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FOMC holds steady in July, remains well positioned to respond to economic developments

Transcript

Kathleen Navin: Welcome to this edition of *Take Five 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 29 and 30.

At this meeting, the FOMC voted to maintain the current target range at 4.25% to 4.5%, where it has been now since the December meeting. Now, there were two dissents from this policy decision. The dissents were from Governor Miki Bowman and Governor Chris Waller. It's very common for a dissenting member to release a statement in the days following the FOMC with some clarity around that dissent. So we'll be looking for that for more guidance in the days following the meeting.

Now, when talking about the FOMC's decision to maintain that target range at 4.25% to 4.5%, Chair Powell discussed during his opening remark of the FOMC press briefing the following: "We believe that the current stance of monetary policy leaves us well positioned to respond in a timely way to potential economic developments." So this is very much in line with what we've heard in recent meetings. Essentially, at the current level, Chair Powell views this as a modestly restrictive stance of monetary policy and views this as appropriate in determining what the next move will be.

And when making those decisions, it really comes down to the economic data. Now, along with the FOMC meeting this week, we had a lot of economic data that were released, some in time for the FOMC meeting, such as the latest GDP report for the second quarter, but some after the meeting, including new data on prices as well as the employment report, which will be released on the Friday following the meeting on August 1. So let's take a look at some of this recent data.

Well, when we look at real GDP growth here in the maroon bars, we see that we had that slight decline in the first quarter of this year, but then we have a very strong rebound to 3% growth in the second quarter. Now, when looking at these headline figures, that's a pretty strong number of 3% growth, but we need to look under the surface to see what the actual underlying trend is in the economy. And when we do that, one very helpful way is to look at contributions to real GDP growth.

Here, I have those contributions broken down by major components. So we see personal consumption expenditures—that's our consumer spending category—business fixed investment and residential investment, those are all in the maroon color with different patterns. What you'll notice is that when I'm looking at personal consumption expenditures in that solid maroon bar, we see a much smaller contribution over the last two quarters than we did over the previous two years. And so we are seeing that slowing in consumer spending—still a decent number, but we are seeing that pullback on the consumer side.

Now, when we look at what really moved the economic data in Q1 and Q2, it really comes down to net exports, which we see in that solid gray bar. We had a very large drag from net exports in Q1, and that contributed, really more than accounted for, that negative print we had for headline GDP last quarter, and then we have a rebound in Q2. So imports, they are something that subtracts from GDP growth. So as we saw that surge in imports in the first quarter as businesses and consumers looked to get ahead of tariffs, well, when that reverses in the second quarter, that actually adds positively to GDP. So that 3% growth is really showing an economy that is, you know, is solid—3% is probably overstating that amount of strength given this flow that we have in net exports and that volatility.

When we're thinking about the economy, we're not just thinking of headline GDP; we're also thinking about the Fed's dual mandate, so price stability and maximum employment. Well, the day following the FOMC meeting, we have new data on the PCE price index. What we saw is that headline PCE ticked up to 2.6%, and this is on a year-over-year basis. And then core PCE, which removes the volatile components of food and energy, that was ticking up to 2.8%. Now, these numbers were likely not a surprise. We know that data on CPI and PPI released earlier in the month give a good sense of what they will be. But it still does show an inflation picture that is above the Fed's 2% objective. And we know there's a lot of conversation about how will tariffs influence this inflation picture. We saw that short-term inflation expectations increased earlier this year with the expectation that tariffs would increase inflation. And that's really something to be focused on, because stable inflation expectations are very important for achieving the 2% mandate.

And indeed, Chair Powell shared during his remarks during the press briefing the following: "Our obligation is to keep longer-term inflation expectations well anchored and to prevent a one-time increase in the price level from becoming an ongoing inflation problem." So we see this discussion around a one-time price increase, which is what you would expect tariffs to do, but also wanting to prevent that from getting into inflation expectations and creating a more persistent inflation picture.

Now, the dual mandate—we have price stability but also maximum employment, as we discussed. So where are we on the employment picture? Well, data on employment will actually be released on August 1, two days following the FOMC meeting. So at the time of the meeting, looking at data through June, what we saw is an unemployment rate of 4.1%, and that unemployment rate has really been in this very narrow range of 4% to 4.2% throughout the last year or so. So we're seeing a very stable employment picture. When we look at payroll gains, we do see that slowing and payroll gains from the very hot labor market that we had coming out of the pandemic. And so we really have seen this move back into better balance. We see that more stable employment picture.

So when we're talking about that side of the dual mandate, a lot of times you'll hear that we are at maximum employment. And so it makes sense that things would be kind of stable. You wouldn't want to see them much hotter, but you also don't want to see them cooler because that would suggest that the economy may be slowing too much. So all of this will be taken into consideration and looking at new data as the months progress.

And indeed, by the time we get to the September meeting, we will have a few more reports on CPI inflation, we'll have a few more reports on employment, and then an additional report on PCE inflation. And all of that will help give clarity to what the appropriate stance of policy should be. So again, when looking ahead to September, all of these things happen on a meeting-by-meeting basis. We don't know what will happen until we've seen all of the data, have all that data in hand. So we'll be looking toward September to see what appropriate policy will be.

Until that time, thank you so much for joining us. And this is *Take Five with the St. Louis Fed*.

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