this meeting, and all four — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — pointed in the same direction, each prescribing a 25 basis point reduction. The staff noted that this uniformity reflected the combination of a sizable inflation undershoot, an output gap that was essentially neutral given unemployment at the natural rate, and a negative estimated r^* . On this basis the loss-minimizing path implied a lower funds rate than the prevailing range, with the risk that maintaining the current stance would leave policy restrictive against a backdrop of soft inflation and cooling activity in manufacturing, services, and household credit.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive discussion, all participants judged that the appropriate action at this meeting was to leave the target range unchanged at 0.25 to 0.5 percent. Participants generally emphasized that core PCE inflation at 1.33 percent remained well below the 2 percent objective and that, with energy and import declines still weighing on prices, there was no inflation trigger that would justify tightening. The participant most attentive to inflation risk observed that, precisely because inflation was running low rather than elevated, a hawkish framework offered no basis for a hike, while the tight labor market — unemployment at the 4.9 percent natural rate — did not point to overheating either. Several participants noted the upward wage pressure in services flagged in the regional review as worth



watching, but agreed it had not yet fed into broad price gains.

The participant focused on employment stressed that the labor data gave no case for easing at this meeting: jobless claims of 278,000 were low and stable, the Chicago Fed index at 0.28 indicated above-trend growth, and the yield curve was positive rather than inverted. At the same time, this participant flagged weakening manufacturing, service-sector contraction, softening residential real estate, and declining household loan demand as forward-looking caution signals that could bear on future employment. The participant most concerned with financial stability characterized the overall stress picture as benign — a low stress index and moderate VIX — while singling out the somewhat wide Baa spread and cooling credit channels as genuine fragilities, and cautioned that a hike could widen those spreads unnecessarily. The participant weighting market pricing noted that the slightly negative 3-month T-bill spread indicated markets were not anticipating a near-term move, and the data-dependent participant summarized the consensus as a literal, data-supported hold. In the rebuttal round, no participant was moved from that position; the discussion converged on holding while monitoring the sector-weakness flags.

When the discussion turned to the deterministic framework's recommendation of a 25 basis point cut, participants engaged directly with the gap between that optimal call and their predictive votes. The participant attentive to inflation risk examined the divergence candidly and concluded that a usual reluctance to ease lacked an anchor this meeting: with core PCE at 1.33 percent, inflation momentum of only 0.085, and an estimated r^* of -0.5 percent, holding effectively kept policy restrictive against a weak backdrop, and the Taylor rule's logic — an inflation shortfall with a neutral output gap — was persuasive. The employment-focused participant found the Balanced Approach rule most compelling, reasoning that keeping policy above a negative neutral rate while demand softened risked the labor market itself, and that pre-emptive easing was preferable to waiting for jobs to weaken before acting.

The participant concerned with financial stability worked through a genuine tension: with the stress index low and the VIX moderate, a cut was not acutely forced by instability, and a hold could avoid signaling alarm that might itself unsettle credit markets. Weighing the wide Baa spread, cooling household loan demand, and the negative front-end T-bill signal against that caution, this participant found the ELB-adjusted rule most persuasive given proximity to the effective lower bound and ultimately concluded that a single, measured 25 basis point step would ease credit-cost stress without destabilizing markets and was consistent with prior 'only gradual' language. The data-dependent participant read the numbers at face value — inflation undershooting by roughly two-thirds of a percentage point, labor at target, all four rules unanimous — and judged the cut well-grounded, treating the stability member's hesitation as a matter of signaling rather than fundamentals. The



market-weighted participant likewise emphasized that the negative T-bill spread reflected latent easing pressure and that the rules' unanimity validated the direction, while acknowledging that the Committee's prior gradualist posture explained why a predicted hold could coexist with an optimal cut.

Across the optimal-framework discussion, participants broadly agreed that the current stance appeared modestly too tight relative to what the rules, the negative estimated r^* , and market-implied pricing jointly indicated. Those who had emphasized caution in the predictive rounds — chiefly on grounds of calm financial conditions and the Committee's established preference for gradual moves — came to view that caution as explaining the hold-versus-cut gap rather than refuting the case for easing. The disinflationary tenor of the regional review, with manufacturing and services softening and prices little changed, reinforced the sense that the risks around the inflation shortfall dominated the rule prescriptions at this meeting.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate policy action at this meeting, all five participants supported leaving the target range for the federal funds rate unchanged at 0.25 to 0.5 percent, a unanimous 5-0 outcome. On the deterministic framework's recommendation of a 25 basis point reduction, the Committee's recorded optimal-side stance was 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 only partial agreement.