



DEVELOPMENTS IN FINANCIAL MARKETS AND OPEN MARKET OPERATIONS

The System Open Market Account held \$7,148.1 billion in domestic securities as of December 6, 2023, comprising \$4,091.1 billion in Treasury notes and bonds, \$230.4 billion in Treasury bills, and \$2,438.8 billion in agency mortgage-backed securities. Total holdings declined by \$30.4 billion from the prior release on November 29, continuing a gradual reduction in the portfolio. The manager noted that these figures capture SOMA securities holdings only — total size, composition, and week-over-week change — and do not encompass the results of repurchase or reverse-repurchase operations, for which no point-in-time-safe data source is currently available; accordingly, no discussion of those operations is included in this review.

STAFF REVIEW OF THE ECONOMIC SITUATION

The staff reported that core PCE inflation stood at 2.77 percent on a twelve-month basis, still above the Committee's 2 percent objective but well off its earlier peaks. The unemployment rate was 3.9 percent, below the estimated natural rate of 4.42 percent, and initial jobless claims remained low at 218,000, indicating no acute deterioration in labor conditions. Broader activity measures were softer: the Chicago Fed National Activity Index registered -0.49, consistent with below-trend growth. The Employment Cost Index reading was 160.7, and M2 money supply stood at \$20,725.6 billion.

The Beige Book described economic activity as flat or down slightly across much of the country, with employment stable but labor demand showing weakness. Reports were mixed among manufacturers, several of whom had experienced an extended stretch of weak activity. Multiple Districts flagged rising loan defaults on office properties and anticipated further distress ahead, alongside declining commercial real estate lending and activity. Several Districts reported cooling labor markets, easing wage pressures, and a return to more normal wage increases. Price pressures moderated broadly — one District noted that wage and price inflation 'subsided significantly' even as price levels remained high for many items, and others reported reduced pricing power amid weakening demand and competition. Consumer spending was uneven, with some Districts noting softer retail sales and more price-sensitive consumers, while housing remained constrained by exceptionally low inventory even as some markets showed signs of becoming more balanced.

STAFF REVIEW OF THE FINANCIAL SITUATION

The staff characterized financial conditions as calm on the surface but restrictive in substance. The financial stress index was low at 0.1612, and the VIX stood at 12.97, both consistent with an absence of acute market strain. The Baa corporate spread was contained at 1.65, indicating no broad credit dislocation despite the office-property default warnings surfacing in the Beige Book. The



10-year/2-year Treasury spread was inverted at -0.48 , a persistent recession-risk signal, and the 3-month T-bill traded 12.5 basis points below the current target rate, suggesting market participants saw no further firming and were leaning toward eventual easing. The current target range for the federal funds rate was 5.25 to 5.50 percent.

STAFF ECONOMIC OUTLOOK

The staff outlook emphasized that the stance of policy appeared meaningfully restrictive relative to a low neutral rate. With the estimated neutral rate (r^*) at -0.5 and core PCE near 2.77 percent, the real policy rate implied by the 5.25 to 5.50 percent range sat well above neutral, a configuration that tends to weigh on activity and credit conditions with a lag. Inflation momentum was estimated at -0.415 , indicating that disinflation was actively underway, while unemployment momentum was mildly positive at 0.1, pointing to gradual loosening of the labor market rather than a sharp turn.

The reference rules diverged in their prescriptions. The Taylor rule, Balanced Approach rule, and ELB-adjusted rule each pointed to a rate roughly 75 basis points above the current midpoint, anchoring on the level of the inflation gap. The First-Difference rule, which responds to the change in conditions rather than levels, implied 50 basis points of easing. The staff noted that if inflation continued to decelerate while nominal rates were held steady, real rates would rise passively — an automatic incremental tightening. Taken together with the reference rules judged reliable, the loss-minimizing framework recommended a modest reduction of 25 basis points, reflecting the tension between an unmet inflation objective and an accumulating case that policy had grown more restrictive than conditions warranted.

PARTICIPANTS' VIEWS ON CURRENT CONDITIONS AND THE ECONOMIC OUTLOOK

In their predictive discussion, all five participants independently arrived at holding the target range at 5.25 to 5.50 percent, though their reasoning reflected distinct priorities. The participant most focused on inflation risk stressed that core PCE at 2.77 percent remained meaningfully above the 2 percent target and that the disinflation, while underway, was incomplete; the prior characterization of inflation as 'unacceptably high' still resonated. This participant nonetheless judged that a further hike was hard to justify given flat-to-contracting activity, the inverted yield curve, and the CFNAI reading of -0.49 , and that low jobless claims left no case for accommodation. Holding, in this view, preserved the ability to firm again should disinflation stall.

The participant most attentive to employment risk took seriously the broad-based labor cooling documented in the Beige Book — weakening labor demand across nearly every District, easing wage pressures, and slowing hiring. Even so, this participant acknowledged that the hard data showed no



break: unemployment at 3.9 percent remained below the 4.42 percent natural rate, and claims at 218,000 were low. A cut was therefore judged premature, though this participant noted the next move was likely to be a cut and indicated a readiness to advocate for one quickly should unemployment or claims turn sharply. The participant weighing financial stability most heavily flagged rising office-property loan defaults and declining commercial real estate lending as genuine warning signs, but observed that the stress index at 0.1612, the VIX at 12.97, and the Baa spread at 1.65 pointed to contained conditions with no systemic dislocation. This participant judged that a hike would risk accelerating CRE distress while a cut was unwarranted with inflation still above target. The data-dependent and market-focused participants reinforced the same conclusion from their respective vantage points, the latter noting that the 3-month T-bill trading below the current rate confirmed markets saw no further hikes and no crisis demanding a cut.

When the discussion turned to the framework's loss-minimizing recommendation of a 25 basis point cut, the tenor of the conversation shifted. Several participants noted that although the level-based Taylor and Balanced Approach rules pointed roughly 75 basis points higher, the framework's easing recommendation rested on negative inflation momentum (-0.415) and a deeply negative neutral rate (-0.5), which together implied that the current real rate — on the order of 2.6 percent — was substantially above neutral and more restrictive than intended. The 'passive tightening' argument recurred across participants: with inflation decelerating, holding the nominal rate steady would let real rates drift higher automatically, quietly adding restriction. The First-Difference rule, which responds to change rather than level, was cited by multiple participants as the logic that best fit the moment.

Participants weighed the case differently according to their mandates. The employment-focused participant argued that the -25 basis point step would front-run the labor deterioration the Beige Book already showed, rather than waiting for unemployment to spike, and found the easing well justified given policy lags. The financial-stability participant framed a modest cut as insurance against slow-building CRE credit fragility without abandoning inflation vigilance, favoring the -25 basis point magnitude over larger moves precisely because surface metrics remained calm. The data-dependent participant concluded that momentum and neutral-rate arithmetic together justified a small correction — insurance against over-tightening, not capitulation — while noting that larger easing was unsupported given calm markets and above-target inflation. The market-focused participant endorsed the step as consistent with front-end pricing already leaning toward a cut.

The inflation-focused participant remained the dissenting voice on the optimal case. This participant conceded that the real rate against a negative neutral rate was deeply restrictive and that easing was eventually warranted, and found the passive-tightening argument to have merit. But with core PCE



near 2.8 percent and the 2 percent target unmet, this participant judged an immediate cut premature, cautioning that inflation momentum could reverse and preferring to hold longer to secure inflation's return. If easing were to occur, this participant would insist on a modest step paired with strong optionality to re-firm.

COMMITTEE POLICY ACTIONS

In the predictive vote, all five participants supported maintaining the target range for the federal funds rate at 5.25 to 5.50 percent, a unanimous decision (5 to 0). On the framework's optimal recommendation of a 25 basis point reduction to 5.00 to 5.25 percent, the Committee was divided: four participants — those weighting employment, financial stability, the broad data, and market signals — endorsed the recommendation as-is, while one participant, focused on inflation risk, declined to support it, judging a cut premature with core PCE still meaningfully above target. No participant favored the direction while dissenting on magnitude or timing.