



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$6,187.2 billion as of the January 21, 2026 release, the most recent data available on or before this meeting. The portfolio's composition remained dominated by Treasury notes and bonds at \$3,587.8 billion, alongside \$258.2 billion in Treasury bills and \$2,028.1 billion in agency mortgage-backed securities. Total holdings rose by \$16.2 billion from the prior release of January 14. The staff noted that these figures cover SOMA securities holdings only — total size, composition, and the week-over-week change — and do not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available; the discussion of open market operations was therefore limited to the securities portfolio itself.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 1.9 percent on a twelve-month basis, slightly below the Committee's 2.0 percent objective. The unemployment rate was 4.4 percent, modestly above the estimated natural rate of 4.31 percent, while initial jobless claims remained low at 198,000. The Chicago Fed National Activity Index registered -0.21, consistent with somewhat below-trend growth. The Employment Cost Index was reported at 172.745. The current target range for the federal funds rate was 3.50 to 3.75 percent, above the last median projection of 3.4 percent from the Committee's own reference set.

The most recent Beige Book indicated that economic activity increased at a slight to modest pace in eight of the twelve Districts, with three reporting no change and one a modest decline — an improvement over the prior three report cycles, in which a majority of Districts had reported little change. Consumer spending grew slightly to modestly, largely tied to the holiday shopping season, though several Districts noted stronger spending among higher-income consumers on luxury goods, travel, and experiential activities, while lower- and moderate-income consumers were described as increasingly price sensitive. Auto sales were little changed to down, and manufacturing was mixed, with five Districts reporting growth and six contraction. On the labor side, employment was mostly unchanged, with eight Districts reporting no change in hiring; when firms hired, it was mostly to backfill vacancies rather than to add positions. Multiple Districts noted greater use of temporary workers, with one contact describing this as a way 'to stay flexible in uncertain times,' and several reports mentioned fewer workers switching jobs. Wages grew at a moderate pace, and banking conditions were generally stable or improving, with some pickup in credit card, home equity, and commercial lending demand. Residential real estate softened in most reporting Districts.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were broadly characterized as calm. The financial stress index stood at 0.1282, a low reading, and the VIX at 16.9 pointed to benign equity volatility. The Baa corporate spread of 1.65 percentage points was tight, consistent with healthy credit conditions and no evident borrowing-cost strain. The 10-year/2-year Treasury yield curve spread was positive at 0.66, indicating that the earlier inversion had resolved and that the curve was no longer flashing an imminent-recession signal. The 3-month Treasury bill spread relative to the current policy rate was slightly negative at -0.035, suggesting that markets saw little urgency for a near-term policy move and viewed the current stance as roughly appropriate.

STAFF ECONOMIC OUTLOOK

The staff's outlook drew on the available forward-looking quantities. With the estimated neutral rate (r^*) at 0.285 percent, a nominal neutral rate of roughly 2.3 percent was implied when combined with inflation near 1.9 percent — placing the current 3.50 to 3.75 percent target range modestly above neutral and therefore still somewhat restrictive. Inflation momentum was negative at -0.215, pointing to continued disinflation rather than building price pressure, while unemployment momentum was only marginally positive at 0.05, consistent with gradual rather than sharp labor-market softening.

The reference rules spanned a notable range. The Taylor rule pointed to -75 basis points and the Balanced Approach rule to -50 basis points, both leaning substantially toward easing as they weighed the small unemployment gap and the negative inflation gap. The ELB-adjusted rule likewise indicated -50 basis points, while the First-Difference rule, which responds to momentum rather than level gaps, indicated no change. The deterministic policy engine, which judged the reference rules reliable in the current configuration, blended these into a recommended -25 basis points. Taken together, these figures implied a policy path drifting gradually toward neutral, with the central tension being one of timing and magnitude of the next step rather than direction.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, four of the five participants favored holding the target range at 3.50 to 3.75 percent, with one favoring a 25 basis point reduction. Participants generally observed that core PCE inflation at 1.9 percent had eased to slightly below the 2.0 percent objective, that the unemployment rate at 4.4 percent stood only marginally above the 4.31 percent natural rate, and that financial conditions were calm across the board — a low stress index, moderate volatility, tight credit spreads, and a positively sloped yield curve. Several participants drew on the near-zero 3-month Treasury bill spread of -0.035 to argue that markets were not demanding an aggressive near-term cut and viewed the current stance as roughly neutral.



The participant most focused on inflation risk emphasized that, while the disinflation to 1.9 percent had genuinely eased his primary concern, the Beige Book continued to flag tariff-driven input cost pressures as a lurking upside risk. From that seat, cutting again with those pressures still live risked eroding credibility and reigniting price gains; he preferred to hold one meeting and confirm that the disinflation was durable, noting that the current range sits above the 3.4 percent reference median and that wages were still growing at a moderate pace. The participant attentive to financial stability made a parallel case: easing is warranted when financial conditions or emerging credit stress demand it, and neither was present. With banking conditions stable to improving and credit demand picking up in credit cards, home equity, and commercial lending, he judged that a cut into already-calm markets would add no stability benefit while reducing optionality. The data-dependent participant and the market-signal participant reached similar conclusions from their respective vantage points, the former stressing that the prior meeting had already delivered a cut and that no fresh deterioration compelled a back-to-back move, the latter stressing that market pricing corroborated a gradual path rather than front-loaded easing.

The participant weighting employment most heavily dissented, favoring a 25 basis point reduction. In his reading, unemployment above the natural rate, together with a Beige Book showing employment mostly unchanged, hiring confined to backfilling vacancies, fewer job switchers, and greater reliance on temporary workers 'to stay flexible in uncertain times,' described precisely the kind of gradual softening that warrants a pre-emptive response. With inflation at or below target and the CFNAI at -0.21 signaling below-trend activity, he argued that keeping policy modestly restrictive risked unnecessary employment damage, and that the absence of an acute crisis was not itself a reason to hold. He characterized a measured quarter-point step — not fifty — as consistent with an orderly, data-dependent path toward the reference median, and acknowledged he was likely in the minority.

When the discussion turned to the framework's loss-minimizing recommendation of -25 basis points, participants engaged directly with the reference-rule dispersion and the estimated neutral rate. Most agreed that the r^* estimate of 0.285 percent implied the current range was modestly restrictive relative to neutral, giving genuine room for a small adjustment, and that inflation momentum of -0.215 supported drift toward easing. The employment-focused participant endorsed the -25 basis point call outright, finding the Taylor and Balanced Approach rules most persuasive as insurance against the very downside the prior meeting had cited. The inflation-focused participant declined, reasoning that those rules overweighted a small unemployment gap and that the First-Difference rule's zero reading better matched an environment lacking any clear shock. The remaining three participants landed on a partial view: they accepted that the direction of drift was toward easing and that the r^* gap was the honest case for -25, but judged the magnitude or timing not yet compelled this meeting given calm markets,



low jobless claims at 198,000, and inflation and unemployment both near mandate.

A recurring theme across the optimal-framework discussion was that the debate was narrow — a choice between holding and a single small cut, with the stance near-neutral either way. The financial-stability participant summarized this by noting that a modest quarter-point step would not destabilize anything he monitored, even as he leaned toward patience; the data-dependent participant agreed the direction was correct while judging the move premature absent confirmation; and the market-signal participant observed that markets had largely already discounted the modest restrictiveness gap. Participants generally accepted that, whether policy held or trimmed a quarter point, the underlying assessment pointed toward a gradual approach to neutral rather than any abrupt shift.

COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy decision, the Committee's vote was to hold the target range at 3.50 to 3.75 percent, by a tally of four members favoring no change and one member favoring a 25 basis point reduction. On the separate question of the deterministic framework's recommendation of a 25 basis point cut, the Committee did not reach full agreement: one member endorsed the recommendation as stated, one member declined it, and three members offered partial agreement — accepting the easing direction implied by the below-neutral r^* estimate and negative inflation momentum, but not the magnitude or timing at this meeting. Both records reflect a near-neutral stance in which the operative disagreement was over the timing of the next small step rather than the direction of policy.