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Five Key Takeaways from the July Federal Open Market Committee Rate Decision

Economic
INSIGHT

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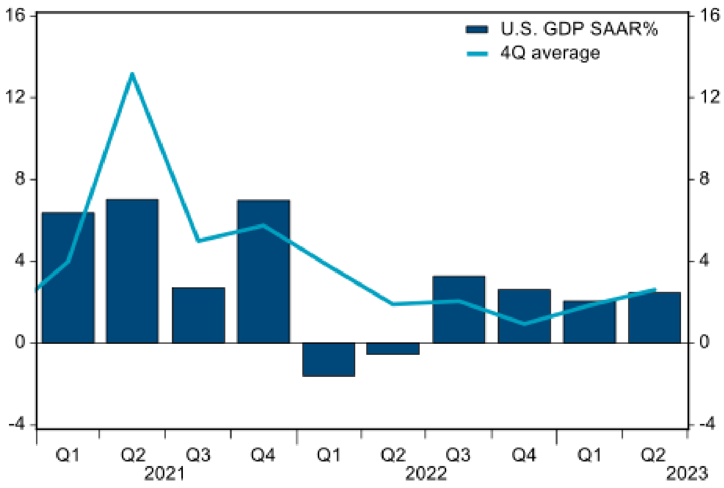
1. ***The Federal Reserve (Fed) opted to raise rates and will likely raise rates further.*** In the July Federal Open Market Committee (FOMC) statement, the Fed repeated what is said in its June statement that it will "*continue to assess additional information*" as it considers "*the extent of additional policy firming that may be appropriate.*" In other words, it is not a matter of whether or not further policy firming is needed, but how much more. "*Monetary policy is restrictive, more so after today's decision,*" Federal Reserve Chairman Jerome Powell noted during Wednesday's press conference. "*And we're prepared to further tighten if that is appropriate … the process of getting inflation back down to two percent has a long way to go.*"

   Of course, that doesn't mean the Fed will automatically revert to a predetermined or steady pace of hiking at every other meeting (skip-reengage). In fact, Powell was clear consecutive meeting hikes are not off the table, nor is a longer span between rate hikes out of the realm of possibilities. While there is a value to moderating the pace of additional policy firming, he noted that decisions would be made on a meeting-by-meeting basis. "*We haven't made any decision about – about any future meetings,*" Powell said. "*It is certainly possible that we would raise funds again at the September meeting if the data warranted, and I would also say it's possible that we would choose to hold steady at that meeting.*"

2. ***The Committee continues to hold a relatively solid assessment of the current economy and the labor market, but conditions are beginning to cool.*** In the July FOMC statement, the Fed upgraded its characterization of topline activity from "*modest*" to "*moderate,*" an assessment further supported by the recent stronger-than-expected rise in second quarter GDP. Policy makers additionally reiterated that job growth remains "*robust,*" and the banking sector is "*sound and resilient.*"

   The labor market continues to be strong, Powell noted during the July press conference, and growth, he added, has been stronger than expected. However, while demand for labor is still solid, outpacing supply, it is gradually cooling, "*a good prescription for getting where we want to get,*" Powell said. "*We're looking for supply and demand through the economy coming into better balance. Including in particular, the labor market.*"



Source: Bureau of Economic Analysis/Haver Analytic

   Striking a positive note, Powell applauded the overall resilience of the

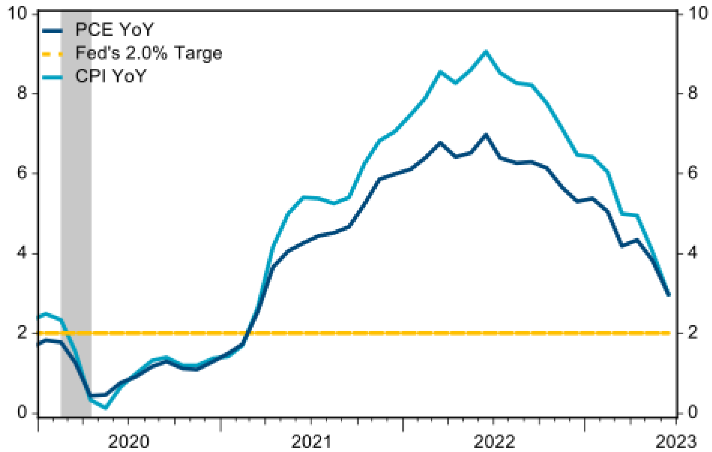
U.S. economy. He said being able to achieve some level of disinflation without a meaningful negative impact on employment is good news, buoying consumer confidence. But at the margins, he warned, stronger growth and a continued imbalance between labor demand and supply could lead to higher inflation and could require a stronger response from monetary policy.

"*It's not that we're aiming to raise unemployment, I would just say … we have to be honest about the historical record, which does suggest that when central banks go in and slow the economy to bring down inflation, the result tends to be some softening in labor market conditions,*" said Powell, "*and so that is still the likely outcome here.*"

He reminded the audience that the worst outcome is not dealing with inflation. "*Whatever the short-term social costs of getting inflation under control, the longer-term social costs of failing to do so are greater and the historical record is very, very clear on that.*"

3. ***The Committee still sees a lot of uncertainty surrounding the level and directional momentum of inflation.*** In Wednesday's FOMC statement, the Committee repeated its description of inflation as "*elevated*." Inflation has retreated from peak levels, but remains "*pretty elevated*," Powell said during the Q&A portion of the press conference. Some measures show inflation to be more than double the Fed's 2% target.

The latest inflation surge, Powell explained, was the result of elevated demand and constrained supply during and following the pandemic, coupled with an unprecedented policy response. Now, the normalization of the pandemic-related supply and demand imbalances and tighter monetary policy are restoring price stability. The Consumer Price Index, in particular, was more favorable than expected in June, but Powell cautioned that was only one report, and the Fed needs to see more data. "*We're going to be careful about taking too much signal from a single reading,*" he said. "*Many forecasts call for rates, for inflation to remain low, but we just don't know that until we see the data.*"



Source: BEA, BLS/Haver

The American public experiences *headline* inflation, thus a reduction in overall price pressures is a "*good thing*." However, for Fed policy, it is the "*totality*" of inflation in terms of getting back to 2%. "*Core inflation is actually our better signal of where headline inflation is going, because inflation is affected greatly by volatile energy and food prices … and core inflation is still pretty elevated,*" Powell said.

4. ***The Fed doesn't anticipate cutting rates anytime soon.*** "*We intend, again, to keep policy restrictive until we're confident that inflation is coming down sustainably to our two percent target,*" Powell said during the press conference. "*You'd stop*

GLOSSARY

CPI – Consumer Price Index

FOMC – Federal Open Market Committee

GDP – Gross Domestic Product

PCE – Personal Consumption Expenditures

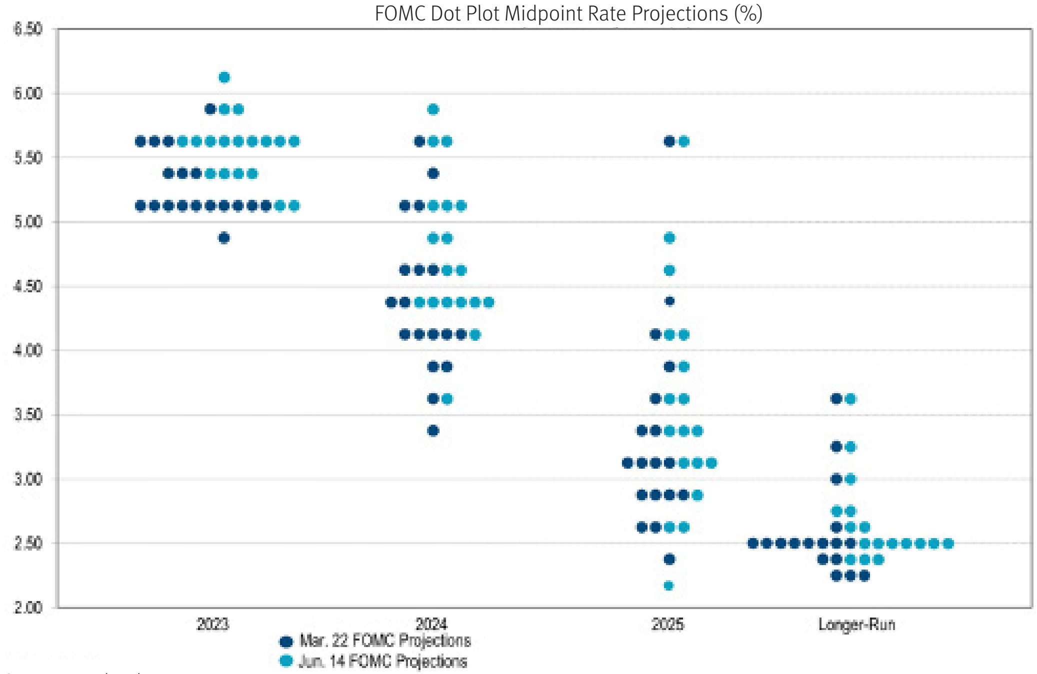
SAAR – Seasonally Adjusted Average Rate

SEP – Summary of Economic Projections

YoY – Year over Year

raising (rates) long before you got to two percent inflation and you'd start cutting before you got to two percent inflation too. We don't see ourselves getting two percent ... until 2025 or so."

FOMC Dot Plot Midpoint Rate Projections (%)



Source: Federal Reserve

Powell explained that cutting rates sends a signal that the Committee is confident inflation is cooling and it is the appropriate time to reduce policy firming. However, he emphasized there is a lot of uncertainty. Referencing the Summary of Economic Projections (SEP), he noted that some Fed officials indicated a possible rate cut next year in their individual forecasts. "*And that's just going to be a judgment that we have to make then, a full year from now and it'll be about how confident we are that inflation is in fact coming down to our two percent goal*," Powell said. "*I think, but I mean there's a lot of uncertainty between what happens you know, in the next meeting cycle, let alone over the next year.*"

Before the next meeting, there is a slew of data scheduled for release, including two jobs reports, two reports on consumer-price inflation and data on employment costs. "*All of that information is going to inform our decision as we go into that [September] meeting*," he said.

"*We've come a long way*," Powell said, but "*inflation... repeatedly has proved stronger than we and other forecasters have expected.*" "*We have to be ready to follow the data, and given how far we've come, we can afford to be a little patient as well as resolute as we let this unfold.*"

5. ***The Fed is still optimistic a soft landing can still be achieved.*** Powell asserts that his view has consistently been that a soft landing is possible: "*My base case is that we will be able to achieve inflation moving back down to our target without the kind of really significant downturn that results in high levels of job losses that we've seen in some past instances.*"

In fact, given the resiliency of the economy, the Fed staff is no longer forecasting a recession. The staff's outlook did include a noticeable slowdown as recently as the

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March report but given the strength of the consumer and the tight labor market, there is no longer an expectation of a severe recession. In fact, Fed staffers now see the possibility of a soft landing almost as equally as possible as a mild-recession base-case.

"*Given the continued strength in labor market conditions and the resilience of consumer spending, however, the staff saw the possibility of the economy continuing to grow slowly and avoiding a downturn as almost as likely as the mild recession baseline,*" the June 13-14 FOMC meeting minutes read.

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