



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that total System Open Market Account holdings of domestic securities stood at \$3,712.2 billion as of December 11, 2013, up \$57.9 billion from the prior release of December 4. The portfolio remained composed principally of Treasury notes and bonds, at \$2,080.6 billion, alongside \$1,483.0 billion in agency mortgage-backed securities. The staff noted that these figures cover SOMA securities holdings only — their total size, composition, and week-over-week change — and do not reflect the results of repurchase or reverse repurchase operations, for which no point-in-time-safe data source is available at this time; accordingly, no discussion of such operations is included in this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff's review of the economic situation described an economy expanding at a modest pace with substantial slack still present. The unemployment rate stood at 7.0 percent, well above the estimated natural rate of 5.5 percent, indicating a gap of roughly a percentage and a half. Initial claims for unemployment insurance were relatively low at 298,000, and the Chicago Fed National Activity Index registered -0.18, a reading somewhat below its trend. On the price side, core PCE inflation was running at 0.98 percent on a year-over-year basis, less than half the Committee's 2 percent objective, and the Employment Cost Index at 119.5 was consistent with only limited wage pressure. The federal funds rate remained in its target range of 0.0 to 0.25 percent, and the M2 money stock was reported at \$10,952.2 billion.

Information from the most recent Beige Book, drawn from the First District, reinforced the picture of gradual improvement without price pressure. Most respondents in manufacturing, retail, tourism, software and IT services, and staffing reported year-over-year revenue gains, and both residential and commercial real estate contacts described continued improvement in market conditions. Retail contacts reported comparable-store sales increases ranging from 7 to 25 percent, with one firm down 3 percent, and demand was described as strong for apparel, home furnishings, and furniture. Most firms were holding headcounts level while wages were steady or increasing modestly, and the report stated plainly that 'upward price pressures remain minimal.' The overall tally of contacts was characterized as more upbeat than in the October round, though several respondents cautioned that the holiday season would be a better test of the apparent improving trend. A few pockets of softness were noted, including a plastics firm describing its bulk chemical business as 'coming in for a landing' and reduced attendance and revenue at some museums and attractions affected by the government shutdown.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were characterized as calm and accommodative across the staff's indicators. The financial stress index stood at 0.018, an extremely low reading indicating no signs of systemic strain, and the VIX at 15.42 pointed to subdued equity market volatility. In credit markets, the Baa corporate spread of 2.55 percentage points was described as moderate and consistent with markets functioning normally rather than under distress. The term structure gave no recession signal: the 10-year/2-year Treasury spread was steeply positive at 2.55 percentage points, with no inversion. At the front end, the 3-month Treasury bill spread relative to the current rate was slightly negative at -0.055 percentage point, consistent with market participants pricing no near-term change in the policy rate.

STAFF ECONOMIC OUTLOOK

The staff's forward-looking assessment emphasized that several of the underlying quantities pointed to continued gradual movement toward the Committee's goals rather than any abrupt shift. The estimated neutral real rate of interest (r^*) was put at -0.5 percent, a negative value implying that underlying conditions remained depressed and that the current 0.0 to 0.25 percent target range was not, relative to that neutral level, an especially loose stance. Momentum readings were modest in both directions: inflation momentum was only weakly positive at 0.09, suggesting little near-term firming in prices from their current sub-1 percent pace, while unemployment momentum was -0.2, consistent with a labor market improving slowly rather than rapidly.

The reference rules diverged sharply, and the staff noted the source of that divergence. The Taylor rule, the Balanced Approach rule, and the ELB-adjusted rule each prescribed 75 basis points, reflecting the large unemployment gap under an assumption of more normal neutral conditions. The First-Difference rule, by contrast, prescribed 0 basis points, since it responds to the weak momentum in both inflation and unemployment rather than to an absolute level. The staff observed that the gap between these prescriptions largely reflects the negative estimate of r^* and the binding effective lower bound: with neutral this low and the rate already at its floor, the level-rule prescriptions overstate feasible tightening room. Taken together, the projected path implied by these quantities was one of persistently below-target inflation firming only slowly and unemployment declining gradually, with the loss-minimizing recommendation landing at 0 basis points.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their discussion of current conditions, participants converged early and broadly on the view that the appropriate action was to maintain the target range at 0.0 to 0.25 percent, though they arrived at that conclusion through distinct lenses. A participant focused on inflation risk observed that his usual concern found no fuel in the present data: core PCE at 0.98 percent was running a full percentage point below the 2 percent objective, and the Beige Book confirmed that price pressures remained minimal



and wage gains modest. With inflation this far below target and no sign of acceleration, this participant judged that hiking could not be justified despite his hawkish lean, and that the rate was already at its floor so cutting was not feasible.

A participant weighting employment and labor market risk most heavily emphasized the roughly 1.5 percentage point gap between the 7.0 percent unemployment rate and the 5.5 percent natural rate as evidence of continuing slack that warranted maximum accommodation. This participant stressed, however, that the decisive constraint was the effective lower bound — there was no room to cut conventional rates further — and that the data showed gradual improvement rather than deterioration, with jobless claims low at 298,000 and a Beige Book tone more upbeat than in October. Withdrawing support prematurely, in this view, would risk stalling the labor recovery. A participant attentive to financial stability reviewed the stress indicators first and found them benign across the board: the stress index at 0.018 was extraordinarily low, the VIX calm at 15.42, credit spreads contained, and the yield curve steeply positive with no inversion. This participant saw no market strain demanding either a stabilizing move or defensive tightening, while cautioning as a structural matter that calm markets under prolonged accommodation are precisely where imbalances can build quietly — a watch-item, not a present action trigger. A participant emphasizing incoming data and a participant anchored in market pricing both reached the same destination, the latter noting that the slightly negative T-bill spread signaled no near-term hike was being priced and that market signals pointed unambiguously to steady policy.

In the rebuttal round, no participant was moved to revise. Each noted that the arguments of the others reinforced rather than challenged his own reasoning, and the concern about future imbalances raised from the financial-stability seat was acknowledged by several as legitimate but not yet supported by any evidence in the current stress or inflation data.

When the discussion turned to the framework's loss-minimizing recommendation of 0 basis points, participants engaged directly with the sharp split among the reference rules. Several observed that the 75 basis point prescriptions from the Taylor, Balanced Approach, and ELB-adjusted rules rested on assumptions that did not hold in the present environment, most importantly a healthier neutral rate; with r^* estimated at -0.5 percent, those level rules overstated the appropriate degree of policy and the feasible room for tightening near the lower bound. A common thread was that the First-Difference rule, prescribing 0 basis points, was the more persuasive guide because it responded to the actual momentum in the data — inflation momentum of only 0.09 and unemployment momentum of -0.2 — arguing against any abrupt level jump.



The inflation-focused participant put the point in terms of his own mandate: even for a hawk, tightening when core inflation was a full point below target and only weakly firming would risk pushing already-subtarget inflation lower and entrenching disinflation. The labor-focused and centrist participants read the divergence between the 75 basis point rules and the 0 basis point recommendation as simply reflecting the binding lower bound and the negative neutral rate, not as a signal that the current stance was too loose. The market-oriented participant added that market pricing, the First-Difference logic, and the framework's output all converged on holding, and that a stance consistent with a deeply negative r^* should be understood as appropriately accommodative rather than behind the curve. Participants generally concluded that patience was warranted: financial conditions permitted it, and the real economy, with its persistent slack and subdued inflation, required it.

COMMITTEE POLICY ACTIONS

In the predictive vote on the policy action, all five members supported holding the federal funds target range at 0.0 to 0.25 percent, a unanimous outcome of 0 basis points (5 members). On the framework's loss-minimizing recommendation of 0 basis points, the Committee likewise reached full agreement: all five members — the participant focused on inflation risk, the participant focused on the labor market, the participant focused on financial stability, the data-dependent centrist, and the market-signal-oriented participant — endorsed the recommendation as-is, with none declining and none registering partial support. The two votes were therefore fully aligned.