



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held a total of \$4,213.7 billion in domestic securities as of December 10, 2014, unchanged from the prior release of December 3. The portfolio was composed of \$2,346.7 billion in Treasury notes and bonds and \$1,729.8 billion in agency mortgage-backed securities. With no week-over-week change in total holdings, the composition of the account remained steady across the reporting interval. It should be noted that these figures cover SOMA domestic securities holdings only — total size, composition, and the change from the prior release — and do not encompass the results of repo or reverse-repo operations, for which no point-in-time-safe data source is currently available.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming indicators as pointing to continued moderate expansion. Core PCE inflation stood at 1.34 percent on a twelve-month basis, well below the Committee's 2 percent objective. The unemployment rate was 5.8 percent, somewhat above the estimated natural rate of 5.5 percent, indicating that a modest degree of labor market slack remained. Initial jobless claims at 297,000 were low, consistent with continued firming in labor conditions, and the Chicago Fed National Activity Index reading of 0.14 suggested growth at or slightly above trend. The Employment Cost Index stood at 122.2, and M2 money supply was \$11,511.3 billion.

The Beige Book account for the Twelfth District described economic activity as continuing to improve moderately during the early-October through mid-November reporting period, with overall price and wage inflation remaining modest. Several disinflationary influences were noted on the price side: historically low iron ore prices and strong competition from abroad pressured finished steel prices lower, grain prices remained very low, and natural gas prices declined. Health-care contacts reported that medical insurance premium increases for individual coverage in 2015 were very low by historical standards. Wages generally rose at a modest pace, though shortages of workers in skilled construction trades, computer programming, electronic game design, and bank loan origination boosted pay in those sectors, and some employers raised wages for long-term high-value employees whose nominal pay had been flat for several years. Retail sales grew moderately, with contacts citing lower gasoline prices and improving employment as supports, while spending remained soft where local labor conditions were still weak.

STAFF REVIEW OF THE FINANCIAL SITUATION

Financial conditions were characterized as calm and accommodative. The financial stress index at 0.045 was very low, indicating no systemic strain. The VIX at 18.53 reflected moderate volatility, well within normal ranges. The Baa corporate spread of 2.51 was contained, consistent with orderly



functioning in credit markets and no evident borrowing-cost stress. The 10-year/2-year Treasury yield curve spread of 1.59 was comfortably positive, showing no inversion and no recession signal from the term structure. The 3-month T-bill spread relative to the current target rate was slightly negative at -0.085, consistent with market participants anchoring expectations at the prevailing near-zero range and pricing no imminent change in policy.

STAFF ECONOMIC OUTLOOK

The staff projection pointed to a continuation of gradual, non-destabilizing improvement rather than any near-term inflection. The estimated neutral real rate (r^*) of -0.5 percent implied that the neutral setting for policy remained below zero in real terms, so that a target range of 0.0 to 0.25 percent was not especially accommodative relative to that benchmark. Inflation momentum was essentially flat at 0.02, suggesting no upward drift in prices over the projection horizon and reinforcing the picture of core PCE remaining below the 2 percent objective for some time. Unemployment momentum of -0.1 indicated that joblessness was still falling, consistent with a further, gradual narrowing of the remaining gap to the 5.5 percent natural rate.

The reference-rule benchmarks were mutually reinforcing on this outlook. The Taylor rule, Balanced Approach rule, First-Difference rule, and the ELB-adjusted rule each prescribed a rate of 0 bps, and the rules were judged reliable for this meeting. Taken together with the negative estimated neutral rate, the convergence of these prescriptions implied that the effective lower bound was the operative constraint on the projected path: with inflation soft, labor slack diminishing but not yet closed, and neutral below zero, the framework projected conditions consistent with maintaining the current stance rather than adjusting it in either direction.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, all five participants independently favored holding the target range at 0.0 to 0.25 percent, and the discussion across rounds served to test that convergence from distinct vantage points rather than to open a genuine divide. The inflation-focused member framed the question around upside price risk and found none: with core PCE at 1.34 percent and the Beige Book documenting falling steel, grain, and natural gas prices along with only modest wage gains, this participant judged that a hike would be premature and could risk further entrenching low inflation. At the same time, this member saw no distress warranting easing — financial stress was very low, the curve was not inverted, and credit spreads were contained — and observed that the policy rate was in any case near its floor.



The participant most attentive to employment reasoned that the labor data pointed the other way from any easing case. Unemployment at 5.8 percent remained above the 5.5 percent natural rate, but it was falling, initial claims at 297,000 were low, and the Chicago Fed index at 0.14 signaled near-trend growth. This member concluded that with employment firming rather than deteriorating there was no basis for further accommodation, and that the existing stance already provided full support to the labor market. The participant focused on financial stability reached a parallel conclusion from the market-conditions side, noting that a stress index of 0.045, a VIX of 18.53, and a Baa spread of 2.51 all described well-functioning markets in which a premature move to tighten could needlessly disturb calm conditions, while the absence of any recession or distress signal ruled out easing.

The data-dependent member characterized the reading as a literal consensus one, with below-target inflation and residual slack both arguing against a hike and no indicator supporting a cut. The market-attentive participant emphasized that the slightly negative 3-month T-bill spread of -0.085 indicated markets were pricing no imminent hike, and that the positively sloped curve carried no near-term tightening expectation; in this member's view market pricing and the fundamentals corroborated one another.

When the discussion turned to the framework's loss-minimizing recommendation, participants engaged directly with the underlying quantities. Several noted that the estimated neutral rate of -0.5 percent meant that holding at the floor was not overly loose, since neutral itself lay below zero. The convergence of all four reference rules at 0 bps, judged reliable this meeting, was cited as removing any tension to arbitrate. The employment-focused and market-attentive members both found the ELB-adjusted rule's logic most persuasive, observing that with neutral negative and the rate pinned near zero the lower bound was the binding constraint; the inflation-focused and data-dependent members leaned on the Taylor logic, under which below-target inflation and above-natural unemployment together kept the prescribed rate at the floor.

In the rebuttal exchanges, no participant was moved from the hold position, and each described the others' reasoning as reinforcing rather than challenging their own. The market-attentive member raised one caution — that the negative T-bill spread hinted markets might welcome easier conditions — but concluded that the effective lower bound prevented such a move, so that holding represented the constrained optimum. Participants generally judged that with inflation momentum near flat at 0.02, unemployment momentum modestly negative at -0.1, and financial conditions calm across the board, patience rather than action was warranted, and that conditions had not materially shifted since the prior decision to hold with 'considerable time' guidance.

COMMITTEE POLICY ACTIONS



In the predictive vote, all five participants supported maintaining the target range for the federal funds rate at 0.0 to 0.25 percent, a unanimous outcome of 5 to 0 for no change. On the deterministic framework's loss-minimizing recommendation of 0 bps, the Committee likewise reached full agreement: all five members — the inflation-focused member, the employment-focused member, the financial-stability-focused member, the data-dependent member, and the market-attentive member — endorsed the recommendation as-is, with none declining and none registering only partial agreement. The predictive and optimal-side outcomes were therefore fully concordant.