



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$3,756.5 billion as of the January 22 release, the most recent available on or before the point-in-time cutoff. The portfolio's composition was concentrated in Treasury notes and bonds, at \$1,999.7 billion, alongside \$210.0 billion in Treasury bills and \$1,398.6 billion in agency mortgage-backed securities. Holdings rose by \$12.7 billion from the prior release on January 15. Staff noted that these figures capture SOMA securities holdings only — total size, composition, and week-over-week change — and do not reflect the results of repo or reverse-repo operations, for which no point-in-time-safe data source currently exists; accordingly, no assessment of those operations is included here.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data as pointing to continued but restrained expansion. Core PCE inflation stood at 1.4 percent on a twelve-month basis, below the Committee's 2.0 percent objective. The unemployment rate was 3.5 percent, well beneath the estimated natural rate of 4.56 percent, and initial jobless claims remained low at 204,000. The Employment Cost Index registered 138.0, and the Chicago Fed National Activity Index came in at -0.35, a reading consistent with growth somewhat below its longer-run trend. M2 stood at \$15,401.8 billion. The current target range for the federal funds rate was 1.50 to 1.75 percent, with a midpoint of 1.625 percent, close to the Committee's most recent median projection of 1.6 percent.

The Beige Book described economic activity as generally continuing to expand modestly through the final six weeks of 2019. Consumer spending grew at a modest to moderate pace, with several Districts noting a pickup and holiday sales characterized as solid; online shopping was cited as increasingly important. Manufacturing activity was essentially flat in most Districts, and transportation was mixed, with a majority reporting flat to weaker activity. Home sales were flat overall, with some Districts pointing to low inventories as a restraint, while residential rental markets strengthened and new residential construction expanded modestly. Labor markets remained tight nationwide, with most Districts citing widespread labor shortages as a constraint on job growth and, in a few cases, on business expansion. At the same time, a number of Districts reported job cuts or reduced hiring among manufacturers, with scattered reports in transportation and energy. Wage growth was characterized as modest or moderate, similar to the prior period, and prices continued to rise at a modest pace. Tariffs and trade uncertainty were reported to be weighing on some businesses, though the near-term outlook remained modestly favorable.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were reviewed as calm and broadly accommodative. The financial stress index registered 0.063, a very low reading, and the VIX stood at 12.91, indicating subdued equity-market volatility. Corporate credit conditions appeared healthy, with the Baa spread at 1.97, a comparatively tight level. The yield curve was no longer inverted, with the 10-year to 2-year spread positive at 0.24, though still relatively flat. The 3-month T-bill spread against the current policy rate was -0.095, suggesting money markets leaned slightly toward the prospect of somewhat lower rates ahead but signaled no pressing demand for a near-term move. On balance, the staff characterized financial conditions as orderly, with no signs of distress in credit or funding markets.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and the reference-rule outputs. The estimated r^* of -0.265 implied a low neutral setting, suggesting that the current midpoint of 1.625 percent sat modestly above what the reference framework would treat as neutral in real terms — pointing to a policy stance that was mildly restrictive rather than clearly accommodative. Inflation momentum of -0.095 indicated prices drifting further from, rather than toward, the 2.0 percent objective, while unemployment momentum of -0.05 suggested only marginal softening in labor conditions.

The reference rules diverged in magnitude but not direction. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to -75 bps, reflecting the sizable inflation shortfall and the low neutral rate. The First-Difference rule, which responds to changes rather than to the level of the gap, indicated -25 bps. With the reference rules judged reliable, the framework's loss-minimizing output settled at -25 bps — a reading that weighed the persistent inflation shortfall and mild negative momentum against a labor market that remained tight by the level of unemployment. Taken together, these quantities implied that, absent a change in stance, conditions would likely continue to drift rather than deteriorate sharply, with soft inflation the most persistent feature of the projection.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, all five participants independently arrived at a preference to hold the target range at 1.50 to 1.75 percent, and none was moved off that view in the rebuttal round. The reasoning, however, came from distinct vantage points that reinforced rather than duplicated one another. The participant most attentive to inflation risk observed that core PCE at 1.4 percent gave no signal of imminent price acceleration and therefore no case for tightening; at the same time, with inflation soft, the usual instinct to resist easing was muted, though this participant continued to watch the 3.5 percent unemployment rate — far below the 4.56 percent natural rate — as the primary channel through which future wage-price pressure might eventually build.



The participant focused on the labor market emphasized that employment signals showed historic strength: unemployment at 3.5 percent, jobless claims at 204,000, and widespread labor shortages in the Beige Book. This participant flagged the scattered manufacturing, transportation, and energy job cuts as worth monitoring but judged them localized rather than systemic, and thus not yet grounds for preemptive easing. The participant weighing financial stability stressed that every relevant indicator — a stress index of 0.063, a VIX of 12.91, a Baa spread of 1.97, and a positive 10-year to 2-year spread — pointed to calm, orderly conditions, and cautioned that easing into already-loose conditions could encourage excessive risk-taking. The data-dependent participant noted that the policy midpoint sat essentially at the Committee's own most recent median projection of 1.6 percent, so policy was where it was expected to be, while the participant weighing market signals observed that the mildly negative T-bill spread implied only a slight easing lean, with markets not pricing a move at this meeting.

The character of the discussion shifted when participants turned to the deterministic framework's loss-minimizing recommendation of -25 bps, which diverged from the unanimous predictive hold. Participants engaged directly with the gap. Several noted that the Taylor, Balanced Approach, and ELB-adjusted rules all pointed to -75 bps, driven by the roughly 0.6 percentage point inflation shortfall and the low estimated r^* of -0.265, but generally judged those level-based prescriptions too aggressive given a labor market this tight. The First-Difference rule's -25 bps, which responds to momentum rather than the full level gap, was repeatedly cited as the more persuasive logic — modest, momentum-based, and unwilling to over-ease into widespread labor shortages.

Within this convergence, real differences of emphasis remained. The labor-focused participant came to view the -25 bps step as better honoring the employment mandate than a pause would, reasoning that a modest, reversible cut could cushion the early manufacturing and transportation job cuts before they broadened, and reading the framework's divergence as evidence that the expected pause leaned slightly restrictive. The data-dependent participant likewise concluded that inflation momentum of -0.095 and the below-trend Chicago Fed reading of -0.35 justified one modest insurance step rather than standing pat, describing -25 bps as the literal, consensus-consistent reading. The financial-stability participant endorsed -25 bps as a responsible reconciliation — enough to address the inflation shortfall without inflaming asset valuations — while the market-signals participant found that the mild T-bill lean plus below-target inflation tipped optimal policy toward a small cut, with the real rate sitting slightly above the low neutral estimate.

The participant most focused on inflation was the most reluctant. This participant accepted the direction of the framework's recommendation only guardedly, reasoning that below-target inflation did not by itself scream for action and that cutting into a 3.5 percent unemployment rate ran against an



instinct to guard against latent wage-price pressure. This participant characterized a single 25 bps cut as the maximum step tolerable — defensible as measured insurance but no deeper — and rejected the -75 bps prescriptions outright. Across the four rounds, the shared thread was that current policy appeared close to neutral, with reasonable participants split between holding and a single precautionary step, and no one persuaded that the aggressive level rules should govern.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported holding the target range at 1.50 to 1.75 percent, a unanimous 5-to-0 outcome consistent with the prior meeting's pause. On the separate question of the framework's -25 bps recommendation, four participants — those weighing labor-market conditions, financial stability, data dependence, and market signals — endorsed the recommendation as-is, while the participant most focused on inflation risk gave partial support, agreeing with the direction of a modest cut but not with any move beyond a single 25 bps step. There were no participants who declined the recommendation outright.