Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

Data Insights: FOMC Minutes

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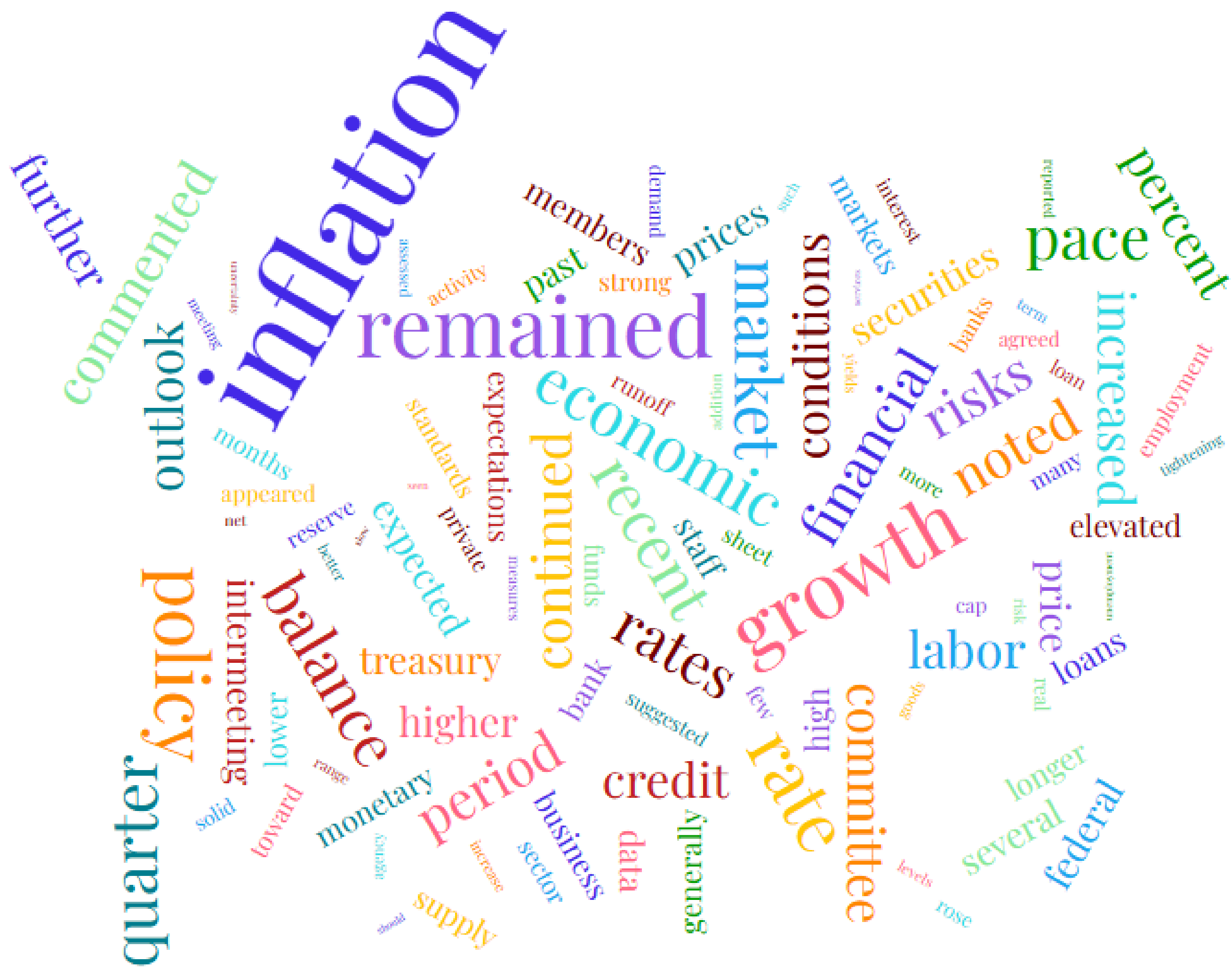

Review of Monetary Policy Strategy, Tools, and Communications

Committee participants continued their discussions related to their review of the Federal Reserve's monetary policy framework, with a focus on issues related to assessing the risks and uncertainty that are relevant for monetary policy and the potential implications of these issues for the FOMC's policy strategy and communications. The staff reviewed qualitative and quantitative tools that are commonly used to measure uncertainty about the economic outlook and the balance of risks, drawing on U.S. and international experience. The staff then discussed monetary policy strategies that aim to be robust to a variety of economic environments and ways in which risk-management considerations can be incorporated into monetary policy analysis and decisionmaking. The staff also considered the role of scenario analysis as a tool to communicate to the public risks and uncertainty around the economic outlook and their implications for monetary policy.

Participants noted that risks and uncertainty are important factors affecting their decisionmaking and emphasized the need for a policy strategy that aims to achieve the Committee's maximum-employment and price-stability objectives across a wide range of highly uncertain developments. Participants acknowledged that risks and uncertainty about the economy are pervasive and pose challenges to both the design and communication of monetary policy. They remarked that measuring and assessing risks and uncertainty are difficult and that the Committee has been well served by relying on a wide range of indicators, as well as information from business and community contacts, to gauge evolving risks, especially during periods of heightened uncertainty.

Participants remarked that effective communications about risks and uncertainty help the public understand the Committee's decisions and enhance the transparency, accountability, and effectiveness of monetary policy decisions. Participants had a preliminary discussion about a range of issues related to enhancing the Committee's suite of communication tools, including possible changes to the Summary of Economic Projections (SEP) and a potential broader use of alternative scenarios. Participants highlighted, however, the challenges associated with adjustments to these tools and noted that any revisions to the Committee's communication policies would need to be considered carefully and receive broad support across participants.

Participants agreed to continue their discussions of ways to enhance the Committee's communication tools and practices once they completed their review of their Statement on Longer-Run Goals and Monetary Policy Strategy. Participants expected that they would complete that review by late summer.

…Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, participants submitted their projections of the most likely outcomes for real GDP growth, the unemployment rate, and inflation for each year from 2025 through 2027 and over the longer run. The projections were based on participants' individual assessments of appropriate monetary policy, including their projections of the federal funds rate. The longer-run projections represented each participant's assessment of the rate to which each variable would tend to converge under appropriate monetary policy and in the absence of further shocks to the economy. Participants also provided their individual assessments of the level of uncertainty and the balance of risks associated with their projections. The SEP was released to the public after the meeting.

Participants noted that the available data showed that economic growth was solid and the unemployment rate was low. Participants observed that inflation had come down but remained somewhat elevated. Growth in consumer spending and business investment had been solid, though many participants observed that measures of household and business sentiment remained weak. Participants judged that uncertainty about the outlook was elevated amid evolving developments in trade policy, other government policies, and geopolitical risks, but that overall uncertainty had diminished since the previous meeting. Some participants commented that high uncertainty had the potential to restrain economic activity, including private-sector hiring, in the near term. Participants judged that there were downside risks to employment and economic activity and upside risks to inflation, but that these risks had decreased as expectations about effective tariff rates and their effects had declined from levels in April.

Participants observed that inflation had eased significantly since its peak in 2022 but remained somewhat elevated relative to the Committee's 2 percent longer-run goal. Participants noted that the progress in returning inflation to target had continued even though that progress had been uneven. Some participants observed that services price inflation had moved down recently, while goods price inflation had risen. A few participants noted that there had been limited progress recently in reducing core inflation. Some participants noted that geopolitical developments in the Middle East posed an upside risk to energy prices.

In discussing their outlooks for inflation, participants noted that increased tariffs were likely to put upward pressure on prices. There was considerable uncertainty, however, about the timing, size, and duration of these effects. Many observed that it might take some time for the effect of higher tariffs to be reflected in the prices of final goods because firms might choose not to raise prices on affected goods and services until they had run down inventories of products imported before the increase in tariffs or because it would take some time for tariffs on intermediate goods to work through the supply chain. Several participants commented that upward pressure on prices could be greater if tariffs disrupted supply chains or acted as a drag on productivity. Many participants noted that the eventual effect of tariffs on inflation could be more limited if trade deals are reached soon, if firms are able to quickly adjust their supply chains, or if firms can use other margins of adjustment to reduce their exposure to the effects of tariffs. Several participants noted that firms not directly subject to tariffs might take the opportunity to increase their prices if other prices rise, particularly those of complementary products. Participants relayed a range of assessments from their business contacts regarding the extent to which tariff-related cost increases would be passed on to consumers. Several participants observed that the pass-through of tariffs might be limited if households and businesses exhibit a low tolerance for price hikes or if firms seek to increase their market share as others raise their prices. A few participants noted that the pass-through of tariff-related costs likely would be greater for smaller businesses or businesses with narrow profit margins.

Participants noted that longer-term inflation expectations continued to be well anchored and that it was important they remain so. Several participants commented that shorter-term inflation expectations had been elevated and that this development had the potential to spill over into longer-term expectations or to affect price and wage setting in the near term. While a few participants noted that tariffs would lead to a one-time increase in prices and would not affect longer-term inflation expectations, most participants noted the risk that tariffs could have more persistent effects on inflation, and some highlighted the fact that such persistence could also affect inflation expectations. Some participants observed that because inflation has been elevated for some time, there was a heightened risk of longer-term inflation expectations becoming unanchored if there is a long-lasting rise in inflation.

In their discussion of the labor market, participants judged that conditions remained solid and that the labor market was at, or near, estimates of maximum employment. Several participants observed that the recent stability of the labor market reflected a slowing in both hiring and layoffs, and several participants also mentioned that their contacts and business survey respondents reported pausing hiring decisions because of elevated uncertainty. Several participants noted that immigration policies were reducing labor supply. In their outlook for the labor market, most participants suggested that higher tariffs or heightened policy uncertainty would weigh on labor demand, and many participants expected a gradual softening of conditions. A few participants noted that some indicators already provided signs of softness and that they would be attentive to indications of further labor market weakening. Some participants observed that wage growth had continued to moderate and that it was not expected to contribute to inflationary pressures.

Participants judged that economic activity had continued to grow at a solid pace, although uncertainty remained elevated. The outlook was for continued economic growth, although a majority of participants expected that the pace of growth was likely to moderate going forward. Regarding the household sector, several participants observed that some recent data indicated continued solid consumer spending growth, whereas several other participants pointed to other data that suggested softening. Several participants noted that lower- and moderate-income households were switching to lower-cost items and brands or that these households could be disproportionately affected by tariff-related price increases. Many participants observed that measures of household sentiment remained low, although these measures had risen a bit recently. A few participants noted that consumer sentiment had not been a good predictor of consumer spending in recent years.

In their discussion of the business sector, participants noted that activity remained solid, although there have been signs of softening, and many observed that indicators of business sentiment remained low. With respect to investment spending, several participants reported that business contacts had indicated that their firms were proceeding with existing investment projects but that heightened uncertainty was making them cautious about beginning new projects, especially larger ones; some smaller new investments or those with more certain payoffs were still being undertaken. Several participants noted that financing from both banks and financial markets was readily available for larger investment projects. A couple of participants noted that business investment in artificial intelligence could boost productivity. Several participants commented that there had been signs of softening production activity in the manufacturing sector and pointed to reductions in orders and shipments in manufacturing surveys or in reports of business contacts. A couple of participants noted that the agricultural sector faced strains from low crop prices and high input costs.

In their consideration of monetary policy at this meeting, participants noted that inflation remained somewhat elevated. Participants also observed that recent indicators suggested that economic activity had continued to expand at a solid pace, although swings in net exports and inventories had affected the measurement and interpretation of the data. Participants further noted that the unemployment rate remained at a low level and that labor market conditions had remained solid. Participants observed that uncertainty about the economic outlook had diminished amid a reduction in announced and expected tariffs, which appeared to peak in April and had subsequently declined, but that overall uncertainty continued to be elevated. All participants viewed it as appropriate to maintain the target range for the federal funds rate at 4-1/4 to 4-1/2 percent. Participants judged it appropriate to continue the process of reducing the Federal Reserve's securities holdings.

In considering the outlook for monetary policy, participants generally agreed that, with economic growth and the labor market still solid and current monetary policy moderately or modestly restrictive, the Committee was well positioned to wait for more clarity on the outlook for inflation and economic activity. Participants noted that monetary policy would be informed by a wide range of incoming data, the economic outlook, and the balance of risks. Most participants assessed that some reduction in the target range for the federal funds rate this year would likely be appropriate, noting that upward pressure on inflation from tariffs may be temporary or modest, that medium- and longer-term inflation expectations had remained well anchored, or that some weakening of economic activity and labor market conditions could occur. A couple of participants noted that, if the data evolve in line with their expectations, they would be open to considering a reduction in the target range for the policy rate as soon as at the next meeting. Some participants saw the most likely appropriate path of monetary policy as involving no reductions in the target range for the federal funds rate this year, noting that recent inflation readings had continued to exceed the Committee's 2 percent goal, that upside risks to inflation remained meaningful in light of factors such as elevated short-term inflation expectations of businesses and households, or that they expected that the economy would remain resilient. Several participants commented that the current target range for the federal funds rate may not be far above its neutral level.

Various participants discussed risks that, if realized, would have the potential to affect the appropriate path of monetary policy. Regarding upside risks to inflation, participants noted that, if the imposition of tariffs were to generate a larger-than-expected increase in inflation, if such an increase in inflation were to be more persistent than anticipated, or if a notable increase in medium- or longer-term inflation expectations were to occur, then it would be appropriate to maintain a more restrictive stance of monetary policy than would otherwise be the case, especially if labor market conditions and economic activity remained solid. By contrast, if labor market conditions or economic activity were to weaken materially, or if inflation were to continue to come down and inflation expectations remained well anchored, then it would be appropriate to establish a less restrictive stance of monetary policy than would otherwise be the case. Participants noted that the Committee might face difficult tradeoffs if elevated inflation proved to be more persistent while the outlook for employment weakened. If that were to occur, participants agreed that they would consider how far the economy is from each goal and the potentially different time horizons over which those respective gaps would be anticipated to close.

In considering the likelihood of various scenarios, participants agreed that the risks of higher inflation and weaker labor market conditions had diminished but remained elevated, citing a lower expected path of tariffs, encouraging recent readings on inflation and inflation expectations, resilience in consumer and business spending, or improvements in some measures of consumer or business sentiment. Some participants commented that they saw the risk of elevated inflation as remaining more prominent, or as having diminished by less, than risks to employment. A few participants saw risks to the labor market as having become predominant. They noted some recent signs of weakening in real activity or the labor market, or commented that conditions could weaken in the future, particularly if policy were to remain restrictive. Participants agreed that although uncertainty about inflation and the economic outlook had decreased, it remained appropriate to take a careful approach in adjusting monetary policy. Participants emphasized the importance of ensuring that longer-term inflation expectations remained well anchored and agreed that the current stance of monetary policy positioned the Committee well to respond in a timely way to potential economic developments.

Source: Federal Reserve Board