MARKET COMMENTARY

The Fed eyes a rate hike this year, the new chair announces sweeping changes

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- **A divided FOMC now sees a rate hike this year. The Fed appears more concerned than expected about high and sticky inflation. Its much shorter statement dropped forward guidance and stuck to the facts.**
- **New Chair Kevin Warsh held back his own projections and offered little economic analysis in the Q&A. Instead, he began to set out his vision for the Fed: a central bank with a narrower remit, a wider lens, and a stronger focus on financial-market signals.**
- **Five task forces will review how the Fed communicates, manages its balance sheet, uses data, assesses productivity, and analyses inflation. They are expected to complete their work by year-end.**
- **Our baseline has no Fed rate moves this year or next. Markets pushed the two-year Treasury yield to 4.2%, its highest level in more than a year.**

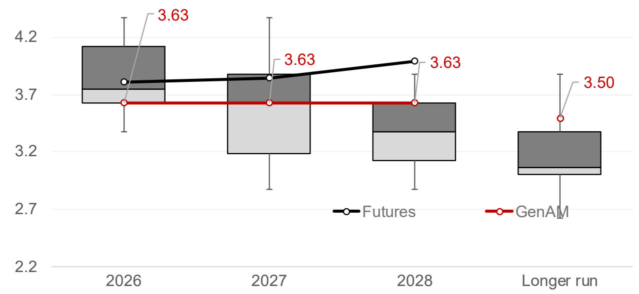
The June meeting saw no changes in the policy rate but delivered three clear surprises: a Fed that sounded more hawkish than expected, a sharply streamlined communication strategy, and the launch of a broad review of how the central bank operates.

At the start of the press conference, the new Chair Warsh said he had received a “warm welcome” from the FOMC. The Committee’s stance on inflation and rates has indeed warmed significantly since the March meeting. The FOMC is now divided: nine members favour a rate increase, compared with none in March, while nine prefer stable or lower rates. The median dot for this year is now consistent with a rate hike, (instead of the cut pencilled in in March) and the median for 2027 is some 50 bps higher than in March. However, Warsh stressed that participants submitted their projections with low confidence, saying they had been “written with a pencil”. There was no discussion of rate cuts, but neither did anyone argue that a hike was needed to preserve credibility. He described the meeting as a “good family fight” that ultimately left the FOMC in a better position.

The FOMC now sees core inflation as not only higher but also stickier: the Fed project it to remain above 2% for the next two and a half years. Consistent with his criticism of the projections, Warsh refrained from submitting his own view.

FOMC "dots" and Fed fund rates forecasts

Middle of the range.
Year-end, median, quartiles and extremes of the distribution



Source:Federal Reserve Board,NY Fed; Datastream,GenAM estimates

Distribution of the projected year-end Fed funds rate

Estimate of year-end appropriate rate by each FOMC member, by meeting.

2026		2027		2028		Long term	
Mar-26	Jun-26	Mar-26	Jun-26	Mar-26	Jun-26	Mar-26	Jun-26
3.63	4.38	3.88	4.38	3.88	3.88	3.88	3.88
3.63	4.13	3.63	4.13	3.63	3.88	3.75	3.75
3.63	4.13	3.63	4.13	3.63	3.88	3.63	3.63
3.63	4.13	3.63	3.88	3.63	3.63	3.50	3.50
3.63	4.13	3.38	3.88	3.38	3.63	3.38	3.38
3.63	4.13	3.38	3.88	3.38	3.63	3.38	3.38
3.63	3.88	3.38	3.88	3.38	3.63	3.25	3.25
3.38	3.88	3.38	3.88	3.13	3.63	3.13	3.13
3.38	3.88	3.13	3.63	3.13	3.38	3.13	3.13
3.38	3.63	3.13	3.63	3.13	3.38	3.13	3.00
3.38	3.63	3.13	3.38	3.13	3.13	3.00	3.00
3.38	3.63	3.13	3.38	3.13	3.13	3.00	3.00
3.38	3.63	3.13	3.38	3.13	3.13	3.00	3.00
3.38	3.63	3.13	3.13	3.13	3.13	3.00	3.00
3.13	3.63	2.88	3.13	2.88	3.13	3.00	3.00
3.13	3.63	2.88	3.13	2.88	3.13	2.88	3.00
2.88	3.63	2.88	3.13	2.88	2.88	2.88	2.88
2.88	3.38	2.63	2.88	2.63		2.63	2.88
2.63		2.38		2.63		2.63	

Source: Federal Reserve Board, GenAM

Median Projection

	2026	2027	2028	Longer run
Change in real GDP	2.2	2.3	2.2	2.0
Mar. projection	2.4	2.3	2.1	2.0
Unemployment rate	4.3	4.3	4.2	4.2
Mar. projection	4.4	4.3	4.2	4.2
PCE inflation	3.6	2.3	2.0	2.0
Mar. projection	2.7	2.2	2.0	2.0
Core PCE inflation	3.3	2.5	2.1	
Mar. projection	2.7	2.1	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	3.8	3.6	3.4	3.1
Mar. projection	3.4	3.1	3.1	3.1

The Fed provided much less information than in the past. The easing bias was removed from the press release, as expected, but the broader change was more striking: the communiqué was fully rewritten and is now much shorter. It states only the main economic facts, the commitment to fight inflation, and the decision to maintain the ample reserves framework.

The Federal Open Market Committee approved the following statement for release by a 12 – 0 vote:

The Committee decided to maintain the target range for the federal funds rate at 3-1/2 to 3-3/4 percent, in support of the Federal Reserve's dual mandate. The Committee reaffirmed its policy of maintaining ample reserves in the banking system.

Economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East. Productivity growth and capital investment are strong. Job gains have kept pace with the workforce, and the unemployment rate has changed little.

Inflation remains elevated relative to the Committee's 2 percent goal, in part reflecting supply shocks that have driven price increases in certain sectors, including energy. The Committee will deliver price stability.

In the Q&A, Warsh largely reiterated the economic outlook described in the projections and added no colour. Most of the session focused instead on announcing and motivating the reform initiatives he has launched.

The main exception was his discussion of the policy stance. Rather than saying whether policy is restrictive, Warsh described it as uneven. It is probably too tight for the housing market, but not tight at all for financial markets, reflecting differences in the transmission mechanism and in the elements of monetary policy that matter most for each sector, namely rates versus the balance sheet.

Forward guidance has been replaced by repeated commitment to deliver on inflation. Warsh believes financial markets function better when they respond to new data rather than to sometimes vague central bank guidance. He also sees price signals from financial markets as key data for the central bank to monitor.

Warsh's stated aim is to build a "central bank with a wider lens and a smaller remit". To that end, he will set five task forces to review key aspects of monetary policy. They will focus on:

1. Revising and improving how the Fed communicates its thinking and decisions. Warsh expects deep changes to the Summary of Economic Projections.
2. Reconsidering how the balance sheet works. The ample reserves regime, confirmed at this meeting, will be assessed against alternatives.
3. Considering new and alternative data that are more relevant for real-time, actionable decisions. Warsh said that current survey and national accounts data are already stale when published, describing them as "an echo of the past". One source of inspiration will be how private-sector CEOs gather and use data, while new techniques to process information will also be adopted.
4. Studying the pace and reach of productivity growth, with a particular focus on the impact of AI.
5. Reviewing how the Fed thinks about inflation and its drivers. However, the 2% target is not under discussion, at least until inflation has been brought back to that level.

The task forces will include people from both inside and outside the Fed and will be open to participants from financial markets and the technology sector. A more precise description and timeline will be provided soon, but Warsh expects the task forces to complete their work by the end of the year.

The price signal from market was unequivocal: a 25bp rate increase in October is now fully priced, while a second hike by April 2027 has an 84% probability. We currently expect the Fed not to move for the foreseeable future.

The two-year Treasury yield shot up by 17bps to 4.22%, the highest level in more than a year The S&P 500 initially fell by 0.9%, before recovering around half of those losses.