



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings totaled \$7,041.8 billion as of the January 24 release. The portfolio remained concentrated in Treasury notes and bonds, which stood at \$4,026.7 billion, alongside \$212.2 billion in Treasury bills and \$2,420.4 billion in agency mortgage-backed securities. Holdings declined by \$4.6 billion relative to the prior release of January 17, a modest week-over-week reduction. It should be noted that this review covers SOMA securities holdings only — total size, composition, and the change from the prior release. It does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source currently exists; the staff accordingly offered no characterization of those operations.

STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation stood at 2.24 percent on a twelve-month basis, above the Committee's 2 percent objective but reflecting continued progress. The labor market remained tight: the unemployment rate was 3.7 percent, well below the estimated natural rate of 4.42 percent, and initial jobless claims were very low at 187,000. The Employment Cost Index registered 160.7, and the Chicago Fed National Activity Index came in at 0.03, consistent with growth running close to trend. M2 money supply was reported at \$20,865.2 billion. The Committee's own most recent projected fed funds rate of 4.6 percent sat below the current target range of 5.25 to 5.50 percent.

The Beige Book described economic activity as down slightly, with employment stable and wage growth moderate. Reports across Districts pointed to cooling but still-solid labor conditions and easing wage pressures. Manufacturers generally reported weaker sales while remaining cautiously optimistic for 2024, and manufacturing activity contracted sharply in some Districts. Consumer spending was mixed to modestly higher, supported in places by a strong holiday season, though some Districts noted consumers pushing back on higher prices and leaning more on 'buy now, pay later' payment options. Home sales stayed in the doldrums, with contacts expressing optimism about a rebound pending lower mortgage rates. A recurring theme was widespread concern about the high cost and reduced availability of credit affecting households and businesses. Price pressures moderated further, rising at a slight-to-modest pace, though upward pressure persisted in certain industries.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were benign at the aggregate level. The financial stress index stood at 0.1281, a low reading, and the VIX was 13.14, indicating calm and, by some readings, complacent equity-market conditions. The Baa corporate spread was 1.62, a relatively tight level suggesting credit markets were not pricing distress. At the same time, the yield curve remained inverted, with the 10-year/2-year



spread at -0.16, and the 3-month T-bill yielded 0.165 below the current policy rate. Both signals were read by the staff as consistent with market expectations of eventual policy easing and with a policy stance perceived as restrictive relative to a lower neutral rate. Taken together, the market-level indicators showed no acute stress even as the Beige Book pointed to ground-level credit strain not yet visible in aggregate spreads.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff pointed toward a policy stance that was restrictive relative to neutral. The estimated neutral real rate (r^*) of -0.5 percent implied a neutral nominal rate in the neighborhood of 1.5 percent, against a current real policy rate on the order of 3 percent given core PCE near 2.24 percent. On this measure, the prevailing target range of 5.25 to 5.50 percent would exert meaningful restraint on activity if maintained. Inflation momentum was negative at -0.21, indicating that price pressures were continuing to abate rather than merely pausing, while unemployment momentum was slightly positive at 0.05, consistent with the gradual labor-market cooling reported in the Beige Book but not with any sharp deterioration.

The reference rules spanned a wide range. The Taylor rule prescribed 50 basis points and the Balanced Approach and ELB-adjusted rules each pointed to 75 basis points above the current setting — outputs that primarily reflected the sizable gap between unemployment and its estimated natural rate. The First-Difference rule, which responds to changes rather than levels, prescribed no change. With the reference rules judged reliable this meeting, the loss-minimizing calculation, weighing the deeply restrictive stance implied by low r^* against modestly above-target inflation and its negative momentum, netted to a recommendation of -25 basis points. The implication was that, holding the range steady while disinflation continued would passively tighten real rates further, and that a measured first step toward neutral would reduce accumulated over-restriction without abandoning the inflation objective.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their opening assessments, all five participants independently favored holding the target range at 5.25 to 5.50 percent at this meeting. Participants generally judged that core PCE at 2.24 percent, while reflecting genuine progress, remained above the 2 percent objective, and that the prior meeting's emphasis on wanting more evidence that inflation was sustainably abating had not been satisfied by the single week of new data since. A participant weighting inflation risk most heavily stressed that premature easing was the primary risk to avoid, noting that unemployment at 3.7 percent stood well below the 4.42 percent natural rate and that jobless claims at 187,000 signaled a labor market still tight rather than one in distress.



The participant most attentive to employment made the strongest case for eventual easing, citing the Beige Book's repeated references to cooling labor demand, easing wage pressures, sharp manufacturing contraction in some Districts, and widespread credit-availability strain, together with the inverted 2-year/10-year spread as a recession-risk signal. That participant nonetheless concluded that a January move would be premature, observing that the feared labor damage was prospective rather than realized — unemployment had not risen — and characterized their own trigger for cutting as unemployment rising or job growth clearly slowing. A participant focused on financial stability observed that the low stress index of 0.1281, calm VIX of 13.14, and tight Baa spread of 1.62 showed no systemic distress that would compel a defensive cut, while the Beige Book's credit-availability concerns argued against any further tightening. A participant weighting market pricing read the negative T-bill and yield-curve spreads as anticipation of easing at future meetings rather than a demand for immediate action, and a data-focused participant offered the most literal consensus reading: inflation still above target and solid labor argued for holding, while softening activity ruled out a hike. On rebuttal, no participant was moved off the hold, and the predictive discussion closed with all five aligned.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, participants engaged directly with the divergence between that recommendation and their predictive holds. Several found the case for a measured cut more compelling than their forecast votes had suggested. The employment-focused participant endorsed the cut as a preemptive, insurance-style step that would front-run the labor softening evident in the Beige Book while keeping policy well above neutral, arguing that waiting for unemployment to actually rise risked being late. The financial-stability participant likewise endorsed it, reasoning that the transmission of a 5.25 to 5.50 percent stance was biting credit availability more than aggregate spreads revealed, and that holding while disinflation continued would passively tighten real rates and worsen the credit strain — with home-sales optimism explicitly hinging on lower mortgage rates. The market-signal participant endorsed the cut as well, noting that the -0.165 T-bill spread amounted to markets forecasting precisely a roughly 25 basis point adjustment, that the 75 basis point rules would overshoot what pricing and near-target inflation justified, and that contained credit spreads meant a small cut carried little instability risk.

Two participants resisted the recommendation in whole or in part. The inflation-focused participant declined, cautioning that the case for a cut rested heavily on r^* at -0.5, an unobservable and uncertain estimate, while realized inflation remained above target and inflation momentum, though negative at -0.21, could stall. That participant emphasized that two of the reference rules actually pointed toward more restriction, that tight labor combined with above-target inflation was precisely the condition in which premature cuts risk re-accelerating prices, and that market pricing reflected expectation rather than prudence — preferring to see inflation reach target before easing. The data-focused participant



took a partial stance, accepting that the easing direction was defensible given low r^* and the softening in the Beige Book, but treating magnitude and timing as the sticking point; with three of four rules leaning restrictive and realized labor data not yet deteriorated, that participant preferred to wait for further disinflation confirmation before the first cut.

Across both strands of the deliberation, a common thread emerged: participants broadly agreed that the current stance was restrictive relative to a low estimated neutral rate and that the eventual direction of policy was toward easing, but they differed on whether the evidence justified acting now. The disagreement was less about the diagnosis of restrictiveness than about the weight to place on realized versus prospective conditions — inflation still 24 basis points above target and labor still tight on the one hand, against negative inflation momentum, cooling labor demand, and ground-level credit strain on the other.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy decision for this meeting, all five participants supported maintaining the target range for the federal funds rate at 5.25 to 5.50 percent, a unanimous 5-0 outcome. On the separate question of the framework's -25 basis point recommendation, the Committee did not reach full agreement: three participants — those focused on employment, financial stability, and market signals — endorsed the recommendation as-is; one participant, focused on inflation, declined to support it, judging a cut premature with inflation still above target; and one participant, the data-focused member, took a partial stance, agreeing with the easing direction but not with the magnitude or timing at this meeting.