



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on System Open Market Account holdings was available on or before the cutoff for this meeting, so the Committee had no current figures on total SOMA size, its composition across security types, or any change from a prior release to review in this section. Accordingly, the customary summary of holdings could not be prepared. It should be emphasized that this limitation concerns SOMA holdings only; results of repurchase and reverse repurchase operations are a separate matter, and no point-in-time-safe source for those operation results currently exists either. The Committee's discussion of open market operations was therefore conducted without reference to updated holdings or operation data.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that the incoming data described an economy operating close to trend. The Chicago Fed National Activity Index stood at 0.07, essentially at its long-run average, indicating growth neither notably above nor below potential. The unemployment rate was 5.6 percent, slightly above the estimated natural rate of 5.34 percent, pointing to a modest degree of labor-market slack. Initial jobless claims registered 346,000, a moderate reading that the staff characterized as neither sharply deteriorating nor clearly improving. Core PCE inflation on a twelve-month basis was 2.14 percent, marginally above the 2.0 percent objective. M2 stood at \$3,755.1 billion.

The most recent Beige Book, covering commentary through November and released December 6, was available to the Committee, though the summary material at hand consisted principally of its cover and district table of contents rather than detailed narrative by District. The staff noted the twelve Federal Reserve Districts reporting, from Boston through San Francisco, but had no district-level anecdotal detail to summarize beyond the document's structure. Taken together, the quantitative indicators pointed to an economy near equilibrium: inflation slightly elevated, labor markets close to but not fully at balance, and activity roughly at trend.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were calm by every available measure. The financial stress index registered 0.0741, a very low reading consistent with unstressed conditions, and the VIX stood at 10.63, an unusually subdued level suggesting little market anxiety or fear of volatility. The Baa corporate spread was 1.77, a moderate level showing no sign of credit-market distress or widening. The 10-year/2-year Treasury spread was positive at 0.33, flat but not inverted, and thus carrying no recession warning. Of particular note for policy, the 3-month Treasury bill traded 0.5 percentage point below the current 5.75 percent funds rate, a spread the staff read as indicating that market participants anticipated some near-term



easing. In sum, the financial data described accommodative, orderly conditions with markets pricing in a modest cut while displaying no distress that would compel action.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment drew on the estimated neutral rate and on the momentum in the two key gaps. The estimate of r^* underlying the reference rules was 2.654 percent, which, when combined with the small gaps in inflation and unemployment, implied that the current 5.75 percent stance sat somewhat above a level-based reading of neutral. This tension was visible in the reference-rule outputs: the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each pointed to a reduction on the order of 75 basis points, reflecting the combination of a lower neutral rate with modest slack and near-target inflation. The First-Difference rule, by contrast, recommended no change, because it responds to the pace of change in conditions rather than to the level of the gaps.

The momentum figures help explain why these rule families diverged. Inflation momentum was slightly negative at -0.065 and unemployment momentum was -0.1 , both small and close to neutral, indicating that conditions were drifting gently rather than deteriorating or accelerating. On this reading, the level-based rules capture a stance that is modestly restrictive relative to neutral, while the difference-based logic suggests little is changing that would demand a rapid response. The deterministic policy engine, judging the reference rules reliable, nonetheless returned a loss-minimizing recommendation of 0 basis points, effectively weighting the stability implied by benign momentum against the larger cuts implied by the level gaps. The projection that emerges is one of conditions likely to remain near equilibrium in the near term, with the principal open question being how quickly, if at all, the modest slack and cooling inflation would resolve the gap between the level rules and current policy.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive positions, four of the five participants favored a 25 basis point cut, while one favored holding the funds rate at 5.75 percent. The participant emphasizing inflation risk grounded a hold in core PCE remaining above the 2.0 percent objective, arguing that a small overshoot is still an overshoot and that easing before inflation is anchored risks re-igniting price pressures. This participant read the labor-market slack as real but thin — a gap of roughly a quarter point against the natural rate — and read the calm in financial markets, with the stress index at 0.0741 and the VIX at 10.63, as describing complacent, easy conditions that argued against adding accommodation rather than for it.

The four participants leaning toward a cut arrived there by distinct routes. The participant focused on employment weighted the unemployment rate above the natural rate and the moderately elevated



jobless claims as signs of a softening labor market, contending that waiting for inflation to reach exactly 2.0 percent would risk unnecessary deterioration in jobs. The participant attentive to financial stability observed that while no crisis compelled a cut, no stress argued for holding restrictive policy either, and reasoned that a hold would be the more destabilizing move relative to what a complacent, low-volatility market had already priced. The market-signal participant treated the 3-month bill trading 0.5 point below the funds rate as the clearest single signal that a 25 basis point cut was expected, and the data-dependent participant endorsed the same move as the literal consensus reading of an economy near equilibrium. In the rebuttal round, positions held firm: the inflation-focused participant acknowledged being outnumbered four to one but was not persuaded that market expectation constituted a mandate, while the others reinforced one another's convergence on a measured, non-aggressive cut. No participant saw a case for a 50 basis point move.

When the discussion turned to the deterministic framework's loss-minimizing recommendation of 0 basis points, participants engaged closely with why that output diverged from the level-based rules calling for 75 basis points of easing. There was broad agreement across the committee that the First-Difference rule's logic best fit present conditions, because inflation momentum of -0.065 and unemployment momentum of -0.1 were both small and near-neutral, giving little that demanded a rapid response. The inflation-focused participant found the framework's hold aligned precisely with a preference to guard against premature accommodation, noting that the Taylor-family rules over-weight small gaps and that cutting 75 basis points into calm markets with above-target inflation would risk credibility. The financial-stability participant likewise endorsed the hold, cautioning that a large cut into placid markets could fuel excess and destabilize the very calm being prized.

The three participants who accepted the direction of the framework's recommendation but not a full hold did so from their respective priorities. The employment-focused participant argued that calm markets do not erase the persistent level of labor-market slack, that the level rules correctly flagged restrictiveness, and that a modest 25 basis point step would protect jobs prudently while a full 75 basis point cut would over-ease into stable conditions. The data-dependent participant characterized the truth as policy that was only mildly tight — level rules signaling restriction, the difference rule signaling stability — and favored a small insurance step over a pure hold. The market-signal participant maintained that the framework's zero ignored the genuine near-term easing signal in the -0.5 bill spread, while conceding that the absence of distress, positive yield curve, and near-trend growth ruled out any aggressive action. Across both the predictive and optimal-framework discussions, the committee's center of gravity settled on the view that policy was close to appropriate and drifting gently, with the live disagreement concerning whether a small easing step was warranted now or whether patience better fit benign momentum and calm conditions.



COMMITTEE POLICY ACTIONS

On the predictive question of the appropriate policy action at this meeting, the Committee's vote was for a 25 basis point cut, by a tally of four members in favor and one member preferring no change, the dissent reflecting the concern that easing with core PCE above the 2.0 percent objective risked inflation credibility. On the separate question of the deterministic framework's recommendation to hold the funds rate unchanged at 0 basis points of change, the Committee did not divide on direction but on magnitude: two members — the participant emphasizing inflation risk and the participant attentive to financial stability — endorsed the recommendation as-is, while three members — the employment-focused participant, the data-dependent participant, and the market-signal participant — offered partial agreement, supporting the cautious direction against an aggressive cut but judging a modest 25 basis point easing more appropriate than a full hold. No member declined the recommendation's direction outright.