FOMC meeting, July 30-31

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Authors: **Gregory Daco and Lydia Boussour**

Meeting minutes: stage is set for a September rate cut

The minutes of the July Federal Open Market Committee (FOMC) meeting revealed that Fed policymakers are increasingly leaning toward recalibrating policy at the upcoming September meeting, with a "vast majority" of participants observing that if the data continued to come in about as expected, it would likely be appropriate to ease policy at the next meeting. Fed officials have grown more confident that inflation is moving sustainably toward the Fed's 2% target and see risks to achieving the employment and inflation goals as better balanced.

At the July FOMC press conference, Fed Chair Jerome Powell's statement that there was a "real discussion" about the case for cutting interest rates at the meeting came as a surprise. The minutes provided color to this statement as several participants noted that the recent progress on inflation and increases in the unemployment rate had provided a "plausible case" for lowering the target range by 25 basis points (bps) at the meeting.

Fed officials viewed the incoming data as enhancing their confidence that inflation was moving toward the committee's objective, and the soft July Consumer Price Index (CPI) report that was released subsequently likely solidified that confidence. Moreover, almost all participants expected the disinflation process to continue in coming months, driven by the waning of pricing power, moderating economic growth, the runoff in excess household savings, easing labor cost growth and more shelter disinflation.

In discussing the uncertainty surrounding the economic outlook, participants noted that upside risks to the inflation outlook had diminished while downside risk to the labor market outlook had increased. The factors still posing upside risks to inflation included potential supply chain disruptions and geopolitical conditions. A few participants also noted the risk that financial conditions could add undue momentum to economic activity and lift economic growth and inflation.

Importantly, the minutes showed that Fed officials have become increasingly attuned to the possibility that labor market conditions could deteriorate quickly, with an increasing number of participants concerned about the risk to the employment side of the Fed's dual mandate. Some participants noted "the risk that a further gradual easing in labor market conditions could transition to a more serious deterioration." The weak July jobs report and a further increase in the unemployment rate have likely reinforced these concerns.

There was a noticeable and dovish shift in the committee's perception of the balance of risks as many participants noted that reducing policy restraint too late or too little could risk unduly weakening economic activity or employment while only several participants noted that removing policy restraint too soon could boost final demand leading to renewed inflationary pressures.

In our view, the sustained moderation in inflation in recent months and the tame CPI report for July provide ample room for the Fed to start its policy recalibration — in fact, we continue to believe that a July rate cut would have been optimal. Importantly, signs that the labor market slowdown is accelerating have further strengthened the case for some policy accommodation. In addition to the soft July jobs figures, large negative revisions to payroll employment from early 2023 through March of this year indicated that the pace of hiring was slower than previously thought, highlighting the risk to the labor market outlook.

In sum, we continue to expect three 25bps rate cuts before year-end, and we foresee an additional 125bps of rate cuts in 2025. While we continue to expect a 25bps rate cut in September, we believe another weak August jobs report would likely put a 50bps rate cut on the table.

Meeting recap: Powell favors an open nod to a shy wink: markets blush

- The Federal Reserve held the federal funds rate unchanged at 5.25% to 5.50% with no dissents. The main changes to the policy statement came from the Federal Open Market Committee (FOMC) being attentive to "both sides of its dual mandate" (instead of just inflation risks) and that risks to achieving the employment and inflation goals "continue to move" into better balance — a shy wink to a September rate cut.
- The policy statement remained focused on recent data points, noting "some" further inflation progress toward 2%, a rise in the unemployment rate and more moderate job gains. The negative conditionality statement for rate cuts was unchanged ("Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence …").
- As we expected, Fed Chair Jerome Powell noted that policymakers were now attentive to both sides of the Fed's mandate and that easing too little or too late could unduly weaken the economy. He added that labor market conditions were similar to 2019 — "strong but not overheated" — and that more good data would increase the Committee's confidence in easing policy.
- Powell said that while there was a "real discussion" of what the case would be for moving at this meeting, a strong majority supported not moving, and all 19 FOMC participants supported the unanimous decision to hold the federal funds rate unchanged.
- While Powell started the press conference saying that no decision had been made about the timing of future rate cuts, he was quick to add that if there were no upside surprises to inflation, "a rate cut could be on the table at the September meeting."
- While Powell tried to retain some optionality, he stressed that the FOMC had gained greater confidence that inflation was moving in the right direction and that the disinflation momentum was "better and broader than last year." He referred to the softer Employment Cost Index compensation print and a rebalanced labor market as evidence of a "normalized economy" that is not inflationary.
- Powell did not try to hide the fact that much of the FOMC meeting centered around the September rate cut, saying: "We had a nice conversation about this issue. The overall sense of the FOMC is that we're getting closer to the point at which it will be appropriate to begin to dial back restriction."
- During the press conference, Powell mentioned a variation of "balanced" and "normalized" 24 times, showing he understands that excessively restrictive policy could lead to an undesired weakening of employment growth and the economy.

- The Fed Chair explained that he viewed monetary policy's "long and variable" lags as being symmetric and that there was about a six-month lag until the impact on the economy. He added that policy was well positioned to respond to an unexpected weakening of the economy with the policy rate at 5.3%, and that for now, final sales to private domestic purchasers growing 2.6% in Q2 were an indication of a solid economy.
- Looking ahead, Fed officials will have the benefit of hindsight of two additional employment and Consumer Price Index reports before the next FOMC meeting in mid-September. In all likelihood, however, the die is cast as policymakers will proclaim greater confidence even if inflation moves sideways over the summer.
- Markets are now pricing more than a full 25-basis-points-rate cut in September, nearly two by November and almost three before the end of the year. This may be more than the Fed bargained for.

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Contacts

Gregory Daco

EY-Parthenon Chief Economist
Strategy and Transactions
Ernst & Young LLP

Lydia Boussour

EY-Parthenon Senior Economist
Strategy and Transactions
Ernst & Young LLP

Marko Jevtic

EY-Parthenon Senior Economist
Strategy and Transactions
Ernst & Young LLP

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