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Data Insights: FOMC Minutes

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In their discussion of inflation, many participants observed that overall inflation remained somewhat above the Committee's 2 percent longer-run goal. Participants noted that tariff effects were becoming more apparent in the data, as indicated by recent increases in goods price inflation, while services price inflation had continued to slow. A couple of participants suggested that tariff effects were masking the underlying trend of inflation and, setting aside the tariff effects, inflation was close to target.

With regard to the outlook for inflation, participants generally expected inflation to increase in the near term. Participants judged that considerable uncertainty remained about the timing, magnitude, and persistence of the effects of this year's increase in tariffs. In terms of timing, many participants noted that it could take some time for the full effects of higher tariffs to be felt in consumer goods and services prices. Participants cited several contributors to this likely lag. These included the stockpiling of inventories in anticipation of higher tariffs; slow pass-through of input cost increases into final goods and services prices; gradual updating of contract prices; maintenance of firm–customer relationships; issues related to tariff collection; and still-ongoing trade negotiations. As for the magnitude of tariff effects on prices, a few participants observed that evidence so far suggested that foreign exporters were paying at most a modest part of the increased tariffs, implying that domestic businesses and consumers were predominantly bearing the tariff costs. Several participants, drawing on information provided by business contacts or business surveys, expected that many companies would increasingly have to pass through tariff costs to end-customers over time. However, a few participants reported that business contacts and survey respondents described a mix of strategies as being undertaken to avoid fully passing on tariff costs to customers. Such strategies included negotiating with or switching suppliers, changing production processes, lowering profit margins, exerting more wage discipline, or exploiting cost-saving efficiency measures such as automation and new technologies. A few participants stressed that current demand conditions were limiting firms' ability to pass tariff costs into prices. Regarding inflation persistence, a few participants emphasized that they expected higher tariffs to lead only to a one-time increase in the price level that would be realized over a reasonably contained period. A few participants remarked that tariff-related factors, including supply chain disruptions, could lead to stubbornly elevated inflation and that it may be difficult to disentangle tariff-related price increases from changes in underlying trend inflation.

Participants noted that longer-term inflation expectations continued to be well anchored and that it was important that they remain so. Several participants emphasized that inflation had exceeded 2 percent for an extended period and that this experience increased the risk of longer-term inflation expectations becoming unanchored in the event of drawn-out effects of higher tariffs on inflation. A couple of participants noted that inflation expectations would likely be influenced by the behavior of the overall inflation rate, inclusive of the effects of tariffs. Various participants emphasized the central role of monetary policy in ensuring that tariff effects did not lead to persistently higher expected and realized inflation.

In their discussion of the labor market, participants observed that the unemployment rate remained low and that employment was at or near estimates of maximum employment. Several participants noted that the low and stable unemployment rate reflected a combination of low hiring and low layoffs. Some participants observed that their contacts and business survey respondents had reported being reluctant to hire or fire amid elevated uncertainty. Regarding the outlook for the labor market, some participants mentioned indicators that could suggest a softening in labor demand. These included slower and more concentrated job growth, an increase in cyclically sensitive Black and youth unemployment rates, and lower wage increases of job switchers than job stayers. Some of these participants also noted anecdotes in the Beige Book or in their discussions with contacts that pointed to slower demand. Furthermore, a number of participants noted that softness in aggregate demand and economic activity may translate into weaker labor market conditions, as could a potential inability of some importers to withstand higher tariffs. Some participants remarked, however, that slower output or employment growth was not necessarily indicative of emerging economic slack because a decline in immigration was lowering both actual and potential output growth as well as reducing both actual payroll growth and the number of new jobs needed to keep the unemployment rate stable. A few participants relayed reports received from contacts that immigration policies were affecting labor supply in some sectors, including construction and agriculture.

Participants observed that growth of economic activity slowed in the first half of the year, driven in large part by slower consumption growth and a decline in residential investment. Several participants stated that they expected growth in economic activity to remain low in the second half of this year. Some participants noted that economic activity would nevertheless be supported by financial conditions, including elevated household net worth, and a couple of participants highlighted stable or low credit card delinquencies. A couple of participants remarked that economic activity would be supported by the resolution of policy uncertainty over time. Regarding the household sector, several participants observed that slower real income growth may be weighing on growth in consumer spending. A few participants noted a weakening in housing demand, with increased availability of homes for sale and falling house prices. As for businesses, several participants remarked that ongoing policy uncertainty had continued to slow business investment, but several observed that business sentiment had improved in recent months. A few participants commented that the agricultural sector faced headwinds due to low crop prices.

In their evaluation of the risks and uncertainties associated with the economic outlook, participants judged that uncertainty about the economic outlook remained elevated, though several participants remarked that there had been some reduction in uncertainty regarding fiscal policy, immigration policy, or tariff policy. Participants generally pointed to risks to both sides of the Committee's dual mandate, emphasizing upside risk to inflation and downside risk to employment. A majority of participants judged the upside risk to inflation as the greater of these two risks, while several participants viewed the two risks as roughly balanced, and a couple of participants considered downside risk to employment the more salient risk. Regarding upside risks to inflation, participants pointed to the uncertain effects of tariffs and the possibility of inflation expectations becoming unanchored. In addition to tariff-induced risks, potential downside risks to employment mentioned by participants included a possible tightening of financial conditions due to a rise in risk premiums, a more substantial deterioration in the housing market, and the risk that the increased use of AI in the workplace may lower employment.

In their discussion of financial stability, participants who commented noted vulnerabilities to the financial system that they assessed warranted monitoring. Several participants noted concerns about elevated asset valuation pressures. Regarding banks, a couple of participants commented that, though regulatory capital levels remained strong, some banks continued to be vulnerable to a rise in longer-term yields and the associated unrealized losses on bank assets. A few participants commented on vulnerabilities in the market for Treasury securities, raising concerns about dealer intermediation capacity, the increasing presence of hedge funds in the market, and the fragility associated with low market depth. A couple of participants discussed foreign exchange swaps, noting that these served as key sources of dollar funding for foreign financial institutions that lend dollars to their customers in the U.S. and abroad, but also that they entailed vulnerabilities due to maturity mismatch and rollover risk. Many participants discussed recent and prospective developments related to payment stablecoins and possible implications for the financial system. These participants noted that use of payment stablecoins might grow following the recent passage of the GENIUS Act (Guiding and Establishing National Innovation for U.S. Stablecoins Act). They remarked that payment stablecoins could help improve the efficiency of the payment system. They also observed that such stablecoins could increase the demand for the assets needed to back them, including Treasury securities. In addition, participants who commented raised concerns that stablecoins could have broader implications for the banking and financial systems as well as monetary policy implementation, and thus warranted close attention, including monitoring of the various assets used to back stablecoins.

In their consideration of monetary policy at this meeting, participants noted that inflation remained somewhat elevated. Participants also observed that recent indicators suggested that the growth of economic activity had moderated in the first half of the year, 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 the labor market was at or near maximum employment. Participants judged that uncertainty about the economic outlook remained elevated. Almost 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 at this meeting. All participants judged it appropriate to continue the process of reducing the Federal Reserve's securities holdings.

In considering the outlook for monetary policy, almost all participants agreed that, with the labor market still solid and current monetary policy moderately or modestly restrictive, the Committee was well positioned to respond in a timely way to potential economic developments. Participants agreed that monetary policy would be informed by a wide range of incoming data, the economic outlook, and the balance of risks. Participants assessed that the effects of higher tariffs had become more apparent in the prices of some goods but that their overall effects on economic activity and inflation remained to be seen. They also noted that it would take time to have more clarity on the magnitude and persistence of higher tariffs' effects on inflation. Even so, some participants emphasized that a great deal could be learned in coming months from incoming data, helping to inform their assessment of the balance of risks and the appropriate setting of the federal funds rate; at the same time, some noted that it would not be feasible or appropriate to wait for complete clarity on the tariffs' effects on inflation before adjusting the stance of monetary policy. Some participants stressed that the issue of the persistence of tariff effects on inflation would depend importantly on the stance of monetary policy. Several participants commented that the current target range for the federal funds rate may not be far above its neutral level; among the considerations cited in support of this assessment was the likelihood that broader financial conditions were either neutral or supportive of stronger economic activity.

In discussing risk-management considerations that could bear on the outlook for monetary policy, participants generally agreed that the upside risk to inflation and the downside risk to employment remained elevated. Participants noted that, if this year's higher tariffs were to generate a larger-than-expected or a more-persistent-than-anticipated increase in inflation, or if medium- or longer-term inflation expectations were to increase notably, 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 remained solid. By contrast, if labor market conditions were to weaken materially or if inflation were to come down further 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 the labor market weakened. Participants agreed that, if that situation were to occur, they would consider each variable's distance from the Committee's goal and the potentially different time horizons over which those respective gaps would be anticipated to close. Participants noted that, in this context, it was especially important to ensure that longer-term inflation expectations remained well anchored.

Several participants remarked on issues related to the Federal Reserve's balance sheet. Of those who commented, participants observed that balance sheet reduction had been proceeding smoothly thus far and that various indicators pointed to reserves being abundant. They agreed that, with reserves projected to decline amid the rebuilding of the TGA balance following the resolution of the debt limit situation, it was important to monitor money market conditions closely and to continue to evaluate how close reserves were to their ample level. A few participants also assessed that, in this environment, abrupt further declines in reserves could occur on key reporting and payment flow days. They noted that, if such events created pressures in money markets, the Federal Reserve's existing tools would help supply additional reserves and keep the effective federal funds rate within the target range. A couple of participants highlighted the role of the SRF in monetary policy implementation—as reflected in increased usage at the June quarter-end—and expressed support for further study of the possibility of central clearing of the SRF to enhance its effectiveness.

…Governors Bowman and Waller preferred to lower the target range for the federal funds rate by 1/4 percentage point at this meeting. Governor Bowman preferred at this meeting to lower the target range for the federal funds rate by 25 basis points to 4 to 4-1/4 percent in light of inflation moving considerably closer to the Committee's objective, after excluding temporary effects of tariffs, a labor market near full employment but with signs of less dynamism, and slowing economic growth this year. She also expressed her view that taking action to begin moving the policy rate at a gradual pace toward its neutral level would have proactively hedged against a further weakening in the economy and the risk of damage to the labor market.

Source: Federal Reserve Board