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MONETARY AFFAIRS:

Review: The FOMC Remains on Hold in July, With Several Hawkish Dissenters Emerging

by

Brunello Rosa and Nato Balavadze

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Executive Summary

- **Decision Made**: *The Fed kept US interest rates unchanged in July.* The The FOMC voted 9-3 to hold the federal funds rate at 3.5%–3.75%, despite dissent from officials favoring a rate hike. Regional Fed presidents Beth Hammack, Neel Kashkari, and Lorie Logan dissented in favor of a rate hike, citing persistently elevated inflation. The policy rate has been unchanged since late 2025.

  Warsh's June overhaul of Fed communications, a shorter statement and no easing bias, was maintained today, with little guidance despite markets expecting a September hike. June projections still indicate one 25-bps rate increase by end-2026.

  In terms of *balance sheet policies*, the Fed also reaffirmed its “ample reserves” framework, signalling no immediate plans to accelerate the reduction of its $6.7 trillion balance sheet despite Warsh’s support for faster quantitative tightening.

- **Policy Discussion**: *The divisions underscore growing uncertainty over how the Fed should respond to persistent inflation and emerging price pressures.* The FOMC held rates steady despite dissent from three regional Fed presidents, Beth Hammack, Neel Kashkari, and Lorie Logan—the largest number of dissenting votes since September 2016. The split highlights increasing concern within the Committee that inflation remains too persistent to justify continued policy restraint. Warsh described the unusually divided decision as a "family fight," emphasizing that policymakers openly debated the key issues facing monetary policy.

  Warsh reiterated that the Fed remains fully committed to returning inflation to its 2% target, while rejecting suggestions that the decision to hold rates represented a "pause." Instead, he described it as a rigorous assessment of economic conditions, stressing that future decisions will remain data dependent. Discussions focused on whether inflation is broadening beyond energy into other sectors and on new sources of price pressures, including higher oil prices, tariffs, tighter labor supply from immigration restrictions, and AI-driven demand for semiconductors, electricity, and data-center infrastructure.

  Warsh also continued to reshape the Fed's communication strategy, arguing that reduced forward guidance allows markets to respond more directly to economic data and provides policymakers with a more "unfiltered" market signal. Looking ahead, he said his Jackson Hole speech may incorporate recommendations from the five policy task forces he recently established. Markets remain focused on incoming inflation data, with Fed funds futures pricing roughly a 63% probability of a 25-bps rate hike in September.

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Key Picture: US Federal Reserve Forecasts – 2025-2028

	2026*f*			2027*f*		2028*f*		Longer Run	
	Latest Reading	June Report	March Report	June Report	March Report	June Report	March Report	June Report	March Report
GDP *(real growth, y-o-y)*	**2.7**	**2.2**	**2.4**	**2.3**	**2.3**	**2.1**	**2.1**	**2.0**	**2.0**
Unemployment rate *(%, y-o-y)*	**4.2**	**4.3**	**4.4**	**4.3**	**4.3**	**4.2**	**4.2**	**4.2**	**4.2**
PCE Inflation *(%, y-o-y)*	**4.1**	**3.6**	**2.7**	**2.3**	**2.2**	**2.0**	**2.0**	**2.0**	**2.0**
Core PCE Inflat. *(%, y-o-y)*	**3.4**	**3.3**	**2.7**	**2.5**	**2.2**	**2.1**	**2.0**	-	-
Federal Funds Rate *(%)*	**3.75**	**3.8**	**3.4**	**3.6**	**3.1**	**3.4**	**3.1**	**3.1**	**3.1**

Source: Federal Reserve '*Summary of Economic Projections' March and June 2026. Note:* 1. GDP reading for Q1-2025; 2. Unemployment rate as of June 2026; 3. PCE and core PCE inflation as of March 2026; 4. Projections reflect the median of FOMC projection.

Analysis

- **DECISION MADE**: *On July 29, the US Federal Reserve voted 9-3 to keep its Fed funds range at 3.50% - 3.75%.* Regional Fed presidents Beth Hammack (Cleveland), Neel Kashkari (Minneapolis), and Lorie Logan (Dallas) dissented in favor of a rate hike, citing persistently elevated inflation, which has remained above the Fed's 2% target for more than five years. The federal funds rate has remained unchanged since the Fed cut rates by 75 basis points in late 2025.

  Kevin Warsh's first Federal Reserve meeting in June removed language signalling a bias toward future rate cuts and introduced a significantly shorter policy statement. Today's statement was virtually unchanged, reflecting his preference for less forward guidance and greater emphasis on the economic conditions that would warrant policy action. As a result, it offered little indication of the policy outlook despite markets largely expecting a September rate hike, reinforcing the Fed's wait-and-see approach following three rate cuts in late 2025. The FOMC's June projections continued to point to one additional 25-basis-point rate hike by the end of 2026.

  Regarding *balance sheet policies*, the statement also reaffirmed the Fed's commitment to maintaining an "ample reserves" framework, suggesting no immediate plans to shrink its $6.7 trillion balance sheet more aggressively, despite Warsh's support for faster balance-sheet reduction.

- **POLICY DISCUSSION:** *The divisions underscore growing uncertainty over how the Fed should respond to persistent inflation and emerging price pressures.* The FOMC held rates steady despite dissent from three regional Fed presidents, Beth Hammack, Neel Kashkari, and Lorie Logan, the largest number of dissenting votes since September 2016. The split reflects growing concern within the Committee that inflationary pressures remain too persistent to justify continued policy restraint. Chair Warsh described the unusually divided decision as a "family fight," emphasizing that policymakers openly debated the key questions facing monetary policy rather than seeking consensus.

  Despite recent moderation in inflation, Warsh reiterated that the Fed remains fully committed to returning inflation to its 2% target. At the same time, he rejected describing the decision to leave rates unchanged as a "pause," arguing instead that it reflected a rigorous assessment of economic conditions and marked the beginning, not the end, of the current policy cycle. Future decisions, he stressed, will remain data dependent.

  Much of the Committee's discussion centered on whether recent inflationary pressures are broadening beyond energy into other sectors, which would strengthen the case for further rate hikes. Policymakers

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also examined several emerging sources of inflation, including higher oil prices linked to the Iran conflict, additional tariffs imposed by the Trump administration, tighter labor supply resulting from immigration restrictions, and strong AI-driven demand for semiconductors, electricity, servers, and other technology infrastructure. Warsh declined to offer his own assessment of whether inflation is becoming more broad-based.

Warsh also continued to reshape the Fed's communication strategy. Rather than providing detailed forward guidance, he argued that the central bank should allow markets to respond directly to incoming economic data. According to Warsh, reducing guidance will provide the Fed with a more "unfiltered" market signal by limiting investors' focus on anticipating policy communications.

Looking ahead, Warsh said his Jackson Hole speech remains unwritten and may incorporate recommendations from the five policy task forces he recently established. Markets are therefore likely to remain focused on incoming inflation data ahead of the September meeting, with expectations increasingly pointing toward a 25-bps hike. Following the decision, Fed funds futures priced in a roughly 63% probability of a 25-bps hike at the September meeting.

- **ECONOMIC ASSESSMENT:** *Warsh argued AI will support long-term productivity and wages but may create short-term inflationary pressures through rising demand for chips, energy, and data centers.* Warsh highlighted two key developments since the Fed's June meeting. First, Treasury yields (in both nominal and real terms) rose sharply despite an unchanged policy rate, reflecting markets' greater focus on incoming economic data rather than Fed guidance. He argued that reduced forward guidance is encouraging investors to "play the ball, not the referee," while reiterating that the Fed "will not hesitate to act" if inflation requires.

  Second, Warsh pointed to exceptionally strong business investment, particularly in AI-related capital spending, which has supported manufacturing and strengthened the economy. However, he cautioned that the timing and scale of its supply-side benefits remain uncertain, complicating the inflation outlook.

  He also said policymakers focused their discussions on whether five years of elevated inflation continue to shape the economy, how recent supply-side shocks—including tariffs, geopolitical tensions, and the AI investment boom—affect growth and employment, and whether sector-specific price increases risk evolving into broader inflationary pressures.

  Q1 GDP was revised up to 2.1% annualized, driven by stronger business investment, particularly AI-related capex, and a smaller drag from imports, although consumer spending weakened. Headline inflation slowed to 3.5% in June from 4.2%, while core inflation eased to 2.6%, reducing pressure for an immediate rate hike. However, higher oil prices are expected to push inflation higher in July and August. Payroll growth slowed sharply to 57,000 in June, while the unemployment rate edged down to 4.2% as labour force participation fell to a five-year low.

- **OUR TAKE:** *We expect a rate increase in September*. In our baseline scenario, we expect the FOMC to increase policy rates in September, likely with a 25-bps hike. At that point the Fed will not provide further guidance about future moves, but the market will start pricing in a December rate increase.
- **MARKET REACTION AND IMPLICATIONS:** *Markets traded choppily during Warsh's press conference*, with stocks briefly rebounding after he suggested higher bond yields were doing some of the Fed's work before quickly giving back their gains. *In the fixed-income space,* UST yields diverged after the decision as investors shifted expectations for the next rate hike to September. The policy-sensitive two-year Treasury yield fell 2 basis points to 4.26%, while the 30-year yield rose 5 basis points to 5.14%, further steepening the yield curve. *In the currency space,* the US dollar fell to its lowest level in nearly a week and Dollar index currently trades around 101. Markets scaled back expectations for a September rate hike, interpreting the decision to hold rates as evidence that a majority of policymakers may still be

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reluctant to tighten. *In the equity space,* the US markets were mixed after the Fed left rates unchanged but delivered a more hawkish message through three dissenting votes in favour of a rate hike. The Dow fell 1.4%, the S&P 500 slipped 0.3%, while the Nasdaq edged higher.

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For information about Rosa&Roubini Associates, please send an email to info@rosa-roubini-associates.com or call +44 (0)20 7101 0718.

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