



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account's domestic securities holdings stood at \$2,605.7 billion as of December 5, 2012, the most recent release on or before the point-in-time-safe cutoff. Of that total, Treasury notes and bonds accounted for \$1,569.4 billion and agency mortgage-backed securities for \$883.6 billion. Holdings rose by \$7.1 billion from the prior release of November 28, consistent with the continued reinvestment and asset-purchase activity supporting the current stance. Staff noted that these figures describe SOMA holdings only — the total size, composition, and week-over-week change — and do not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available; that dimension of open market operations is therefore not reflected in this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

Core PCE inflation was running at 1.29 percent on a year-over-year basis, well below the Committee's 2 percent objective. The labor market remained soft: the unemployment rate stood at 7.9 percent, far above the estimated natural rate of 5.4 percent, and initial jobless claims were reported at 393,000. The Chicago Fed National Activity Index at -0.56 pointed to activity running below its historical trend. The Employment Cost Index reading of 117.8 gave no indication of accelerating wage pressure, and M2 stood at \$10,221 billion. Taken together, the data described an economy expanding but with substantial slack and subdued price pressures.

The Beige Book characterized economic activity as expanding at a measured pace across the twelve Districts. Most Districts — Cleveland, Richmond, Atlanta, Chicago, Kansas City, Dallas, and San Francisco — grew at a modest pace, with St. Louis and Minneapolis somewhat stronger and Boston slower. Weakness in New York and Philadelphia was tied to disruptions from Hurricane Sandy at the end of October and into November, while the storm's effects were reported as 'mostly limited' in Boston and Richmond. Consumer spending grew at a moderate pace in most Districts, but manufacturing weakened on balance, with seven of the twelve Districts reporting slowing or outright contraction and two others giving mixed reports. Several Districts saw slight gains in residential and commercial real estate, and higher demand for home mortgage and auto loans lifted consumer lending in some areas, while small business loan demand was generally weaker to only moderately higher; credit quality improved on net. Contacts in a number of Districts voiced concern and uncertainty about the federal budget, especially the fiscal cliff, and drought conditions persisted in several agricultural Districts.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were calm and orderly across the indicators reviewed. The financial stress index at 0.072 was very low, and the VIX at 16.46 was subdued, consistent with little near-term market fear. The Baa corporate spread over Treasuries at 2.97 was moderate and did not signal acute credit stress, and credit markets appeared to be functioning normally. The 10-year/2-year Treasury spread of 1.35 was positively sloped, showing no inversion and no recession warning emanating from the yield curve. The 3-month T-bill spread of -0.025 relative to the current policy rate indicated that front-end funding markets were well anchored at the prevailing stance, with no dislocation and no market pricing of an imminent change in the target range.

STAFF ECONOMIC OUTLOOK

The forward-looking quantities available to the staff pointed to conditions that were likely to remain accommodative-appropriate at the current stance rather than calling for a change in the target range. The estimated neutral real rate (r^*) was -0.5 percent, implying that even a nominal rate held at the 0.0 to 0.25 percent floor represented only mild accommodation in real terms. Inflation momentum registered -0.01, essentially flat with a slight disinflationary tilt, giving no indication of building upward price pressure over the projection horizon. Unemployment momentum at -0.2 suggested gradual improvement in the labor market, though from a level well above the natural rate, so the slack projected to close only slowly.

All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — produced outputs of 0 bps and were judged reliable for this meeting. With the inflation shortfall and the wide unemployment gap both arguing for a policy setting below zero, the effective lower bound was the binding constraint, and the ELB-adjusted rule captured this directly. The staff projection therefore implied a path in which policy remained pinned at the floor, with existing accommodation left to work its way through the economy while inflation stayed contained below target and the labor market recovered gradually. Downside risks from fiscal cliff uncertainty and the lingering effects of Hurricane Sandy weighed on the outlook and argued against any near-term withdrawal of support.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants approached the decision from distinct vantage points but arrived at a common reading of the current stance. The member most focused on inflation risk observed that core PCE at 1.29 percent was well below the 2 percent objective, with no evidence of wage-push pressure in the Employment Cost Index reading of 117.8 or in jobless claims at 393,000. In this member's framing, the two directions that inflation vigilance would ordinarily activate — resisting easing or supporting a hike — were simply not triggered, since inflation risk was muted rather than elevated. With the target range already at its



floor, a cut was not mechanically available either, leaving holding as the disciplined call while inflation was monitored for any future turn.

The member weighting labor market conditions most heavily emphasized the severity of remaining slack: unemployment at 7.9 percent stood far above the 5.4 percent natural rate, and the Chicago Fed National Activity Index at -0.56 pointed to below-trend growth, with manufacturing weakening in seven of twelve Districts. This member's instinct was to ease further, but acknowledged the decisive constraint was mechanical — the range was already at 0.0 to 0.25 percent, and no conventional rate cut was meaningfully available. Employment-focused concerns, in this view, would be carried by continued asset purchases rather than by the rate itself. The member noted that no colleague had offered a coherent path to a lower range and that markets were pricing none.

The member attentive to financial stability began from the stress indicators and found them benign: the stress index at 0.072, the VIX at 16.46, the Baa spread at 2.97, and a positively sloped 10y-2y curve at 1.35 together described markets that were stable but not exuberant. Nothing in the credit or market-stress data demanded a shift in either direction. This member cautioned that abruptly altering the stance amid fiscal cliff uncertainty and Hurricane Sandy disruptions could unsettle otherwise calm-but-fragile conditions, and that continuity best preserved stability, with existing mortgage-related purchases supporting the lending demand noted in the Beige Book. The member tracking market signals reinforced this read, pointing to the 3-month T-bill spread of -0.025 as essentially flat to the current range — the market's aggregated bet that 0.0 to 0.25 percent would hold — and to the absence of any recession premium in the non-inverted curve.

The data-dependent participant read the indicators at face value and found the literal consensus outcome unambiguous: below-target inflation removed any case to tighten, wide labor slack argued against removing accommodation, and the effective lower bound precluded a cut. When the discussion turned to the optimal-policy framework, participants noted with some emphasis that agreement across their different lenses was genuine rather than coincidental. The estimated r^* of -0.5 percent confirmed that the neutral real rate was negative and that the floor was already accommodative; inflation momentum near zero and unemployment momentum at -0.2 showed no impulse demanding a move either way. Several participants singled out the ELB-adjusted rule as the most persuasive of the four reference rules, precisely because it respected the binding zero floor, while the inflation-focused member noted that even the Taylor rule, with inflation below target and unemployment elevated, still pointed to the floor.

In the concluding exchanges, no participant reported being moved from an initial position, and each described the framework's recommendation as matching a stance already reached from a different



starting point. The inflation-focused member reiterated that no hawkish trigger was present in the data; the labor-focused member stressed that holding kept maximum feasible accommodation for employment given the constraint; the stability-focused member reaffirmed that calm markets called for neither defensive tightening nor emergency easing; and the market-signal member emphasized that a flat priced path aligned exactly with the rule outputs. Downside risks from the fiscal cliff and the transitory effects of Hurricane Sandy were seen as reinforcing the case for holding rather than for any change.

COMMITTEE POLICY ACTIONS

In the predictive vote on the appropriate target range, all five members supported no change, holding the federal funds target range at 0.0 to 0.25 percent — a tally of 5 to 0. On the optimal-policy framework's recommendation of 0 bps, the Committee was likewise in full agreement: all five members endorsed the recommendation as-is, with none declining and none registering partial support. The inflation hawk, labor market dove, financial stability voice, data-dependent centrist, and market signal realist each endorsed the framework's 0 bps call, so the predictive and optimal-side outcomes coincided fully at holding the range steady.