



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the most recent data on the System Open Market Account. As of February 19, 2020, total SOMA domestic securities holdings stood at \$3,814.4 billion, comprising \$2,014.3 billion in Treasury notes and bonds, \$265.5 billion in Treasury bills, and \$1,385.8 billion in agency mortgage-backed securities. This represented an increase of \$3.4 billion from the prior release of February 12. It was noted that these figures cover SOMA holdings only — total size, composition, and the week-over-week change — and do not encompass the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source is currently available; the discussion accordingly proceeded without reference to those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that inflation remained below the Committee's longer-run objective, with core PCE prices up 1.51 percent over the prior twelve months. Labor market conditions continued to appear firm: the unemployment rate stood at 3.6 percent, below the estimated natural rate of 4.44 percent, and initial claims for unemployment insurance were low at 210,000. The Employment Cost Index registered 138.9, and the broader tenor of wage developments was consistent with the modest pace described elsewhere. The Chicago Fed National Activity Index was -0.25, pointing to growth somewhat below its historical trend. M2 stood at \$15,438.1 billion.

Drawing on the most recent Beige Book, the staff noted that economic activity had generally continued to expand modestly over the final six weeks of 2019, with the Dallas and Richmond Districts reporting above-average growth while Philadelphia, St. Louis, and Kansas City reported sub-par growth. Consumer spending grew at a modest to moderate pace, and holiday sales were characterized as solid on balance, with several Districts noting the growing importance of online shopping. Manufacturing activity was essentially flat in most Districts, and a number of Districts reported job cuts or reduced hiring among manufacturers, with scattered reports of cuts in transportation and energy. Labor markets remained tight throughout the nation, with most Districts citing widespread labor shortages as a factor constraining job growth, and wage growth was described as modest or moderate. In many Districts, tariffs and trade uncertainty continued to weigh on some businesses, though expectations for the near-term outlook remained modestly favorable across the nation.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions presented a mixed picture in which forward-looking, market-based gauges appeared to have moved ahead of slower-moving stress measures. Equity market volatility, as measured by the VIX, was elevated at 27.85, well above the calm-period range. At the same time, the



financial stress index remained low at 0.051, and the Baa corporate spread, at 2.13, was moderate and not indicative of acute credit strain. The 3-month Treasury bill traded 12.5 basis points below the current target range for the federal funds rate, a negative spread consistent with market participants pricing in near-term easing. The 10-year/2-year Treasury yield curve spread was barely positive at 0.13, leaving that recession-warning signal fragile. The staff observed that the divergence between the elevated VIX and the still-contained stress and credit gauges was characteristic of a rapidly evolving shock in which market pricing leads realized deterioration.

STAFF ECONOMIC OUTLOOK

The staff's outlook drew on several forward-looking quantities available for this meeting. The estimated neutral real rate was negative, at -0.207, implying a low nominal neutral rate and suggesting that the current 1.5 to 1.75 percent target range may be modestly restrictive relative to underlying conditions. Inflation momentum was slightly negative at -0.04, indicating that prices were, if anything, drifting further from the 2 percent objective rather than converging toward it. Unemployment momentum was flat at 0.0, reflecting no realized deterioration in the labor data despite the leading signals of softness elsewhere.

Reference-rule outputs pointed toward some easing, though they differed on magnitude. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed -50 basis points, reflecting the inflation shortfall and the low estimated neutral rate. The First-Difference rule, which adjusts incrementally from the current stance and is sensitive to the flat momentum readings, prescribed -25 basis points. The deterministic policy engine, with reference rules judged reliable, landed on a recommendation of -25 basis points — a measured step that closes part of the gap to the low neutral rate while withholding the more aggressive level-based adjustment given that momentum has not yet turned.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, participants converged on the view that some easing was warranted, though they differed sharply on scale. Four members opened at -50 basis points and one at -25. Those favoring the larger move placed substantial weight on fast-moving, forward-looking signals: the VIX at 27.85 well above calm norms, the 3-month bill trading 12.5 basis points below the current range, and the coronavirus outbreak, which had been flagged as an uncertainty at the prior meeting and which markets now appeared to be repricing sharply. The participant most attentive to market pricing argued that the magnitude of the bill dislocation, combined with the volatility spike, was the market 'screaming for a cut' and supported a decisive move rather than a token 25 basis points. The participant weighting employment risk stressed that although the labor data were genuinely strong — unemployment at 3.6



percent, claims at 210,000 — a preemptive move was needed to buffer jobs before a virus-driven downturn could hit. The participant focused on financial stability framed the same evidence as a case for front-running a shock before it could metastasize into the credit channel.

The participant most concerned with inflation took a distinctive path. Observing that core PCE at 1.51 percent was well below target and that there was no upward inflation pressure to defend against, this participant acknowledged that the usual objection to easing did not apply. But this member cautioned that the 50 basis point arguments rested on volatility that had not yet transmitted into actual credit or labor stress — the stress index remained very low at 0.051, the Baa spread moderate at 2.13, and the yield curve still positive — and that an aggressive move on the basis of fear could squander policy space and signal alarm. This participant accordingly moved from a hold-leaning stance to a measured -25 basis points, adopting the risk-management framing of the centrist rather than the market-panic framing of the larger-cut camp.

The centrist, who had opened at -25 as the most literal reading of solid fundamentals against market stress, ultimately revised toward -50. The decisive consideration was that the bill dislocation and VIX spike were being read across the committee as a sharp, coordinated repricing that a 25 basis point move would underdeliver against, with no inflation cost given soft core PCE. The dove, the financial stability voice, and the market realist all held their -50 positions through the rebuttal round, so the predictive discussion closed with four members at -50 and one at -25.

When the discussion turned to the deterministic framework's recommendation of -25 basis points, the balance of the committee shifted. Several members who had voted -50 predictively found the First-Difference logic persuasive on reflection: with inflation momentum at -0.04 and unemployment momentum at 0.0, there was no realized deterioration to justify the larger level-based adjustment, even as the negative r^* of -0.207 confirmed that current policy was modestly restrictive. The inflation-focused member emphasized that the containment of credit spreads argued directly against a full -50 and preserved optionality. The employment-focused member accepted that hard labor data had not yet turned, only leading signals, and that -25 basis points meaningfully reduced restrictiveness while preserving ammunition for a deeper shock. The financial stability voice added that a full -50 could itself widen spreads by signaling committee panic, a counterproductive outcome from a stability standpoint, and that gradualism from still-contained levels was the loss-minimizing course.

The market-signal member was the lone dissenting voice on magnitude at this stage. This participant agreed that easing was clearly warranted but maintained that momentum rules are backward-looking, that markets aggregate forward information faster, and that with the bill already pricing in one cut and the VIX signaling genuine stress, the shock warranted more than the framework's single step. In this



member's view, a 25 basis point cut only partially closes the gap to the low neutral rate and merely ratifies what markets have already priced. This participant thus supported the direction of the recommendation but viewed -25 basis points as insufficient.

COMMITTEE POLICY ACTIONS

In the predictive vote, the Committee's members favored a reduction in the target range for the federal funds rate of 50 basis points, by a tally of four members at -50 basis points and one member at -25 basis points. On the deterministic framework's recommendation of a 25 basis point cut, the outcome was four endorsements and one partial concurrence, with no member declining: the participants weighting inflation, employment, financial stability, and data-dependence each endorsed the -25 basis point recommendation as-is, while the participant most attentive to market signals agreed with the direction of easing but regarded the magnitude as insufficient given market-implied pricing and elevated stress.