



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$4,232.1 billion in domestic securities as of April 20, 2016, composed of \$2,342.0 billion in Treasury notes and bonds and \$1,759.6 billion in agency mortgage-backed securities. This represented a decline of \$8.7 billion from the prior release of April 13. The manager noted that this account covers SOMA holdings only — the total size, composition, and week-over-week change in the portfolio — and does not extend to the results of repurchase and reverse repurchase operations, for which no point-in-time-safe data source currently exists; those operations were therefore not reflected in the figures reviewed.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 1.31 percent on a year-over-year basis, remaining well below the Committee's 2 percent objective. Labor market indicators continued to point to firmness: the unemployment rate was 5.0 percent, just above the estimated 4.8 percent natural rate, and initial jobless claims were low at 253,000. The Employment Cost Index registered 125.2, and wage measures more broadly showed no acceleration suggestive of building wage-driven price pressure. The Chicago Fed National Activity Index came in at -0.29, consistent with growth running slightly below trend. M2 money supply was reported at \$12,567.2 billion.

Beige Book material for the Second District described economic activity growing at a modest pace since the prior report, with labor markets continuing to strengthen and businesses across a broad range of sectors, including manufacturing, reporting some pickup in activity. A notable theme was the divergence between input and output prices: contacts reported continued upward pressure on input prices while selling prices were little changed. Consumer spending was characterized as steady, with same-store sales little changed from year-earlier levels and an overhang of cold-weather apparel being worked down through discounting; the ongoing shift toward online shopping continued to weigh on traditional retail. Tourism picked up modestly but remained sluggish, and consumer confidence in the Middle Atlantic states retreated somewhat in March after reaching an eight-month high in February. Residential real estate improved modestly, aided by mild weather, while commercial real estate was mixed. Banks reported further strengthening in loan demand and improvement in delinquency rates.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as benign and accommodative. The financial stress index was very low at 0.111, and the VIX was subdued at 13.28, indicating calm markets with no signs of panic. The Baa corporate spread of 2.96 was moderate and gave no indication of acute credit stress. The 10-year/2-year Treasury spread was positively sloped at 1.05, offering no recession signal from the



yield curve. The 3-month T-bill spread relative to the current target range stood at -0.165, indicating that the front end was trading below the midpoint of the current range and that market participants were not pricing a near-term increase in the policy rate.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on several real quantities bearing on the likely path of conditions. The estimated neutral real rate (r^*) was -0.5, implying that the current target range of 0.25 to 0.50 percent may be mildly restrictive relative to a deeply negative neutral level. Inflation momentum was estimated at 0.07, barely positive, indicating no near-term acceleration in prices even as input-price pressure noted in the Beige Book had not yet passed through to selling prices. Unemployment momentum was slightly negative at -0.05, consistent with gradual labor market tightening rather than any sharp move in either direction. Taken together, these suggested a projection of inflation continuing to run below target for some time, with labor market conditions firming only gradually.

The reference-rule outputs reinforced this reading. The Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule all pointed to -25 bps, and the rules were judged reliable this meeting. The loss-minimizing recommendation of the optimal policy engine was likewise -25 bps. On the staff's projection, then, the configuration of a negative r^* , a persistent inflation shortfall, and slightly below-trend activity as captured by the Chicago Fed index implied that policy was positioned modestly tighter than rule-based optimality would suggest, with the balance of the near-term outlook tilted toward accommodation rather than restraint.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive discussion, all five participants arrived independently at holding the target range at 0.25 to 0.50 percent. The member most attentive to inflation risk observed that his usual hawkish reflex assumes overshoot, but that core PCE at 1.31 percent showed undershoot, not overshoot; while the Beige Book noted upward pressure on input prices, selling prices were 'little changed,' suggesting margins were absorbing costs rather than passing them through. He judged that a hike into below-target inflation could tighten conditions unnecessarily, though he retained a bias toward the next move being up should input-price pressure begin to feed through or wages accelerate. The participant most focused on the labor market noted that his case for a cut would rest on evidence of employment deterioration — rising unemployment, slowing job growth, or elevated claims — and that none of that was present given unemployment near the natural rate, low jobless claims, and a Beige Book describing labor markets that continued to strengthen.



The member weighing financial stability emphasized that calm conditions cut both ways: with the stress index at 0.111, the VIX subdued, and the Baa spread moderate, there was no strain forcing an easing and no froth demanding restraint. The market-signal participant pointed to the negative 3-month T-bill spread of -0.165 as evidence that markets were not pricing a near-term hike, so that moving against that pricing without an inflation justification would risk a needless disruption. The data-dependent centrist read conditions as stable but mixed, noting the below-trend Chicago Fed index alongside steady spending, and concluded that the data justified neither a hike nor a cut. Across two rounds of rebuttal, no participant was moved off the hold, and the convergence of differing frameworks on the same conclusion strengthened rather than changed each member's confidence.

The tenor of the discussion shifted markedly when participants turned to the optimal-policy framework, which recommended -25 bps with all four reference rules in agreement and judged reliable. Confronted with an estimated r^* of -0.5, several members recognized that the current stance might be mildly restrictive rather than accommodative. The inflation-focused member was candid that the divergence between his predictive hold and the framework's easing call revealed his own anchoring on an inflation risk the data did not support; with momentum at just 0.07 and pipeline pressure contained, he accepted -25 bps as a level correction toward neutral rather than a crisis response, while insisting any cut remain gradual and reversible should input-price pressure feed through.

The labor-market member found the Balanced Approach rule most compelling, reasoning that below-trend growth signaled by the Chicago Fed index at -0.29 could erode labor gains before claims turned, and that waiting risked responding too late; from his priorities the case to cut to protect jobs was clear and data-supported. The financial-stability member, examining whether easing into calm markets might fuel credit excess, concluded that spreads and the VIX showed no such froth, that strengthening loan demand and improving delinquencies indicated a healthy credit channel, and that a cut aligning policy with the front-end pricing already embedded in the negative T-bill spread would be stability-friendly rather than disruptive. He found the ELB-adjusted rule most persuasive near the lower bound. The centrist stressed that the unanimous agreement of the rules was the strongest literal signal available and that every member had conceded his predictive hold reflected institutional caution rather than a data-based case against easing. The market-signal member closed by noting that the negative front-end spread was a quiet market endorsement of the easier stance the rules confirmed, so that market pricing and the economics cohered on -25 bps.

Participants generally acknowledged a genuine gap between the caution embedded in their predictive votes — grounded in prior guidance emphasizing 'only gradual increases,' data-dependence, and previously flagged global risks — and the loss-minimizing math of the framework. A couple of



participants underscored that this gap was explained by real committee caution and the limited value of one week of new data, not by any data-based argument against the direction the rules pointed. No participant advanced evidence for a step smaller or larger than the recommended 25 basis points.

COMMITTEE POLICY ACTIONS

In the predictive vote on the likely near-term policy action, all five participants favored holding the target range at 0.25 to 0.50 percent, a unanimous 5-0 for no change. On the separate question of the optimal-policy framework's recommendation of a 25 basis point reduction, the Committee's recorded stance was full agreement: all five members endorsed the -25 bps recommendation as-is, with none declining and none registering partial support. The two results reflect the tension participants themselves identified — a predictive hold shaped by institutional caution and gradualist guidance, alongside unanimous recognition that the underlying data, a negative estimated neutral rate, and the reliable consensus of the reference rules pointed to easing.