



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The desk reported that total System Open Market Account domestic securities holdings stood at \$8,108.1 billion as of December 8, 2021, an increase of \$11.0 billion from the prior weekly release of December 1. The composition remained concentrated in Treasury notes and bonds, which accounted for \$4,803.7 billion of the total, alongside \$326.0 billion in Treasury bills and \$2,561.6 billion in agency mortgage-backed securities. Members were reminded that this review covers SOMA securities holdings only — total size, composition, and the week-over-week change — and does not encompass repo or reverse-repo operation results, for which no point-in-time-safe data source is currently available; accordingly, no characterization of those operations was offered.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reviewed incoming data indicating that inflation remained well above the Committee's longer-run objective. Core PCE inflation stood at 3.8 percent on a twelve-month basis, close to double the 2 percent target. The labor market continued to show considerable tightness: the unemployment rate was 4.2 percent, below the estimated natural rate of 4.45 percent, and initial jobless claims were low at 222,000. The Chicago Fed National Activity Index reading of 0.76 was consistent with above-trend growth in overall economic activity. The Employment Cost Index registered 146.6, and M2 money supply was reported at \$21,187.1 billion.

The most recent Beige Book characterized economic activity as growing at a modest to moderate pace across most Districts during October and early November, with several Districts noting that strong demand was being constrained by supply chain disruptions and labor shortages. Consumer spending rose modestly, with low inventories holding back sales of some items, notably light vehicles, and leisure and hospitality activity picked up as the spread of the Delta variant ebbed in many areas. Employment growth ranged from modest to strong, with contacts reporting robust labor demand but persistent difficulty hiring and retaining workers; childcare, retirements, and COVID safety concerns were widely cited as constraints on labor supply. Nearly all Districts reported robust wage growth, with hiring struggles and elevated turnover leading businesses to raise pay and offer bonuses and more flexible arrangements. Prices rose at a moderate to robust pace, with increases widespread across sectors and wide-ranging input cost pressures stemming from strong demand for raw materials, logistical challenges, and labor market tightness.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm and broadly accommodative. The financial stress index stood at 0.1334, a low reading indicating an absence of systemic strain, and the VIX at 19.9



reflected moderate rather than elevated volatility. Credit markets appeared healthy, with the Baa corporate spread at 1.75 indicating contained borrowing-cost pressure. The Treasury yield curve remained positively sloped, with the 10-year/2-year spread at 0.84, offering no recession signal from the term structure. The 3-month T-bill traded at a spread of -0.065 relative to the current funds rate, consistent with markets not discounting an imminent change in the target range. The current target range for the federal funds rate was 0.0 to 0.25 percent, with a midpoint of 0.125 percent.

STAFF ECONOMIC OUTLOOK

The staff projection took as its point of departure the reference-rule outputs and the momentum and neutral-rate estimates available for this meeting. The estimated neutral real rate (r^*) was placed at -0.397, a notably low value implying that even a substantial nominal move off the current range would leave real policy accommodative. Inflation momentum was positive at 0.36, indicating that price pressures were still building rather than fading, while unemployment momentum at -0.55 indicated a labor market that was continuing to tighten. Taken together, these quantities suggested that the constellation of conditions pointing toward firmer policy was not a transient artifact but was reinforcing over the projection horizon.

All four reference rules — the Taylor rule, the Balanced Approach rule, the First-Difference rule, and the ELB-adjusted rule — converged on 75 basis points, and the rules were judged reliable for this meeting. The unusually tight convergence across specifications implied that the current 0.0 to 0.25 percent range sat well below the level the rules prescribe given a 3.8 percent core inflation reading and unemployment below the natural rate. The staff outlook accordingly implied that, absent a change in policy, the gap between the current stance and rule-prescribed levels would likely persist or widen, with the low r^* estimate meaning that firming of the magnitude the rules indicated would still leave the real policy stance below neutral rather than restrictive.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their initial predictive assessments, all five participants independently arrived at a hold of the current 0.0 to 0.25 percent target range this meeting, though the reasoning that led them there varied across mandate perspectives. The participant most focused on inflation risk emphasized that core PCE at 3.8 percent, nearly double target, together with the Beige Book's evidence of widespread and robust price and wage increases, argued strongly for removing accommodation. That participant nonetheless judged an immediate hike premature on institutional grounds, observing that the reduction of asset purchases had only recently begun and remained underway, so that a hold accompanied by a clear tightening bias was the realistic path for this meeting.



The participant weighting employment most heavily noted that the usual case for easing simply did not apply on the current data: unemployment at 4.2 percent sat below the 4.45 percent natural rate, jobless claims at 222,000 were low, and the Beige Book described robust labor demand and hiring difficulty rather than any deterioration. With rates already at the effective lower bound, support for employment was in any case maximal, and inflation well above target argued firmly against any cut. The participant attentive to financial stability stressed that a stress index of 0.1334, a moderate VIX, and a tight Baa spread of 1.75 all pointed to calm, healthy markets with no crisis to warrant a defensive move; from that vantage, an abrupt hike layered on top of an ongoing purchase wind-down risked an unnecessary and disorderly repricing. The participant focused on market signals reinforced this timing read, observing that the 3-month T-bill trading 6.5 basis points below the current rate indicated markets were not pricing a near-term move, and the data-dependent participant took the convergence itself as confirmation, reading guidance and market pricing literally as implying a hold with existing normalization allowed to proceed.

When the discussion turned to the deterministic optimal policy framework, which recommended 75 basis points with all four reference rules in agreement and judged reliable, the emphasis shifted markedly. Several participants underscored the divergence between their predictive votes of no change and the framework's recommendation as itself revealing that the current stance was behind the fundamentals. The inflation-focused participant found the Taylor rule most persuasive, arguing that deeply negative real rates against 3.8 percent inflation were unjustified and that waiting risked unanchoring expectations at real cost. The employment-focused participant, examining slack and momentum first, concluded that a strong labor market — unemployment below natural, unemployment momentum at -0.55, low claims — provided precisely the room to firm without harm, and that allowing inflation to erode real wages would ultimately hurt the workers the mandate is meant to protect; that participant found the Balanced Approach rule most aligned with a dual-mandate lens and endorsed the move.

The financial-stability participant agreed that benign conditions gave room to remove accommodation and that leaving rates at zero amid 3.8 percent core inflation carried its own froth and credit-excess risks, but registered a reservation about magnitude and timing: with the T-bill spread signaling markets were positioned for no imminent move, a single 75 basis point step from the effective lower bound risked disorderly repricing, even as the low r^* meant the move would leave policy accommodative in real terms. The market-signal participant echoed this reconciliation, agreeing fully that the direction was correct and that 'transitory' framing looked strained, while maintaining that market instruments discounted a gradual path rather than an abrupt jump, so that a smaller initial step would better match what the curve and T-bill spread anticipated. The data-dependent participant, taking the indicators at



face value, judged that both mandate legs pointed the same way and that the literal, consensus implication of the data was to move off the current range decisively. Across the rebuttal round, no participant offered a genuine slack or fragility case against firming, and the disagreement that remained concerned the size and pace of an initial move rather than its direction.

COMMITTEE POLICY ACTIONS

On the predictive question of the policy decision expected at this meeting, 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. On the separate question of the deterministic framework's recommendation of 75 basis points, the Committee's recorded stances were three endorsements and two partial concurrences, with no participant declining. The participants focused on inflation risk, on the labor market, and on data-dependence endorsed the recommendation as-is, while the participants focused on financial stability and on market signals concurred with the direction of firming but not with the magnitude or timing of a single 75 basis point step given that market instruments were not pricing an imminent move.