



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

No System Open Market Account holdings data was available on or before the point-in-time-safe cutoff for this meeting, and so the Committee's usual review of the total size, composition, and period-over-period change in SOMA holdings could not be conducted on the basis of confirmed figures. Accordingly, this section reports no holdings detail rather than estimated or remembered values. It should be noted that even where such data are available, this review covers SOMA holdings only and does not extend to the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source currently exists.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff review characterized the national economy as continuing to expand at a solid pace. The most recent Beige Book, prepared on the basis of information collected before November 30, reported continued moderate to strong economic growth across most Districts in October and November. Growth was described as strong in five Districts and moderate in three, with one District reporting further growth at a slower rate than earlier in the year and three Districts reporting business conditions little changed. The Chicago Fed National Activity Index stood at 0.6, consistent with above-trend growth. Consumer spending, hampered earlier in November by warmer-than-normal weather that slowed sales of winter clothing and other seasonal merchandise, picked up significantly over the Thanksgiving weekend in most Districts. Manufacturing activity continued to advance in most Districts, commercial real estate markets remained strong in most parts of the country, and home sales had slipped.

Labor markets were reported to be tight in all Districts. The unemployment rate stood at 4.1 percent, well below the estimated natural rate of 5.13 percent, and initial jobless claims were low at 272,000, showing no sign of labor-market deterioration. Despite this tightness, the pace of wage and salary increases did not appear to be accelerating generally, though there were some reports of larger recent salary increases in certain industries and regions. On prices, core PCE inflation stood at 1.44 percent on a year-over-year basis, below the 2 percent objective. The Beige Book noted that prices appeared mostly steady at the retail level and that reports from manufacturers were mixed: prices of industrial goods were mostly steady in a majority of Districts, though prices of some goods had been on the rise.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were assessed as broadly stable, though not perfectly calm heading into the year-end turn. The financial stress index registered 0.25, a moderate reading indicating no acute systemic strain. The VIX stood at 23.06, elevated but not at panic levels, a reading consistent with



year-end and Y2K-related caution rather than genuine distress. The Baa corporate spread of 1.94 pointed to contained credit conditions with borrowing costs functioning normally and no widening credit panic. The 10-year/2-year Treasury spread was slightly positive at 0.15, showing no inversion and thus no clear recession signal from the yield curve. The 3-month Treasury bill yield sat 27 basis points below the current federal funds rate of 5.5 percent, an indication that markets were not pricing near-term tightening.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities available in the policy framework. The estimated neutral rate (r^*) used in the analysis was 3.68 percent, well below the current 5.5 percent funds rate, implying that the present stance is meaningfully restrictive relative to neutral. Against a large negative unemployment gap — 4.1 percent unemployment versus a 5.13 percent natural rate — the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed a policy setting 75 basis points above the current rate, reflecting the pull of tight labor markets and above-trend activity on those specifications. The First-Difference rule, which reads change and momentum rather than the level of the gap, pointed instead to a 25 basis point reduction, reflecting subdued inflation.

The momentum measures underlying the outlook were both small: inflation momentum of 0.17 and unemployment momentum of minus 0.1, neither indicating a sharp shift in conditions in either direction. Taken together, the reference rules — judged reliable in the current environment — spanned a wide range, from plus 75 to minus 25 basis points, a dispersion that itself signaled genuinely mixed underlying pressures. The framework's loss-minimizing output balanced the aggressive tightening signals from the level-based rules against the caution embedded in the First-Difference rule and the reality of below-target inflation, landing at no change. The projection implied that, absent an acceleration in wages or prices, current conditions were likely to evolve without requiring a near-term shift in the stance.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants agreed that the economy was strong and that the labor market was notably tight, with unemployment at 4.1 percent standing far below the 5.13 percent natural rate and jobless claims low at 272,000. There was likewise broad agreement that immediate inflation pressure was contained, with core PCE at 1.44 percent below the 2 percent objective, wages not broadly accelerating, and retail prices mostly steady. The debate turned less on the reading of the data than on how much weight to place on the tight labor market as a signal of future inflation versus present price behavior as evidence of restraint.



One participant, focused on inflation risk, emphasized that tight labor markets combined with moderate-to-strong growth and above-trend activity as measured by the Chicago Fed index constituted exactly the setup that could produce future wage and price acceleration. This participant considered a preemptive tightening defensible as a hedge against overheating, and firmly ruled out any easing given the growth backdrop, but ultimately judged that the immediate inflation pressure needed to justify a hike was not yet present in the data. A participant weighting employment risk most heavily reported finding no evidence of the labor-market weakness that would ordinarily prompt support for a cut — no rising unemployment, no slowing hiring — and reasoned that with inflation below target there was likewise no case for tightening; from an employment-protection standpoint, an unnecessary hike that could eventually harm the labor market was the outcome most to be avoided.

A participant offering the case closest to a move argued initially that tight labor and above-trend growth warranted a measured 25 basis point increase to lean against overheating risk. Over the course of the discussion, however, this participant gave weight to the Beige Book's plain statement that wage and salary increases did not appear to be accelerating generally and that retail prices were mostly steady, together with the near-term liquidity considerations around the year-end turn, and concluded that the literal reading of the data favored holding. Participants attentive to financial conditions and to market pricing reinforced this conclusion: one noted that funding markets approaching the Y2K transition needed ample liquidity and no destabilizing surprises, and that a move in either direction risked disrupting orderly conditions precisely when markets were most sensitive; another observed that the 3-month Treasury bill trading 27 basis points below the funds rate and the positively sloped yield curve indicated markets were efficiently pricing a pause rather than a hike, so that moving against that consensus would inject unnecessary volatility with the VIX already at 23.

In turning to the framework's recommendation, participants engaged directly with the wide dispersion among the reference rules. Several noted that the Taylor, Balanced Approach, and ELB-adjusted rules all prescribed 75 basis points higher, driven by the large negative unemployment gap, while the First-Difference rule pointed 25 basis points lower on subdued inflation momentum of 0.17. The inflation-focused participant found the Taylor rule most persuasive in principle but read the divergence between the 75 basis point rules and the framework's no-change output as evidence that the current 5.5 percent stance was already restrictive enough to guard against inflation risk, given an r^* of 3.68 well below the funds rate. The employment-focused participant expressed wariness of driving rates up to chase a natural-rate estimate that could needlessly slow a healthy job market, and found the First-Difference logic more consistent with the small momentum readings.



Participants generally concluded that the offsetting rule signals resolved cleanly around the status quo. The centrist framing — that the tightening rules and the easing rule offset around the current rate, with financial conditions benign and no near-term recession warning from the positive yield curve — drew broad agreement. Participants judged that holding at 5.5 percent kept policy firm without an inflation justification for hiking, protected strong employment without inviting overheating, and preserved orderly financial conditions through the year-end turn, while leaving the Committee free to tighten early in the new year should wage or price pressures accelerate once the Y2K risk had passed. Several emphasized that this was a stance to watch and reassess rather than a durable neutral setting, with a clear bias toward action if the tight labor market began to feed through into faster wage growth.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate policy action, all five members supported no change to the federal funds rate, leaving it at 5.5 percent; the vote was 5 to 0 for a hold. On the framework's loss-minimizing recommendation of no change, the Committee's recorded stance was full agreement: all five members endorsed the recommendation as-is, with none declining and none registering partial agreement. The predictive judgment and the optimal-side assessment thus coincided, reflecting a shared view that the current stance was appropriately calibrated given contained inflation, a tight labor market, and the need to preserve orderly financial conditions through the year-end transition.