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Data Insights: FOMC Minutes

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July minutes: key signaling language Featured Important Very important

…The staff continued to judge that the risks to the baseline projection for real activity were skewed to the downside, noting that supply chain bottlenecks, Russia's war against Ukraine, weak incoming data on spending, and the tightening in financial conditions since the start of the year supported this assessment. The staff viewed the risks to the inflation projection as skewed to the upside given the persistent upward surprises seen in the inflation data, the possibility that inflation expectations would become unanchored as a result of the large increase in actual inflation over the past year, and the risk that supply conditions would not improve as much as the baseline projection assumed.

…In their discussion of current economic conditions, participants noted that recent indicators of spending and production had softened. Nonetheless, job gains had been robust in recent months, and the unemployment rate had remained low. Inflation remained elevated, reflecting supply and demand imbalances related to the pandemic, higher food and energy prices, and broader price pressures. Participants recognized that Russia's war against Ukraine was causing tremendous human and economic hardship. Participants judged that the war and related events were creating additional upward pressure on inflation and were weighing on global economic activity. Against this background, participants stated that they were highly attentive to inflation risks.

With regard to current economic activity, participants noted that consumer expenditures, housing activity, business investment, and manufacturing production had all decelerated from the robust rates of growth seen in 2021. The labor market, however, remained strong. Participants observed that indicators of spending and production suggested that the second quarter of this year had seen a broad-based softening in economic activity. Many participants remarked that some of the slowing,

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particularly in the housing sector, reflected the emerging response of aggregate demand to the tightening of financial conditions associated with the ongoing firming of monetary policy. The unwinding of the large-scale support to consumer spending provided by pandemic-related fiscal policy actions, the inflation-induced reduction in real disposable income, and the move down in the demand for some products from the elevated levels seen in earlier stages of the pandemic had also all led to slower growth in households' expenditures. In addition, a deterioration in the foreign economic outlook and a strong dollar were contributing to a weakening of external demand. Participants anticipated that U.S. real GDP would expand in the second half of the year, but many expected that growth in economic activity would be at a below-trend pace, as the period ahead would likely see the response of aggregate demand to tighter financial conditions become stronger and more broad based. Participants noted that a period of below-trend GDP growth would help reduce inflationary pressures and set the stage for the sustained achievement of the Committee's objectives of maximum employment and price stability.

In their discussion of the household sector, participants commented that they were seeing many signs in the data, and hearing reports from business contacts, of slower growth in consumer spending. Although the aggregate balance sheet for the household sector was strong and the unemployment rate was low, consumer sentiment had deteriorated, and households were reportedly becoming more cautious in their expenditure decisions in light of uncertainty about the economic outlook and the reduction in purchasing power induced by price rises, particularly increases in the prices of essentials such as food, housing, and transportation. Participants also observed that housing activity had weakened notably, reflecting the impact of higher mortgage interest rates and house prices on home affordability. Participants anticipated that this slowdown in housing activity would continue and also expected higher borrowing costs to lead to a slowing in other interest-sensitive household expenditures, such as purchases of durable goods.

With respect to the business sector, participants noted that investment spending had likely declined in the second quarter. In addition, business survey data and information received from contacts indicated that manufacturing orders and production had fallen in some Districts. Heightened uncertainty, concerns about inflation, tighter financial conditions, and a cutback in consumer spending had led firms to downgrade economic prospects. Some participants noted that their contacts were reporting that businesses were in the process of reevaluating their capital expenditure plans, though a few participants stated that some contacts had reported a degree of short-term momentum in business activity arising from existing orders and from the implementation of expansion plans made before the tightening of financial conditions. A few participants indicated that some business contacts had assessed that demand and supply were beginning to come into better balance. Even so, contacts in many areas continued to report major supply chain disruptions and anticipated that these were likely to continue while also indicating that there were signs of improvement in supply conditions in some areas.

Participants observed that the labor market remained strong, with the unemployment rate very low, job vacancies and quits close to historically high levels, and an elevated rate of nominal wage growth. Many participants also noted, however, that there were some tentative signs of a softening outlook for the labor market: These signs included increases in weekly initial unemployment insurance claims, reductions in quit rates and vacancies, slower growth in payrolls than earlier in the year, and reports of cutbacks in hiring in some sectors. In addition, although nominal wage growth remained strong according to a wide range of measures, there were some signs of a leveling off or edging down. In some Districts, contacts had suggested that labor demand–supply imbalances might be diminishing, with firms being more successful in hiring and retaining workers and under less pressure to raise wages. Some participants noted that the contribution that increases in labor supply could make to reducing labor market imbalances was likely limited, especially as the scope for labor force participation to pick up was constrained by the ongoing movement of the large baby-boom cohort into their retirement years, while others highlighted factors holding down participation that could wane in the future, such as continuing pandemic-related concerns. Participants observed that, in part because of tighter financial conditions and an associated moderation in the growth of aggregate demand, growth in employment would likely slow further in the period ahead. They noted that this development would help bring labor demand and supply into better balance, reducing upward pressures on nominal wage growth and aiding the return of inflation to 2 percent. Several participants observed that the moderation in labor market conditions might well lag the slowdown in economic activity. Participants remarked that a moderation in labor market conditions would likely involve a decline in the number of job openings as well as a moderate increase in unemployment from the current very low rate. A couple of participants indicated that firms were keen to retain workers—a factor that could limit the increase in layoffs associated with a slowing labor market.

Participants noted that indicators of spending and production pointed to less underlying strength in economic activity than was suggested by indicators of labor market activity. With employment growth still strong, the weakening in spending data implied unusually large negative readings on labor productivity growth for the year so far. Participants remarked that the strength of the labor market suggested that economic activity may be stronger than implied by the current GDP data, with several participants raising the possibility that the discrepancy might ultimately be resolved by GDP being revised upward. Several participants also observed, however, that the labor market might not be as tight as some indicators suggested, and they noted that data provided by the payroll processor ADP and employment as reported in the household survey both seemed to imply a softer labor market than that suggested by the still-robust growth in payroll employment as reported in the establishment survey.

Participants observed that inflation remained unacceptably high and was well above the Committee's longer-run goal of 2 percent. In light of the high CPI reading for June, participants noted that PCE inflation was likely to have increased further in that month. Participants further observed that inflationary pressures were broad based, a pattern reflected in large one-month increases in the trimmed mean CPI and core CPI measures. Participants remarked that, although recent declines in gasoline prices would likely help produce lower headline inflation rates in the short term, declines in the prices of oil and some other commodities could not be relied on as providing a basis for sustained lower inflation, as these prices could quickly rebound. Participants also noted that the high cost of living was an especially great burden on low- and middle-income households. Participants agreed that there was little evidence to date that inflation pressures were subsiding. They judged that inflation would respond to monetary policy tightening and the associated moderation in economic activity with a delay and would likely stay uncomfortably high for some time. Participants also observed that in some product categories, the rate of price increase could well pick up further in the short run, with sizable additional increases in residential rental expenses being especially likely.

Participants noted that supply bottlenecks were continuing to contribute to price pressures. There were, however, some signs of gradual improvement in the supply situation—including improved availability of certain key materials, less upward pressure on input prices, and a decline in delivery times. Contacts reported that there were nevertheless substantial continuing challenges. Participants judged that it would take considerable time for supply constraints to be resolved, and a few suggested that full resolution of supply difficulties would take longer than they previously assessed. Several participants stressed that improvements in supply would be helpful but by themselves could not be relied on to resolve the supply and demand imbalances in the economy sufficiently rapidly. Participants emphasized that a slowing in aggregate demand would play an important role in reducing inflation pressures. They expected that the appropriate firming of monetary policy and an eventual easing of supply and demand imbalances would bring inflation back down to levels consistent with the Committee's longer-run objective and keep longer-term inflation expectations well anchored. Participants discussed a number of factors likely to be helpful in bringing inflation back down to 2 percent. In addition to the Committee's ongoing policy firming and anchored longer-term inflation expectations, these included competitive pressures restraining price increases, the apparent absence of a wage–price spiral, the tightening of monetary policy abroad, and the impact of the appreciation of the dollar on import prices. However, they continued to view commodity price developments as a potential source of upward pressure on inflation.

Participants noted that expectations of inflation were an important influence on the behavior of actual inflation and stressed that moving to an appropriately restrictive stance of policy was essential for avoiding an unanchoring of inflation expectations. Such an unanchoring would make achieving the Committee's statutory objectives of maximum employment and price stability much more difficult. In assessing the current state of inflation expectations, participants noted that recent readings on market-based measures of inflation compensation were consistent with longer-term inflation expectations remaining anchored near 2 percent. They judged that this behavior of longer-term inflation expectations was likely partly due to the actual and expected firming of monetary policy and also likely reflected downward revisions to the growth of aggregate demand expected in coming years. In addition, several participants assessed that the Committee's ongoing monetary policy tightening was helping alleviate concerns among market participants and wage and price setters that elevated inflation would become entrenched. Several participants observed that recent readings on survey measures of inflation expectations were broadly consistent with the Committee's 2 percent longer-run inflation objective, although a few participants noted that household surveys were indicating increasing divergences in views about the likely longer-run rate of inflation.

In their discussion of risks, participants emphasized that they were highly attentive to inflation risks and were closely monitoring developments regarding both inflation and inflation expectations. Uncertainty about the medium-term course of inflation remained high, and the balance of inflation risks remained skewed to the upside, with several participants highlighting the possibility of further supply shocks arising from commodity markets. Participants saw the risks to the outlook for real GDP growth as primarily being to the downside. These downside risks included the possibility that the tightening in financial conditions would have a larger negative effect on economic activity than anticipated, that there would be further pandemic-related economic disruptions, or that geopolitical and global economic developments would lead to additional adverse economic or financial disturbances…

In their consideration of the appropriate stance of monetary policy, participants concurred that the labor market was very tight and that inflation was far above the Committee's 2 percent inflation objective. Participants noted that recent indicators of spending and production had softened, while, by contrast, job gains had been robust and the unemployment rate had remained low. Against this backdrop, all participants agreed that it was appropriate to raise the target range for the federal funds rate 75 basis points at this meeting and to continue the process of reducing the Federal Reserve's securities holdings, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that the Committee issued in May. Participants observed that, following this meeting's policy rate hike, the nominal federal funds rate would be within the range of their estimates of its longer-run neutral level. Even so, with inflation elevated and expected to remain so over the near term, some participants emphasized that the real federal funds rate would likely still be below shorter-run neutral levels after this meeting's policy rate hike.

In discussing potential policy actions at upcoming meetings, participants continued to anticipate that ongoing increases in the target range for the federal funds rate would be appropriate to achieve the Committee's objectives. With inflation remaining well above the Committee's objective, participants judged that moving to a restrictive stance of policy was required to meet the Committee's legislative mandate to promote maximum employment and price stability. Participants concurred that the pace of policy rate increases and the extent of future policy tightening would depend on the implications of incoming information for the economic outlook and risks to the outlook. Participants judged that, as the stance of monetary policy tightened further, it likely would become appropriate at some point to slow the pace of policy rate increases while assessing the effects of cumulative policy adjustments on economic activity and inflation. Some participants indicated that, once the policy rate had reached a sufficiently restrictive level, it likely would be appropriate to maintain that level for some time to ensure that inflation was firmly on a path back to 2 percent.

Participants concurred that, in expeditiously raising the policy rate, the Committee was acting with resolve to lower inflation to 2 percent and anchor inflation expectations at levels consistent with that longer-run goal. Participants noted that the Committee's credibility with regard to bringing inflation back to the 2 percent objective, together with its forceful policy actions and communications, had already contributed to a notable tightening of financial conditions that would likely help reduce inflation pressures by restraining aggregate demand. Participants pointed to some evidence suggesting that policy actions and communications about the future path of the federal funds rate were starting to affect the economy, most visibly in interest-sensitive sectors. Participants generally judged that the bulk of the effects on real activity had yet to be felt because of lags associated with the transmission of monetary policy, and that while a moderation in economic growth should support a return of inflation to 2 percent, the effects of policy firming on consumer prices were not yet apparent in the data. A number of participants posited that some of the effects of policy actions and communications were showing up more rapidly than had historically been the case, because the expeditious removal of policy accommodation and supporting communications already had led to a significant tightening of financial conditions.

In light of elevated inflation and the upside risks to the outlook for inflation, participants remarked that moving to a restrictive stance of the policy rate in the near term would also be appropriate from a risk-management perspective because it would better position the Committee to raise the policy rate further, to appropriately restrictive levels, if inflation were to run higher than expected. Participants judged that a significant risk facing the Committee was that elevated inflation could become entrenched if the public began to question the Committee's resolve to adjust the stance of policy sufficiently. If this risk materialized, it would complicate the task of returning inflation to 2 percent and could raise substantially the economic costs of doing so. Many participants remarked that, in view of the constantly changing nature of the economic environment and the existence of long and variable lags in monetary policy's effect on the economy, there was also a risk that the Committee could tighten the stance of policy by more than necessary to restore price stability. These participants highlighted this risk as underscoring the importance of the Committee's data-dependent approach to judging the pace and magnitude of policy firming over coming quarters….

Source: Federal Reserve Board