



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$7,960.9 billion as of January 25, 2023, the most recent release available on or before the point-in-time-safe cutoff. Holdings comprised \$4,645.4 billion in Treasury notes and bonds, \$286.2 billion in Treasury bills, and \$2,616.3 billion in agency mortgage-backed securities. The portfolio declined by \$16.2 billion from the prior release dated January 18, 2023. It should be noted that these figures cover SOMA securities holdings only — total size, composition, and week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists; accordingly, no representation is made here regarding those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that measured inflation remained elevated, with core PCE prices up 3.63 percent from a year earlier, still well above the Committee's 2 percent objective though moderating from the pace of recent quarters. Labor market conditions stayed very tight. The unemployment rate held at 3.5 percent, below the estimated natural rate of 4.43 percent, and initial jobless claims were low at 190,000, showing no sign of a pickup in layoffs. The Employment Cost Index stood at 154.0. The Chicago Fed National Activity Index registered -0.05, indicating growth slightly below its historical trend. M2 money supply was reported at \$21,207.4 billion.

The Beige Book characterized overall economic activity as relatively unchanged since the previous report, with five Districts noting slight or modest increases, six reporting no change or slight declines, and one citing a significant decline; on balance, contacts expected little growth in the months ahead. Consumer spending rose slightly, aided by some stronger holiday sales, though several retailers observed that high inflation continued to erode purchasing power, particularly for low- and moderate-income households. Housing markets continued to weaken, with sales and construction declining across Districts, and residential mortgage demand remained weak; some bankers reported that higher borrowing costs had begun to dampen commercial lending. Manufacturing activity declined modestly on average, while contacts in many Districts reported that supply chain disruptions had eased. Employment continued to grow at a modest to moderate pace, and firms often reported reluctance to lay off workers, preferring to reduce headcount through attrition if needed. Wage pressures remained elevated across Districts, though five Reserve Banks reported some easing. Selling prices increased at a modest or moderate pace in most Districts, with many contacts noting that the pace had slowed, and manufacturers reporting continued easing in freight costs and in prices for commodities including steel and lumber.

STAFF REVIEW OF THE FINANCIAL SITUATION



The staff reported that financial conditions remained broadly calm. The financial stress index stood at 0.189, a low reading, and the VIX at 19.08 indicated moderate rather than elevated market volatility. The Baa corporate spread of 1.94 percentage points pointed to contained credit conditions, with no evident signs of borrowing-cost distress. The 3-month Treasury bill yielded roughly 0.195 percentage point above the current target range, consistent with market expectations of a further modest firming of policy. The 10-year/2-year Treasury yield curve spread was deeply inverted at -0.65 percentage point, a configuration the staff flagged as a recession-risk signal warranting attention even amid otherwise orderly conditions.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the reference-rule framework and the real forward-looking quantities available. The estimated neutral rate (r^*) used in the assessment was -0.5 percent, a notably low value that shaped the level-based rule outputs. On that basis, the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each recommended a reduction of 75 basis points, reflecting the interpretation that the current 4.25 to 4.50 percent range already stands well above a low neutral rate. In contrast, the First-Difference rule, which keys off the inflation gap and momentum without relying on a precise neutral-rate estimate, recommended an increase of 75 basis points. The loss-minimizing output of the framework reconciled this divergence to an increase of 25 basis points, and the reference rules were flagged as reliable.

Momentum measures pointed to a gradual, rather than abrupt, evolution of conditions. Inflation momentum was slightly negative at -0.055, consistent with the Beige Book's reports of decelerating selling-price increases and easing freight and commodity costs, implying that price pressures are beginning to ebb even as their level remains well above target. Unemployment momentum was 0.0, indicating no opening of labor-market slack and reinforcing the view that the labor market has not yet begun to loosen. Taken together, these quantities suggest a likely path in which policy continues to firm modestly while disinflation proceeds slowly and employment holds up — the wide gap between the level rules and the change-based rule underscoring genuine uncertainty about where the neutral rate truly lies and, by extension, about how restrictive current policy already is.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, all five participants converged on an increase of 25 basis points, to a range of 4.50 to 4.75 percent, though they arrived there from distinct starting points. The participant most focused on inflation risk emphasized that core PCE at 3.63 percent remains nearly double the 2 percent objective, a fact that in this participant's view rules out any pause or cut; the prior meeting's guidance that 'ongoing increases' would be appropriate, together with the Committee's last projected



path of 5.1 percent above the current range, was read as implying that further firming lies ahead. This participant nonetheless judged that the disinflation signals in the Beige Book — slower selling-price increases, easing freight and commodity costs, some moderation in wage pressures — argued for a measured step rather than a reacceleration of the pace.

The participant attentive to labor-market risk framed the question around whether the conditions justifying easing were present, and concluded they were not: unemployment at 3.5 percent sits well below the 4.43 percent natural rate, jobless claims at 190,000 are extremely low, and the Beige Book confirmed that firms continued to grow employment and hesitated to lay off workers. Absent rising unemployment or slowing job growth, this participant saw no basis to cut, but pointed to flat activity, weakening housing, the inverted 2s10s curve, and below-trend activity as reasons to slow the pace of tightening rather than halt it. The participant weighing financial stability found benign conditions across the stress index, the VIX, and the Baa spread, and judged that no acute distress required a pause; the deeply inverted yield curve was singled out as a recession-risk signal counseling against a larger 50 basis point move that might tighten conditions disorderly. The data-dependent participant read the same combination — above-target inflation and a tight labor market on one side, easing price and wage pressures and calm markets on the other — as the most literal case for a smaller, continued hike. The participant weighting market signals emphasized that the 3-month bill sitting roughly 0.195 percentage point above the current range implied that one 25 basis point move was already fully priced, so that a larger step would overshoot market expectations while a pause would conflict with above-target inflation and prior guidance.

In the rebuttal round, no participant was moved off the 25 basis point position; several noted that the convergence of distinct lenses reinforced rather than merely coincided with their own reading. The inflation-focused participant retained a hawkish tilt, cautioning against any framing that this move marked the end of tightening given inflation persistence. The labor-focused participant reiterated that its dovish trigger was not activated and that it would break toward easing only on evidence of rising unemployment. The financial-stability participant found the market participant's front-end reading persuasive as confirmation that a small step could be absorbed without disorderly repricing.

The optimal-framework discussion sharpened the reasoning around the reference rules. Participants took seriously that the Taylor, Balanced Approach, and ELB-adjusted rules all pointed to a 75 basis point cut, but generally discounted those signals as resting on an implausibly low estimated neutral rate of -0.5 percent — a value that, in their judgment, understates how restrictive policy needs to be with core inflation near 3.63 percent. The First-Difference rule's call for a 75 basis point increase was seen as capturing the correct direction of travel while overshooting the appropriate magnitude, given that



inflation momentum had turned slightly negative at -0.055 and the Beige Book documented decelerating prices and some wage-pressure easing in five Districts. Participants described the framework's 25 basis point output as a middle path between the level rules and the change rule, and several observed that the agreement between the framework and their own predictive votes suggested that the current stance is approaching, but has not yet clearly reached, restrictive-enough territory. The wide divergence within the rules was read as a marker of genuine uncertainty about the neutral rate, making a modest, humble increment the prudent choice.

Across both the predictive and optimal-framework rounds, a common thread emerged: with credit and financial conditions orderly, with the labor market showing no slack, and with disinflation only beginning, participants judged that the appropriate posture was to slow the pace of tightening while continuing to move policy toward the projected path, watching cumulative lags and any subsequent softening in employment or prices before contemplating a pause or eventual easing.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported raising the target range for the federal funds rate by 25 basis points, to 4.50 to 4.75 percent, a unanimous 5-to-0 outcome. On the deterministic framework's recommendation of a 25 basis point increase, the Committee's recorded stance was likewise full agreement: all five members endorsed the recommendation as-is, with none declining and none registering partial agreement. The inflation hawk, the labor-market dove, the financial-stability voice, the data-dependent centrist, and the market-signal realist each recorded an endorsement, so that the predictive and optimal-side outcomes coincided in support of a 25 basis point increase.