



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, and so the Committee is unable to report a total portfolio size, a breakdown of composition, or any change relative to a prior release. This gap should be read narrowly: it concerns SOMA holdings only. It does not speak to the results of temporary open market operations — repurchase and reverse repurchase transactions — for which no point-in-time-safe data source currently exists either. The desk's operational activity over the intermeeting period is therefore not characterized here, and any observations elsewhere in these minutes about financial conditions rest on market-price and survey data rather than on holdings figures.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed data pointing to a gradual softening in the pace of activity against a backdrop of contained consumer-price inflation. Core PCE inflation stood at 1.6 percent on a year-over-year basis, below the 2.0 percent objective. The unemployment rate was 4.0 percent, well beneath the 5.1 percent estimate of its natural rate, indicating a labor market still operating with little slack. Initial claims for unemployment insurance were 321,000. The Chicago Fed National Activity Index registered -0.27, consistent with growth running somewhat below its trend pace. The current federal funds rate was 6.5 percent, and M2 stood at \$4,875.8 billion.

The December 6 Beige Book, prepared on information collected before November 29, reinforced the picture of moderating but still-positive growth. Eight Districts — Boston, Cleveland, Richmond, Chicago, St. Louis, Kansas City, Dallas, and San Francisco — noted some slowing in the pace of expansion, while New York, Philadelphia, Atlanta, and Minneapolis reported moderate, steady growth. Automobile sales weakened broadly, but nearly all Districts described a brisk late-November pickup in general merchandise sales, with retailers cautiously optimistic about the balance of the holiday season; Cleveland was a notable exception, with retail spending characterized as soft. Manufacturing activity leveled off or slowed in a number of Districts, and construction slowed in several, though residential and commercial real estate markets were generally described as strong. Labor shortages persisted in almost all areas, with some signs of easing in Boston, Cleveland, and Atlanta. Wage growth was generally moderate, with scattered reports of acceleration, and there were widespread reports of rising costs for employee health benefits. Prices of raw materials were mixed — energy and petroleum-based inputs rose while lumber and metals fell — but prices of finished goods and manufacturers' selling prices were generally flat. Banks reported mixed-to-declining loan demand and tighter commercial lending standards.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions carried a distinctly cautionary cast. The financial stress index stood at 0.2787, a moderate reading, and the VIX at 24.88 indicated elevated equity-market volatility. The spread on Baa-rated corporate bonds over Treasuries was 2.72, a wide level signaling elevated borrowing costs for lower-quality issuers. The Treasury yield curve was inverted, with the 10-year/2-year spread at -0.18, and the 3-month Treasury bill yielded 0.61 percentage point below the current funds rate — a configuration in which markets appeared to be pricing easier policy over the coming months. Taken together with the Beige Book's reports of tighter commercial lending standards and softer loan demand, these readings suggested that some tightening in credit conditions was already occurring apart from the stance of the funds rate itself.

STAFF ECONOMIC OUTLOOK

The staff outlook emphasized that, judged against forward-looking benchmarks, the current 6.5 percent funds rate appeared meaningfully restrictive. With the estimated neutral real rate (r^*) at 3.857 percent and core inflation near 1.6 percent, the implied nominal neutral rate sat well below the prevailing funds rate, leaving the real stance of policy some distance above neutral. Inflation momentum was essentially flat at 0.015, offering little sign of an accelerating price dynamic, while unemployment momentum was mildly negative at -0.05 — soft enough to signal cooling but not yet deterioration in realized labor-market outcomes.

The reference rules spanned an unusually wide range, which itself was informative about the outlook's uncertainty. The First-Difference rule, which responds to inflation gaps and momentum rather than levels, pointed to no change. The Taylor rule indicated a modest reduction of roughly 25 basis points. The Balanced Approach and ELB-adjusted rules, both driven heavily by the wide gap between 4.0 percent unemployment and the 5.1 percent natural-rate estimate, called for materially firmer policy on the order of 75 basis points. The loss-minimizing recommendation, weighing the contained-and-flat inflation picture against slowing activity and the below-neutral signal from r^* , resolved this spread toward a 25 basis point reduction. The projection therefore was one in which realized inflation and momentum did not compel action, but the level of real rates relative to neutral, combined with accumulating downside growth signals, implied that the stance was tighter than fundamentals warranted.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants approached the decision from distinct vantage points but converged, in the predictive discussion, on a common near-term assessment: inflation posed no immediate constraint, activity was clearly softening, and yet the labor market had not visibly broken. The member most attentive to inflation risk stressed that core PCE at 1.6 percent, while below target, sat there against a backdrop of



persistent cost pressures — rising health-benefit costs, higher energy inputs, and scattered reports of wage acceleration. In this member's view the 'signs of easing' in labor shortages appeared in only a few Districts and remained scattered, so wage-push risk could not be declared extinguished; holding at 6.5 percent preserved anti-inflation credibility without any inflation breach that would demand a hike.

The employment-focused member and the member weighting market signals initially favored a 25 basis point cut. Both pointed to the inverted 2-10 spread, the 3-month bill sitting 0.61 point below the funds rate, the Chicago Fed index at -0.27, and elevated credit stress as evidence that 6.5 percent was too restrictive relative to where conditions were heading. The employment-focused member framed a modest first cut as pre-emptive insurance against labor-market damage, taken before the unemployment rate itself confirmed deterioration; claims at 321,000 and the easing of shortages in Boston, Cleveland, and Atlanta were read as early warnings. The member attentive to financial stability shared the diagnosis of accumulating stress but drew the opposite operational conclusion: with no prior easing signal given, an abrupt cut risked a disorderly repricing, cutting against the very stability that member sought to protect. That member's mandate was described as cutting both ways — a desire to relieve credit stress balanced against reluctance to shock markets with an unexpected reversal.

Over the course of the predictive rebuttal, the member weighting market pricing revised toward holding. The reasoning turned on distinguishing what markets priced over the coming months from what was priced for this specific meeting: the -0.61 bill spread reflected cumulative expected easing, not necessarily a full cut now, and delivering one that was not fully anticipated would amount to an over-move relative to aggregated expectations. The data-dependent member reached the same place by a more literal route, reading the First-Difference rule's no-change signal as the best fit for contained inflation and flat momentum, and judging the slowdown gradual rather than a collapse. The result was a predictive plurality for holding, with a single member retaining an easing lean.

When the discussion turned to the framework's loss-minimizing recommendation of a 25 basis point cut, the balance shifted. The employment-focused member, the financial-stability member, and the market-signal member all endorsed the direction, arguing that the gap between their cautious hold votes and the optimal -25 basis points revealed a stance tighter than fundamentals justified — a real funds rate near 4.9 percent against an r^* of 3.857 percent, with inflation flat and credit tightening endogenously through bank standards. Notably, even the inflation-focused member acknowledged in the optimal-framework reasoning that sub-target inflation with flat momentum meant a modest cut would not risk unanchoring prices, and that the Balanced Approach and ELB rules at 75 basis points leaned on a natural-rate assumption that overstated needed restriction.



That acknowledgment, however, did not carry the inflation-focused member all the way to endorsement in the final rebuttal. This member returned to the view that restrictiveness was acceptable insurance against latent cost-push inflation while shortages persisted and unemployment was only 4.0 percent, preferring to hold and confirm that inflation stayed contained; the timing of a cut, in this member's judgment, was premature even if the eventual direction was toward easing. The data-dependent member likewise agreed the direction was defensible given below-target inflation but resisted a move of full magnitude now, characterizing the T-bill and curve readings as indirect signals rather than realized deterioration and judging that the data did not yet force a -25 basis point step. Several members thus distinguished sharply between the correct eventual direction and the appropriate action at this particular meeting.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy action for this meeting, the Committee favored no change to the 6.5 percent federal funds rate by a tally of four to one, with the single dissenting member preferring a 25 basis point reduction. On the separate question of the framework's loss-minimizing recommendation of a 25 basis point cut, the Committee was genuinely divided: three members — the labor-market dove, the financial-stability voice, and the market-signal realist — endorsed the recommendation as-is; the inflation hawk declined to support it, judging a cut premature while cost pressures and labor tightness persisted; and the data-dependent centrist gave partial support, agreeing with the easing direction but not with the magnitude or timing at this meeting.