Take 5 Five
WITH THE ST. LOUIS FED

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As FOMC holds policy rate unchanged in July, attention turns to September

Transcript

Kathleen Navin: Welcome to this installment of *Take 5 with the St. Louis Fed*. I'm Kathleen Navin, senior business economist, and today I'll be discussing the latest FOMC meeting that took place on July 30 and July 31.

At this meeting, the FOMC unanimously voted to maintain the current target for the federal funds rate at a range of 5.25 to 5.5%, where it has been now for a full year. While there are no changes to Fed policy at this meeting, there were some interesting changes to the latest FOMC statement. In the latest statement, it read, "The economic outlook is uncertain, and the Committee is attentive to the risks to both sides of its dual mandate." Now, this is a change from previous statements that solely focused on risks to inflation. So we see that risks to the labor market part of the dual mandate are coming more into focus, and we'll talk about some of the data that are very important to keep an eye on when thinking about the balance of risks to the dual mandate.

There was also a new discussion on economic developments, and there we saw a solid pace of economic growth, some further progress on returning inflation to the Fed's 2% objective, as well as continued normalization in labor market conditions. So to better understand these latest economic developments, let's first look at real GDP growth. Here we see that real GDP growth improved from 1.4% in the first quarter to 2.8% in the second quarter. And underlying the real GDP growth number for Q2 were strong gains in private domestic final purchases, which includes PCE, so personal consumption expenditures, business fixed investment, and residential investment. And when we look at the first half of this year, on average, 2.1% real GDP growth is still solid, though down from 3.1% growth last year.

Now, turning to inflation, we had some disappointing figures on inflation to start the year. So a disappointing Q1. But when we look at Q2, there was more progress, and we saw inflation appear to return on its downward trend toward the 2% objective. And for June, headline PCE inflation came in at 2.5%, down from its peak of 7.1% in June of 2022, and core PCE inflation 2.6% as of this most recent June. And when we look at core PCE inflation, it can be helpful to kind of look at the components. So, core PCE inflation already gives us a good sense of underlying inflation. It removes the volatile components of food and energy. But when we look at the components, we see here we have the three main components. So core goods, core services excluding housing, and then also housing services. And this make

up the full picture of core PCE inflation. We see that there's no longer inflationary pressure coming from core goods. That's actually returned to a small drag on the overall number. But what we see is that there are still inflationary pressures coming from housing services and core services excluding housing, and those had appeared to stall somewhat in the first quarter but then resume moderation in the second quarter. And this is what we're going to continue to watch going forward, and this will be important for gaining a full picture on whether or not inflation is returning to 2% and progress on that part of the dual mandate. But as we know, that's just one side of the dual mandate.

If we look at the other side, turning to labor market conditions, we see that there's been an ongoing normalization from the very hot labor market we had coming out of the pandemic. So turning to the unemployment rate, we see here that at 4.1% as of June, this is up from a low of 3.4% reached last year but is still historically a very low unemployment rate. When we look at payroll gains, also through June, we see this continued normalization from those very strong payroll gains that occurred in 2021 into 2022 coming out of the pandemic recession to more normal monthly gains, but still solid. So at an average of 222,000 over the first half of the year as of the June employment report, these are still solid numbers.

Now, when we look at other reports on employment, we see maybe a little bit more weakening. Here I have numbers from the latest Job Openings and Labor Turnover Survey, known as JOLTS. What we see is that job openings have come down dramatically from the highs reached post-pandemic, but they're still somewhat elevated relative to where they were prior to the pandemic recession. When we look at hires and quits, on the other hand, this gives us a picture of labor market churn, and we see that that has really slowed. Hires especially are down quite a bit from where they were pre-pandemic, whereas quits just a little below that pre-pandemic level. So really an area to keep an eye on, because while we welcome continued normalization in the labor market, we don't want to see a material weakening in the labor market.

And this brings us to a discussion that was very prevalent during the FOMC press briefing, and that was the challenge the FOMC has right now between moving too soon or moving too late. If the FOMC moves too soon in removing policy restraint, the risk is that inflation reaccelerates and we lose and we erase some of that progress made on bringing inflation back toward that 2% objective. On the other hand, if the FOMC waits too long to remove policy restraint, there's a risk that there could be a more material slowdown in economic growth or also labor market conditions. So this is really an area to watch.

And all of this being said, the focus now turns to September, and a question being will the FOMC get the data they need between now and the September meeting to begin removing policy restraint? Well, markets seem to think yes. On the Wednesday following the announcement, essentially markets had priced in a full 25 basis point cut as of the September

meeting. However, we know that the Committee makes decisions on a meeting-by-meeting basis. And as Chair Powell noted, "The question will be whether the totality of the data, the evolving outlook, and the balance of risks are consistent with rising confidence on inflation and maintaining a solid labor market. If that test is met, a reduction in our policy rate could be on the table as soon as the next meeting in September."

That concludes this installment of *Take 5 with the St. Louis Fed*. Thanks so much for joining us.

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