



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The Committee reviewed the composition and size of the System Open Market Account (SOMA) domestic securities portfolio as of December 9, 2009, the most recent release available under the point-in-time-safe cutoff. Total domestic securities holdings stood at \$1,781.2 billion, comprising \$707.6 billion in Treasury notes and bonds, \$18.4 billion in Treasury bills, and \$854.3 billion in agency mortgage-backed securities. The portfolio rose by \$3.2 billion from the prior release of December 2, a modest week-over-week change. Members noted that this review covers SOMA securities holdings only — total size, composition, and week-over-week change — and does not encompass the results of repo or reverse-repo operations, for which no confirmed point-in-time-safe data source is currently available; accordingly, the staff did not report on those operations at this meeting.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data describing an economy in the early stages of a modest recovery, with substantial slack persisting across the labor market and broader activity. The unemployment rate stood at 10.0 percent, roughly double the estimated natural rate of 5.04 percent, and initial jobless claims remained elevated at 457,000. The Chicago Fed National Activity Index registered -0.29, consistent with growth running somewhat below trend. Core PCE inflation on a year-over-year basis was 1.41 percent, below the 2.0 percent objective, and the Employment Cost Index reading of 111.1 pointed to subdued wage pressures. M2 money supply was reported at \$8,360.1 billion.

The Beige Book, prepared on the basis of information collected on or before November 20, characterized economic conditions as having generally improved modestly since the prior report. Eight Districts noted some pickup in activity, while Philadelphia, Cleveland, Richmond, and Atlanta described conditions as little changed and/or mixed. Consumer spending picked up moderately, with a number of Districts noting relatively robust used-auto sales and non-auto retailers holding lean inventories into the holiday season. Manufacturing was described as steady to moderately improving, and nonfinancial services strengthened somewhat with variation across industries. Residential real estate was somewhat improved from very low levels, led by the lower end of the market, though prices were generally flat to modestly declining and construction remained weak. In contrast, commercial real estate markets and construction were depicted as very weak and, in many cases, deteriorating. Financial institutions generally reported steady to weaker loan demand, continued tight credit standards, and steady or deteriorating loan quality. Labor market conditions remained weak, though with scattered signs of stabilization and improvement.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as improved from crisis peaks but not yet fully normalized. The financial stress index stood at 0.2844, a moderate reading well off its crisis highs, and the VIX at 22.66 was elevated relative to calm periods but did not signal acute market distress. The Baa corporate spread of 2.89 indicated that borrowing costs for lower-rated firms remained wide, pointing to lingering credit-cost stress even as spreads had compressed meaningfully from crisis levels. The 10-year/2-year Treasury yield curve spread was steeply positive at 2.69, showing no inversion and consistent with market expectations of an eventual, gradual recovery. The 3-month T-bill spread stood at -0.085 relative to the current target, with bills trading slightly below the prevailing rate — a signal that markets were pricing continuation of the current stance rather than any near-term firming.

STAFF ECONOMIC OUTLOOK

The staff outlook drew on the forward-looking quantities embedded in the policy framework. The estimated neutral real rate (r^*) used in the analysis was 1.505, and standard level-based reference rules — the Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule — each pointed to a policy rate on the order of 75 basis points, reflecting a wide unemployment gap alongside inflation running below target. The First-Difference rule, which prescribes changes from the current setting rather than a computed level, returned 0 basis points. Momentum readings were muted: inflation momentum was 0.0, indicating no upward acceleration in prices, while unemployment momentum was 0.15, suggesting labor market conditions were still drifting in the wrong direction rather than clearly improving.

Taken together, these figures imply a path in which conditions warrant a positive nominal policy rate in the abstract, but in which the binding zero lower bound and the absence of directional momentum leave little scope for near-term adjustment. The gap between the level rules at 75 basis points and the loss-minimizing recommendation of 0 basis points principally reflects the constraint of the effective floor rather than a judgment that the economy is overheating. With inflation momentum flat and unemployment momentum only modestly positive, the projection points to a period of continued below-trend activity and gradually healing credit conditions, in which the current accommodative stance would be maintained until a more durable recovery in employment and spreads takes hold.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants uniformly favored maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, and their reasoning, developed across the deliberation, converged from distinct starting points. The member most attentive to inflation risk observed that core PCE at 1.41 percent sits meaningfully below the 2.0 percent objective, that the conditions generating cost-push inflation were absent given unemployment at 10.0 percent against a 5.04 percent natural rate, and that subdued Employment Cost Index readings and elevated jobless claims confirmed a still-weak labor market. This



participant found no current price pressure to lean against and, with rates already at the floor, saw holding as the natural stance — while flagging vigilance for inflation risk should recovery prove persistent.

The member focused on the labor market emphasized that unemployment near double the natural rate, claims still at 457,000, and a Chicago Fed National Activity Index of -0.29 all argued for maximum accommodation. This participant acknowledged the mechanical constraint directly: with the target range already at the effective lower bound, no meaningful conventional cut was available, so holding at the floor represented the most accommodative feasible stance rather than a withdrawal of support. The Beige Book characterization of labor as 'weak' with only scattered improvement, together with deteriorating commercial real estate and weak loan demand, reinforced the case against any tightening.

The participant weighing financial stability grounded the discussion in the credit indicators. A financial stress index of 0.2844 and a VIX of 22.66 were read as elevated but off crisis peaks, while a Baa spread of 2.89 signaled lingering credit-cost stress for lower-grade borrowers. This member drew particular attention to commercial real estate, described in many Districts as very weak and deteriorating, and to reports of tight credit standards and deteriorating loan quality, viewing these as a live systemic vulnerability. On this view, any premature firming risked re-tightening financial conditions that were only partly repaired. The market-focused participant reinforced this reading, noting that the 3-month T-bill spread of -0.085 showed markets pricing no near-term hike and that a steep 10-year/2-year spread of 2.69 reflected expectations of eventual recovery rather than imminent short-end tightening; abrupt tightening against that pricing was seen as disruptive.

The centrist participant, reading the data at face value, judged that every principal indicator — subdued core inflation, enormous labor slack, below-trend activity, and moderate rather than crisis-level financial stress — pointed to the same literal conclusion, and that no member had advanced an argument on the merits for either a cut or a hike. When the deliberation turned to the framework's recommendation, participants engaged directly with the divergence between the level rules at 75 basis points and the loss-minimizing output of 0. Several found the First-Difference rule's 0 basis points most persuasive: with inflation momentum at 0.0 and unemployment momentum only 0.15, there was no directional impulse calling for a move, and the level rules' prescription was understood to reflect a notional target above the floor that the effective lower bound prevents chasing. Participants generally judged that the 75-basis-point rules understated the binding lower-bound constraint and, in the financial-stability member's framing, the credit-market and commercial-real-estate fragility the level rules read past.



In the rebuttal exchanges, no participant was moved to revise their emphasis, but the arguments reinforced one another: the labor and stability members took the inflation hawk's concession that slack and sub-target inflation left no case to hike as removing any argument for tightening, while the stability member found the market-pricing point sharpened confidence that a hike would shock fragile credit channels. Participants agreed that the divergence between the level rules and the 0-basis-point outcome reflected the lower bound and residual fragility asserting themselves, not a policy error, and that holding at the current range represented the appropriately calibrated, neutral-to-accommodative stance for this meeting.

COMMITTEE POLICY ACTIONS

In the predictive round, all five participants supported maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous vote of 5 to 0 for no change. On the deterministic policy engine's recommendation of 0 basis points, the Committee likewise reached full agreement: all five members — the inflation hawk, the labor market dove, the financial stability voice, the data-dependent centrist, and the market signal realist — endorsed the recommendation as-is, with none declining and none registering a partial view. The two sides of the deliberation thus aligned completely on holding steady.