



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account continued to expand over the intermeeting period. As of the most recent release on January 19, 2022, total SOMA domestic securities holdings stood at \$8,309.4 billion, an increase of \$80.7 billion from the prior release on January 12. Holdings remained concentrated in Treasury notes and bonds, at \$4,887.6 billion, with a comparatively small position in Treasury bills of \$326.0 billion; agency mortgage-backed securities accounted for \$2,677.1 billion. The manager noted that this account covers SOMA securities holdings only — total size, composition, and week-over-week change — and does not encompass the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source is available at this time.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that economic activity expanded at a modest pace in the final weeks of 2021. Growth in many Districts continued to be held back by supply chain disruptions and labor shortages, even as demand for materials, inputs, and workers remained elevated. Consumer spending had grown at a steady pace ahead of the rapid spread of the Omicron variant, but most Districts subsequently noted a sudden pullback in leisure travel, hotel occupancy, and restaurant patronage as new cases rose. Manufacturing continued to expand nationally with some regional variation, and transportation activity grew at a moderate pace. Although optimism remained generally high, several Districts reported that businesses' expectations for growth over the next several months had cooled somewhat in recent weeks. Lending activity picked up slightly toward year-end, led by commercial real estate borrowers. The Chicago Fed National Activity Index stood at 0.37, and initial jobless claims were 230,000.

Labor market conditions were tight. The unemployment rate was 3.9 percent, below the estimated natural rate of 4.45 percent. Employment grew modestly in recent weeks, but contacts in most Districts reported that demand for additional workers remained strong, with payroll growth constrained by persistent labor shortages. Tightness in the labor market drove robust wage growth nationwide, with gains among low-skill workers described as particularly strong and compensation growth reported as well above historical averages across industries, demographics, and geographies; the Employment Cost Index reading was 146.6. On prices, most Districts reported solid growth in prices charged to customers, though some noted that increases had decelerated somewhat from the robust pace of recent months. Core PCE inflation was 4.12 percent on a year-over-year basis, more than double the 2 percent objective. M2 stood at \$21,436.7 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions remained broadly accommodative and orderly over the period. The financial stress index registered 0.1161, a low reading that gave little indication of systemic strain. Credit markets appeared calm: the Baa corporate spread was 1.78, a historically moderate level that showed no sign of distress. The VIX stood at 23.85, modestly elevated and consistent with Omicron-related nervousness rather than acute market stress. The 10-year/2-year Treasury spread was positive at 0.79, flattening somewhat but not inverted, and thus carrying no recession signal. The spread of the 3-month Treasury bill over the current target range was only 0.045, suggesting that markets anticipated tightening in the near term but had not fully priced a move at this specific meeting.

STAFF ECONOMIC OUTLOOK

The staff outlook pointed toward continued firm activity alongside persistent inflation pressure. The estimated neutral real rate (r^*) of -0.458 implied a low neutral level, but even against that backdrop the current target range of 0.0 to 0.25 percent appeared substantially below where standard prescriptions would place policy. Inflation momentum was positive at 0.33, indicating that price pressures were still building rather than fading, while unemployment momentum at -0.5 indicated that joblessness was continuing to decline from an already-tight level. Taken together, these dynamics suggested that, absent policy adjustment, the economy would move further beyond full employment while inflation remained elevated.

The staff's reference rules reinforced this reading. The Taylor rule, Balanced Approach rule, First-Difference rule, and ELB-adjusted rule each prescribed 75 basis points, and the rules were judged reliable this meeting. The convergence of prescriptions built on differing logics — including one that explicitly accounts for proximity to the effective lower bound — implied that the gap between the prevailing stance and a level consistent with the two-sided mandate was sizable and not an artifact of any single model's weighting. The projection thus implied a meaningful degree of accommodation still in place relative to what the underlying inflation and employment configuration would warrant.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their opening assessments, participants agreed almost without exception that the substance of the data pointed toward tightening. Core PCE inflation at 4.12 percent, more than double the objective, was cited as a dominant concern, and the labor market at 3.9 percent unemployment — below the 4.45 percent natural rate — was judged effectively at maximum employment. One participant focused on inflation risk observed that the Beige Book confirmed broad-based, robust wage growth and persistent labor shortages, describing these as clear overheating signals. A participant attentive to employment risk noted that, scanning the data for any sign of labor deterioration that would justify accommodation, none was present: jobless claims at 230,000 were low, demand for workers remained strong, and the



risk now ran toward overheating rather than weakness.

Despite this shared reading of the fundamentals, participants' initial predictive positions converged on holding the target range at 0.0 to 0.25 percent this meeting. The decisive consideration was procedural. Several participants emphasized that the committee's stated framework sequenced the winding-down of asset purchases ahead of the first rate increase, and that purchases were still being wound down. A participant weighing financial stability judged that a move now, while purchases continued, would represent an abrupt, out-of-sequence tightening that risked disorderly repricing — the kind of disruption that participant weighted heavily against. A participant focused on market signals reinforced this, noting that the 3-month Treasury bill spread of only 0.045 implied markets expected liftoff imminently but had not priced a hike at this particular meeting. In the rebuttal round, the participant most inclined toward employment concerns revised an earlier lean toward a small hike to a hold, persuaded that there was no employment cost to waiting and that an orderly, sequenced path was preferable. Even the most inflation-focused participant, while acknowledging the case was close, concluded that acting ahead of the purchase conclusion would break the committee's own timeline without a compelling stability reason. The predictive vote was unanimous to hold.

The discussion then turned to the framework's loss-minimizing recommendation of 75 basis points, supported by the convergence of all four reference rules judged reliable this meeting. Here participants largely set aside sequencing and reasoned from the data directly. The participant focused on inflation found the Taylor rule's logic most persuasive, arguing that 4.12 percent core PCE mechanically drove the prescription and that holding at the floor risked letting inflation expectations un-anchor. The employment-focused participant, examining the Balanced Approach rule as the closest match to a dual-mandate lens, concluded that with the employment gap now adding to rather than subtracting from the case, accommodation no longer served workers and instead fueled a wage-price dynamic that would erode real earnings. The centrist, reading the data at face value, characterized the situation as a two-sided mandate breach paired with unanimous, reliable rules, and endorsed 75 basis points as the literal correct call. Each of these participants framed the divergence between the predictive hold and the framework's recommendation as evidence that the current stance was substantially behind where the rules placed it — a gap reflecting institutional and communication caution rather than an economic case against acting.

Two participants agreed with the direction but not the magnitude. The participant attentive to financial stability accepted that benign credit conditions — the stress index at 0.1161, the Baa spread at 1.78, a positive yield curve — permitted normalization, and that 0.0 to 0.25 percent was too easy for the conditions at hand. But that participant judged a 75 basis point step, taken at once and unpriced by



short rates, to be inconsistent with a smooth glide, warning that an abrupt move risked precisely the disorderly repricing the participant's mandate sought to avoid; a smaller initial step was preferred. The participant focused on market signals reasoned along parallel lines, stressing that the 4.5 basis point Treasury bill spread showed markets had priced gradualism, not a jump from the floor, and that overriding market pricing wholesale inverted that participant's priority ordering. Both affirmed the tightening direction while declining to endorse the full magnitude at this meeting.

COMMITTEE POLICY ACTIONS

On the predictive question of what action to take at this meeting, the Committee voted unanimously, 5 to 0, to maintain the target range for the federal funds rate at 0.0 to 0.25 percent, reflecting the shared judgment that the committee's stated sequencing called for concluding asset purchases before liftoff and that markets had not priced a move at this specific meeting. On the separate question of the framework's optimal recommendation of 75 basis points, the Committee did not reach full agreement: three participants — the inflation-focused member, the employment-focused member, and the centrist — endorsed the recommendation as-is, while two participants — the financial-stability member and the market-signal member — took a partial stance, agreeing with the direction of tightening but not the magnitude or timing of a single 75 basis point move. No participant declined the recommendation's direction outright.