



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No point-in-time-safe data on the System Open Market Account's holdings was available as of the cutoff for this meeting, so the Committee was unable to review the total size, composition, or change from the prior release of the SOMA portfolio. The staff noted that this gap concerns SOMA holdings only. It does not reflect on repurchase or reverse repurchase operation results, for which no point-in-time-safe data source currently exists either; accordingly, no summary of open market operation outcomes could be presented at this meeting.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that the economy continued to expand, though with signs of moderation in several sectors. Core PCE inflation stood at 1.35 percent on a twelve-month basis, well below the 2.0 percent target. The unemployment rate was 4.4 percent, below the estimated natural rate of 5.16 percent, indicating a labor market that remained tight. Initial jobless claims were 305,000, a low level consistent with continued firmness in hiring, and the Chicago Fed National Activity Index at 0.25 pointed to above-trend growth. M2 stood at \$4,376 billion.

The most recent Beige Book, prepared before the start of December, indicated that all twelve District economies continued to expand in November despite contraction in export industries. The pace of expansion slowed in five Districts, was unchanged in four, and strengthened in one. Consumer spending rose, though several Districts described sales as weaker than expected. Manufacturing activity was generally softer, largely on account of output declines in export-related industries, and several Districts noted that some manufacturers anticipated further reductions in output. Construction activity increased overall, with stronger consumer confidence and lower interest rates supporting homebuilding, refinancing, and a rebound in commercial construction in some areas. Loan demand was strong in most Districts, but bankers reported generally tightened credit standards. Labor markets remained tight in nearly all Districts, although reports suggested that wage pressures had subsided somewhat, and prices of goods were reported to be steady or falling in nearly all Districts.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as elevated but not acutely deteriorating. The VIX stood at 29.42, indicating continued market volatility, and the financial stress index registered 0.2535, a meaningfully tight reading though not a spiking one. The Baa corporate spread was 2.6, consistent with pressured credit conditions and the tightened lending standards reported in the Beige Book. The 10-year to 2-year yield curve spread was positive but flat at 0.15, showing no acute recession signal from the term structure. The 3-month Treasury bill traded 37 basis points below the current federal



funds rate of 4.75 percent, a spread the staff noted was closely aligned with market pricing of one additional easing step.

STAFF ECONOMIC OUTLOOK

The staff outlook pointed to a stabilizing economy in which policy stood modestly restrictive relative to prevailing conditions. The neutral real rate used in the assessment was 3.316 percent; set against subdued inflation, this implied that the current stance left some room to ease without adding meaningful inflation risk. Inflation momentum was estimated at 0.015 and unemployment momentum at 0.05 — both weak readings that suggested little in the way of accelerating price pressure or a rapid turn in the labor market, and thus a broadly steady near-term path for the two mandate variables absent a fresh shock.

The reference rules diverged in a way the staff judged informative. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed +75 basis points, reflecting the weight those level-based specifications place on unemployment running well below the estimated natural rate. The First-Difference rule, which responds to changes in momentum rather than to level gaps, prescribed -25 basis points. With the reference rules judged reliable, the loss-minimizing recommendation from the framework was -25 basis points, indicating that the softening in growth momentum and the elevated financial stress captured by the First-Difference logic outweighed the tightness implied by the level rules given how far inflation sat below target.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, participants converged on the view that inflation posed no near-term threat and that the economy, while still expanding, showed pockets of softening. All noted that core PCE at 1.35 percent stood well below the 2.0 percent target, that the Beige Book reported wage pressures subsiding and goods prices steady or falling, and that export-related manufacturing was contracting. Against that backdrop, four of the five members opened at a hold, while one member favored a 25 basis point cut. The member weighting inflation risk most heavily observed that with price pressures absent there was no case for a hike, but also no urgency to ease preemptively while the labor market remained very tight at 4.4 percent unemployment against a 5.16 percent natural rate; that member preferred to hold and assess the effect of prior easing. The member focused on employment reached a similar conclusion by a different route, finding no deterioration in the labor data — low claims, no rising layoffs, above-trend activity on the Chicago Fed index — that would compel further easing this meeting.



The member most attentive to financial stability acknowledged genuine credit-market strain in the VIX at 29.42, the Baa spread at 2.6, and the tightened lending standards reported by bankers, but judged that stress was lingering rather than worsening acutely, that spreads had partially normalized, and that accommodation delivered earlier in the fall was still transmitting through construction and refinancing. The data-dependent member read the same facts as a stabilizing economy that had already received prior easing, with no indicator — the yield curve at +0.15 was flat but not inverted, claims were low, and the Chicago Fed index was positive — signaling an emergent recession. The dissenting member, whose framework prioritizes market-implied pricing, emphasized that the 3-month Treasury bill trading 37 basis points below the funds rate aligned almost exactly with one more 25 basis point cut being priced, and argued that validating that expectation carried no inflation cost with core PCE so far below target.

In the rebuttal exchange, positions held firm. The hold camp characterized the market-signal case as coherent but resting on market pricing rather than deterioration in the real economy, with several members framing the concern about appearing reactive as a communications point rather than a data argument. The market-signal member, in turn, maintained that market pricing efficiently aggregates available information and that the negative bill spread was a direct signal of an expected move lower, one his weighting scheme placed above the level-based readings. The predictive vote closed at four holds to one cut.

Turning to the framework's loss-minimizing recommendation of -25 basis points, participants engaged closely with the divergence between the level-based rules and the First-Difference rule. Several members found the First-Difference logic the more persuasive here, precisely because it responds to softening momentum and financial stress rather than to the low unemployment level that drove the Taylor, Balanced Approach, and ELB-adjusted rules to +75 basis points. The employment-focused member read the framework's recommendation as confirmation that policy remained a touch restrictive and that room existed to insure against building forward risks — slowing expansion in five Districts, softer manufacturing, export contraction — at essentially no inflation cost. The financial-stability member reached the same place from the credit side, judging that insurance against a financial-conditions shock was exactly what the conditions warranted and that acting now rather than waiting mid-stress had genuine appeal.

The member weighting inflation most heavily conceded the direction — no hike was warranted with inflation momentum near 0.015 and a real rate near 3.3 percent leaving room — but preferred confirmation before committing to a full 25 basis point cut, reading the divergence as evidence that policy was modestly restrictive rather than as a call to act immediately. The data-dependent member likewise accepted the easing direction as defensible while cautioning that the momentum readings of



0.015 and 0.05 were very weak signals, that three of four rules pointed to +75 basis points, and that at face value the economy was still expanding with above-trend activity and a positive yield curve — not an obvious case for cutting now. The market-signal member found nothing in the discussion to move him against a full step, holding that the negative bill spread and elevated VIX argued cleanly for the framework's -25 basis points.

COMMITTEE POLICY ACTIONS

The Committee's final predictive vote was for no change to the federal funds rate, held at 4.75 percent, by a tally of four members to one, with the single dissent favoring a 25 basis point cut. On the framework's separate loss-minimizing recommendation of -25 basis points, the Committee did not divide against the direction: three members endorsed the recommendation as-is — the members focused on employment, on financial stability, and on market signals — while two members, those weighting inflation risk and data-dependence most heavily, agreed with the easing direction but not with taking the full step at this meeting, registering partial support. No member declined the recommendation outright.