



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$8,074.2 billion in domestic securities as of December 7, 2022. Holdings were composed of \$4,714.4 billion in Treasury notes and bonds, \$294.1 billion in Treasury bills, and \$2,650.2 billion in agency mortgage-backed securities. Relative to the prior release of November 30, total holdings edged down by \$1.9 billion. The staff noted that this account covers SOMA securities holdings only — their total size, composition, and week-over-week change — and does 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

Incoming data indicated that economic activity had lost momentum. The most recent Beige Book characterized activity as about flat or up slightly, a step down from the modest average pace reported previously; five Districts recorded slight or modest gains while the remainder saw no change or slight-to-modest declines. Many contacts expressed greater uncertainty or increased pessimism about the outlook, and both interest rates and inflation continued to weigh on activity. The Chicago Fed National Activity Index stood at -0.05, consistent with growth running slightly below trend. Consumer spending outside autos was mixed but eked out slight gains on balance, with inflation prompting lower- and moderate-income households to substitute toward cheaper goods; travel and high-end hospitality, by contrast, saw robust demand. Rate-sensitive sectors bore the brunt of tightening — home sales fell at a moderate pace overall and steeply in some Districts, apartment leasing began to slow, residential construction slid further, bank lending declined amid weaker demand and tightening credit standards, and office vacancies edged up.

The labor market remained tight but showed early signs of cooling. The unemployment rate was 3.7%, below the estimated natural rate of 4.43%, and initial jobless claims were 225,000. The Beige Book reported that employment grew modestly in most Districts, though two reported flat headcounts and labor demand weakened overall; hiring and retention difficulties eased further, and scattered layoffs appeared in the technology, finance, and real estate sectors. Some contacts described a reluctance to shed workers despite diminishing labor needs. Wages rose at a moderate pace on average, with a few Districts noting some relaxation of wage pressures. On prices, core PCE inflation was 3.88% on a twelve-month basis, still nearly double the 2% objective. Consumer prices rose at a moderate or strong pace in most Districts, but the pace of increases slowed on balance. The Employment Cost Index reading was 154.0 and M2 stood at \$21,415.2 billion.

STAFF REVIEW OF THE FINANCIAL SITUATION



Financial conditions were tight but orderly, with no evidence of acute stress. The financial stress index registered 0.2338, a moderate reading, and the VIX stood at 22.68 — elevated but well short of crisis levels. Credit markets showed contained strain: the Baa corporate spread was 1.97, suggesting no systemic funding distress. The Treasury yield curve was deeply inverted, with the 10-year/2-year spread at -0.84, a configuration widely read as a recession-risk signal reflecting the cumulative effect of prior tightening. The 3-month T-bill spread relative to the current policy rate was 0.395, implying that markets had priced in additional near-term tightening. The current target range for the federal funds rate was 3.75% to 4.00%, and the Committee's last projected rate stood at 4.4%, above the current midpoint.

STAFF ECONOMIC OUTLOOK

The staff projection pointed to a modest further move toward restrictive territory, though the underlying quantities sent conflicting signals. The estimated neutral rate (r^*) used in the framework was -0.5, a low figure that, taken alone, would argue policy was already close to or beyond restrictive. Inflation momentum remained positive at 0.21, indicating that price pressures were decelerating but had not clearly reversed, while unemployment momentum was slightly negative at -0.05, consistent with a labor market softening only at the margin rather than deteriorating. Taken together, these figures implied continued disinflation over the projection horizon alongside gradually easing labor demand, but with meaningful risk that inflation would prove sticky.

The reference rules diverged sharply, which itself signaled that mechanical guidance was of limited use this meeting. The Taylor rule pointed to -25 basis points, and both the Balanced Approach and ELB-adjusted rules to -75 basis points, each leaning heavily on the negative r^* estimate and the emerging slack story. The First-Difference rule, by contrast, called for +75 basis points, responding to the still-large inflation gap and positive momentum. The framework judged the reference rules reliable and produced a loss-minimizing recommendation of +50 basis points — a path that sits between the easing rules and the First-Difference rule, consistent with continued but moderating tightening toward the projected path near 4.4%.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

Participants agreed that the setting called for continued tightening at a moderated pace, and all five converged on a 50 basis point increase to a range of 4.25% to 4.50%. The common thread was that core PCE at 3.88% remained nearly double the 2% objective, ruling out any pause or cut, while an array of softening signals — flat-to-slight Beige Book activity, the deeply inverted 10-year/2-year spread at -0.84, weakening bank lending, and steep housing declines — argued against a return to the larger increments of prior meetings. Several participants framed 50 basis points explicitly as a step-down in



the pace of tightening rather than a change in direction, keeping policy on course toward the projected level near 4.4%.

The participant weighting inflation risk most heavily observed that prices were decelerating but not defeated, with inflation momentum still positive at 0.21, and cautioned that easing prematurely into sticky inflation would be the costlier error and could risk unanchoring expectations. This participant had considered arguing for +75 basis points to keep maximum pressure on inflation but judged that cumulative tightening, policy lags, and the inverted curve made a jumbo hike an unnecessary overtightening risk. The participant most attentive to employment reached the same 50 basis point conclusion from the opposite starting point: unemployment at 3.7%, below the 4.43% natural rate, and jobless claims at 225,000 showed no labor-market break, and while scattered layoffs in technology, finance, and real estate and weakening labor demand warranted watchfulness, the data were not weak enough to justify supporting jobs through easing. This participant emphasized that a smaller move protects employment by guarding against overtightening into a slowing economy, and noted a readiness to push for a pause at a future meeting should claims climb or headcounts contract broadly.

The participant focused on financial stability stressed that the stress signals watched most closely — the stress index at 0.2338, the VIX at 22.68, and the Baa spread at 1.97 — were moderate and orderly, giving no cause to pause but also no crisis forcing the Committee's hand. This participant regarded the step-down as itself a stability consideration: prior 75 basis point increments were already biting the credit channel through weaker loan demand, tightening standards, and rising vacancies, and a smaller, well-anticipated move reduced the risk of a destabilizing overtightening shock. The participant anchoring on market signals reinforced the point, noting that the 3-month T-bill spread of 0.395 mapped cleanly onto a 50 basis point step and that markets were therefore pricing this move rather than facing a surprise; the curve inversion cautioned against reaccelerating, while contained credit spreads indicated conditions could absorb the increase without fracturing. The data-dependent participant read the wide dispersion of reference rules as a signal that judgment, not any single rule, was required, and located 50 basis points as the literal middle — above the easing rules but below the First-Difference rule — respecting both inflation persistence and cooling activity.

In the framework-oriented discussion, participants engaged directly with the reference-rule divergence. Those inclined toward the inflation side found the First-Difference rule's +75 output the most sympathetic in spirit but declined to follow it, judging that it over-reacted to the inflation level while ignoring the curve inversion and cumulative lags. The easing rules — Taylor at -25 and the Balanced Approach and ELB-adjusted rules at -75 — drew explicit skepticism across participants, who viewed them as leaning too heavily on the negative r^* estimate of -0.5 and an emerging-slack story that



live inflation data did not yet support. Participants generally concluded that the loss-minimizing recommendation of +50 basis points reconciled these tensions and that its agreement with their independent predictive judgments indicated the current 3.75% to 4.00% stance was near, but not yet at, sufficiently restrictive territory. No participant was moved off the 50 basis point position by the rebuttals; if anything, the stability and market-pricing arguments hardened the case against a larger move, and the employment argument against a smaller one.

COMMITTEE POLICY ACTIONS

In the predictive deliberation, all five members supported a 50 basis point increase, taking the target range from 3.75% to 4.00% to 4.25% to 4.50% — a unanimous tally of five for 50 basis points. On the framework's loss-minimizing recommendation of 50 basis points, the Committee's recorded stance was full agreement: all five members endorsed the recommendation as-is, with none declining and none registering partial agreement. The two sides of the deliberation thus coincided completely, reflecting a shared judgment that inflation still demanded continued tightening while softening activity, recession-signal risks, and orderly-but-tight financial conditions warranted a step-down from the prior pace.