



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$4,178.1 billion in domestic securities as of the March 14, 2018 release, the most recent available on or before the point-in-time-safe cutoff. Holdings were composed of \$2,276.9 billion in Treasury notes and bonds and \$1,768.6 billion in agency mortgage-backed securities, with the remainder in other domestic securities. This total represented an increase of \$8.6 billion from the prior release of March 7. It should be noted that this account covers SOMA securities holdings only — total size, composition, and the week-over-week change — and does not encompass results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists; the staff accordingly limited its report to the securities positions that could be documented.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that economic activity had continued to expand. According to the Beige Book, activity grew at a modest to moderate pace across all twelve Districts during January and February. Consumer spending was mixed: non-auto retail sales rose in just over half of the Districts, while auto sales declined or were flat in every District. Tourism was broadly solid, with robust growth reported in the Atlanta and Richmond Districts. Home sales and construction grew modestly on balance, though construction was constrained by shortages of labor and materials, and nonresidential real estate improved moderately, with robust construction noted in three Districts and commercial rents in and around New York City up significantly. Manufacturing production increased on a broad basis, with all but one District reporting at least modest growth. Loan volumes were generally flat, and a handful of Districts noted modestly declining delinquency rates. The Chicago Fed National Activity Index stood at 0.12, consistent with growth somewhat above trend.

Labor market indicators pointed to continued tightness. The unemployment rate was 4.1 percent, below the estimated natural rate of 4.73 percent, and initial jobless claims were low at 231,000. The Beige Book described persistent labor market tightness and brisk demand for qualified workers, with several Districts citing worker shortages across most sectors — particularly construction, information technology, and manufacturing — and increased activity at staffing placement services. Wage growth picked up to a moderate pace in many Districts, with employers raising pay and expanding benefits, and a few Districts reporting modest compensation increases following passage of the Tax Cuts and Jobs Act. On prices, core PCE inflation was 1.51 percent on a twelve-month basis, below the Committee's 2 percent objective. The Beige Book reported that prices rose in all Districts, with most describing moderate inflation; four Districts noted a marked increase in steel prices tied in part to reduced foreign competition, building-material costs such as lumber picked up alongside construction activity, and several Districts reported moderate increases in transportation costs driven by higher fuel prices that



raised freight rates.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and generally accommodative. The financial stress index stood at 0.069, a very low reading indicating no systemic strain, and the VIX at 17.23 reflected moderate volatility without signs of acute market disruption. Credit markets appeared healthy: the Baa corporate spread over Treasuries was 1.8, a relatively tight level suggesting ample risk appetite and no evident borrowing-cost pressure, a reading consistent with the Beige Book's observations of flat loan volumes and modestly declining delinquency rates in some Districts. The 10-year/2-year Treasury spread was positive at 0.55, showing no yield-curve inversion and thus no near-term recession signal from the term structure. The 3-month T-bill spread relative to the current policy rate was 0.325, a level the staff read as consistent with market participants anticipating a near-term upward shift in the target range.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available. The estimated neutral real rate (r^*) used in the reference framework was -0.5 percent, a notably low level implying that a given nominal policy rate exerts more restraint than it would under a higher neutral rate; on this reading, the current 1.25 to 1.50 percent range may already be modestly restrictive relative to the estimated equilibrium. Momentum indicators were both slightly negative — inflation momentum at -0.01 and unemployment momentum at -0.05 — suggesting that inflation was roughly flat rather than accelerating toward the 2 percent objective, while unemployment carried a slight further downward drift consistent with continued labor tightness rather than an emerging turn.

The reference rules, taken together, pointed toward some easing relative to the current stance. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each indicated approximately -50 basis points, reflecting the weight those level-based specifications place on core inflation running below target combined with the low neutral-rate estimate. The First-Difference rule, which adjusts from the prevailing stance rather than solving to an absolute level, indicated a more modest -25 basis points, and the framework's loss-minimizing recommendation likewise landed at -25 basis points, with reference rules assessed as reliable. The staff noted the tension embedded in these outputs: the level rules were driven chiefly by the static inflation gap and the low r^* , while the momentum inputs and the Beige Book's evidence of building cost and wage pressures point in a firmer direction than the realized core reading alone would suggest.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK



In their discussion of current conditions, participants agreed that the labor market remained tight and that activity was expanding at a solid pace. The member most focused on employment risk examined the data specifically for signs of deterioration and found none: unemployment at 4.1 percent stood below the 4.73 percent natural rate, jobless claims were low, and the Beige Book documented persistent worker shortages and a moderate pickup in wages. Because this member's framework calls for accommodation only when unemployment is rising or job growth is slowing, and neither condition was present, the case for easing on employment grounds did not trigger. Other participants emphasized complementary readings — one weighting inflation risk heavily pointed to broad-based price increases across all Districts, marked steel-price gains, and rising freight costs as evidence that inflation risk was building even if the realized core figure still lagged, while the participant most attentive to market signals stressed that the 0.325 T-bill spread indicated markets were already pricing a near-term firming of the range.

Participants weighing financial stability observed that the very low stress index, the moderate VIX, the tight Baa spread, and the positive yield curve together indicated that credit markets could comfortably absorb a modest tightening without disruption, and that a move already anticipated by markets was unlikely to destabilize conditions through surprise. The data-dependent participant read the indicators at face value and reached the same conclusion: tight labor conditions, firming prices across every District, and calm financial conditions supported continuing the gradual normalization signaled by prior guidance of 'further gradual increases,' with the prior median projection of 2.1 percent implying rates above the current midpoint. On this predictive question, all five participants converged, from their differing mandates, on a 25 basis point increase to a target range of 1.50 to 1.75 percent.

The discussion then turned to the framework's loss-minimizing recommendation of -25 basis points, which ran opposite in direction to the participants' predictive lean and prompted a careful examination of the divergence. The participant focused on employment risk found the framework's reasoning persuasive: with r^* estimated at -0.5 percent, inflation momentum essentially flat, and core PCE well below target, this member argued that the level rules' pull toward easing reflected a genuine feature of the economy — that the current stance may be more restrictive than nominal rates suggest — and that hiking into soft inflation without any labor weakness risked future employment harm. This member found the Balanced Approach logic most compelling, tempered by the First-Difference rule's gradualism, and settled comfortably at the -25 recommendation as the loss-optimal path, distinguishing it from the +25 predictive vote which reflected expected policy behavior rather than the framework's optimum.



The other four participants, while engaging seriously with the framework's math, declined to endorse the easing direction. The inflation-risk participant characterized the level rules as resting on backward-looking, static gap arithmetic and expressed distrust of easing into a tightening labor market with building cost pressures, judging that a cut would risk overshooting the 2 percent objective later. The financial-stability participant argued that easing into already-calm, accommodative conditions could foster asset-price imbalances and represent a whipsaw move inconsistent with orderly normalization, noting that no crisis or stress signal justified a cut. The market-signal participant held that market pricing aggregates forward-looking information more reliably than the imprecise r^* estimate driving the level rules, and that the 0.325 T-bill spread pointed to firming rather than easing. The data-dependent participant concluded that face-value indicators — low claims, an above-trend activity index, and rising prices in every District — showed building rather than fading pressure, and that a cut would be inconsistent with the direct data even as the framework's restraint validated keeping any tightening to a single gradual step.

Across both strands of the discussion, participants generally judged that the divergence between the reference rules and the predictive lean helped locate the current stance as roughly neutral to slightly restrictive rather than badly misaligned. Several observed that the modest magnitude of the framework's signal — -25 rather than the deeper -50 of the level rules — and the near-zero momentum inputs argued against any abrupt move in either direction, and that gradualism was the common thread whether one read the data as calling for a small step up or a small step toward the low estimated neutral rate.

COMMITTEE POLICY ACTIONS

On the predictive question of the likely policy decision, the Committee's five members were unanimous, each supporting a 25 basis point increase in the target range to 1.50 to 1.75 percent (5 of 5 for +25 basis points). On the separate question of the deterministic framework's loss-minimizing recommendation of -25 basis points, the Committee did not reach agreement: one member — the participant focused on labor market and employment risk — endorsed the recommendation as optimal, while the remaining four — the inflation-risk, financial-stability, data-dependent, and market-signal participants — declined to support it, judging the easing direction inconsistent with building price and wage pressures, calm financial conditions, and market-implied firming. The recorded optimal-side tally was thus one endorse and four decline, with no partial positions.