



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent data on the System Open Market Account. As of March 8, 2017, total SOMA domestic securities holdings stood at \$4,222.8 billion, comprising \$2,332.4 billion in Treasury notes and bonds and \$1,763.2 billion in agency mortgage-backed securities. Holdings were unchanged from the prior release of March 1, 2017, a week-over-week change of \$0.0 billion, indicating that the portfolio was being maintained at a stable level over the period. Members noted that this review covers SOMA holdings only — the total size, composition, and week-over-week change of the portfolio — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity had accelerated to a modest pace. Core PCE inflation on a twelve-month basis stood at 1.48 percent, still below the Committee's 2 percent objective. The unemployment rate was 4.8 percent, essentially at the estimated natural rate of 4.74 percent, and initial jobless claims were low at 223,000. The Chicago Fed National Activity Index registered -0.05, consistent with growth at roughly its trend pace rather than a marked acceleration or contraction. The Employment Cost Index reading was 128.0, and M2 money supply totaled \$13,268.2 billion.

The Beige Book material indicated that labor markets had strengthened, hiring had picked up, and wages continued to rise modestly. Input cost increases had become more widespread across districts, and selling prices had accelerated somewhat. Reports were uneven across sectors and regions: several districts described activity rising at a modest-to-moderate pace, with pickups noted among manufacturers and homebuilders, while activity was described as essentially flat in several other sectors. Contacts in a number of districts reported difficulty retaining high-skilled workers, and many remained cautiously optimistic even as their uncertainty increased. Housing markets had continued to weaken at the high end, while commercial real estate demand — particularly for industrial and retail space and multi-family development — had picked up. One district reported record container volumes passing through its ports in recent weeks.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and accommodative. The financial stress index stood at 0.075, a very low reading, and the VIX was at 11.86, an exceptionally low level indicating little market fear or volatility. The Baa corporate spread was 2.61, a moderate and stable level suggesting no emerging credit stress. The 10-year/2-year Treasury yield curve spread was positive at 1.21, showing no inversion and no recession signal from the term structure. The 3-month T-bill spread relative to the



current policy rate was 0.125, which the staff noted was consistent with market participants pricing a near-term move upward in the policy rate.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available. The estimated neutral real rate (r^*) used in the framework was -0.5 percent, a very low level implying that the current target range of 0.5 to 0.75 percent may already sit near or above neutral in real terms. Inflation momentum was estimated at -0.09 and unemployment momentum at -0.15 — both modest in magnitude, suggesting neither a sharp acceleration of prices toward target nor a pronounced deterioration in labor market conditions over the near horizon.

The reference-rule outputs, judged reliable by the framework, pointed toward an easing direction. The Taylor rule, Balanced Approach rule, and ELB-adjusted rule each indicated -50 basis points, primarily reflecting the shortfall of inflation below target combined with the low estimated neutral rate. The First-Difference rule, which adjusts incrementally from the current stance rather than solving for a full rate level, indicated -25 basis points. On balance, the framework's loss-minimizing recommendation was -25 basis points, tempering the more aggressive level-based rules with the gradualism of the First-Difference approach. Taken together, these figures imply that on a mechanical, model-based reading, policy need not tighten and the loss function favored an easing direction, even as the broader activity data showed no contraction.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, participants converged on a quarter-point increase in the target range, to 0.75 to 1.0 percent, though they arrived there from distinct starting points. The inflation-weighting participant emphasized that although core PCE at 1.48 percent remained below the 2 percent objective, the Beige Book pointed to selling prices accelerating and input cost increases becoming more widespread — the kind of firming a preemptive approach should address before it broadens. This participant read a tight labor market, with unemployment at 4.8 percent against a 4.74 percent natural rate and difficulty retaining skilled workers, as the very transmission channel through which price pressures build.

The participant most focused on employment risk observed that neither rising unemployment nor slowing job growth was evident; jobless claims at 223,000 and tight labor conditions across several districts argued against any accommodation, while sub-target inflation gave no urgency for aggressive tightening. A gradual step, in this view, posed no threat to labor-market health. The participant attentive to financial stability underscored that a stress index of 0.075, a VIX of 11.86, and a contained



Baa spread of 2.61 left ample room for a measured move without destabilizing markets, and that matching the move already embedded in the 0.125 T-bill spread was the least disruptive path. The data-dependent participant and the market-signal participant reinforced this reading: the current range sat well below the Committee's prior median projection of 1.4 percent, front-end pricing anticipated a near-term move, and a single quarter-point step fit the prior 'only gradual increases' guidance. Participants generally judged that a larger move was not warranted with inflation still under target, and that a hold would risk both falling behind broadening price pressures and surprising markets in the other direction.

The discussion then turned to the framework's loss-minimizing recommendation of -25 basis points, a direction opposite to the predictive vote. Considerable attention was paid to what the recommendation actually implied, and a couple of participants initially conflated the -25 basis point figure with a firming direction before the sign was clarified as an easing. Participants examined the underlying logic: with the neutral real rate estimated at -0.5 percent, inflation momentum at -0.09, and unemployment momentum at -0.15, the level-based rules mechanically penalized the inflation shortfall and low neutral rate, pointing to -50 basis points, while the First-Difference rule's incremental adjustment produced the more gradual -25 basis point figure that the framework ultimately favored.

One participant, weighting employment risk most heavily, accepted the -25 basis point recommendation as the defensible loss-minimizing call. In this view, with inflation soft, momentum mildly negative, and the neutral rate very low, the current range might already be near or above neutral; the First-Difference logic adjusted gradually without overreacting to any single gap, and easing protected employment momentum against premature restriction. The other participants declined the recommendation. The inflation-weighting participant read sub-target inflation as a lagging indicator against accelerating costs and warned that cutting while cost pressures broadened risked unanchoring inflation expectations. The financial-stability participant argued that easing into already-loose, complacent conditions — with no stress to counter — could fuel excess risk-taking over time, and that a cut would surprise markets pricing a hike. The data-dependent participant concluded that on a face-value read, trend growth, firm claims, a tight labor market, and broadening cost pressures showed no deterioration justifying a cut, notwithstanding what the rules produced mechanically. The market-signal participant held that front-end pricing, a contained Baa spread, and a positively sloped curve all pointed toward firming rather than easing, and that a cut would defy every signal weighted in that framework.

Across both strands of the deliberation, participants recognized a genuine tension between a mechanical, model-based reading that favored easing on the inflation shortfall and low neutral rate,



and a face-value reading of the real-economy data — trend-level activity, a labor market at balance, and broadening price pressures — that pointed the other way. Most participants ultimately placed greater weight on the latter, judging the current stance modestly accommodative rather than restrictive.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five members supported a 25 basis point increase in the target range, to 0.75 to 1.0 percent, a unanimous 5-to-0 tally. On the framework's loss-minimizing recommendation of -25 basis points, the Committee did not reach agreement: one member — the participant focused on employment risk — endorsed the recommendation, while four members declined it, namely the inflation-weighting participant, the financial-stability participant, the data-dependent participant, and the market-signal participant. There were no partial endorsements. The optimal-side outcome was thus a 1-to-4 split against the framework's easing recommendation.