MONETARY AFFAIRS:

Preview: Fed Highly Likely To Hike in September, But No Clear Signal For Policy Ahead

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Executive Summary

- **Expected Decision**: *We expect the Fed to hike interest rates in September (80% probability) even if we can't rule out a no hike scenario (20% probability) as the FOMC is partially divided on the matter.* In line with consensus, in our baseline scenario (80% probability) we expect the Fed to increase its target Fed funds range by 25bps to 3.75% - 4.00% in September. The Fed voted 9-3 to hold rates at 3.5–3.75% in July, with three policymakers favoring a hike. Since then, resilient macro data, sticky inflation and Warsh's hawkish Jackson Hole message have strengthened the case for tightening. Markets now price a 90% probability of a 25bp hike, although a pause remains possible even if unlikely given the current reasonable progress on inflation. The open question will be whether the Fed will signal further rate hikes this year or not, for October and/or December. Given Warsh's aversion to any clear forward guidance he will signal – via the FOMC statement and the presser - that further policy changes will depend on the outlook for trend inflation, while recognising that some improvement in the inflation outlook is occurring; after the hawkish Jackson Hole speech he will not want to signal that additional rate hikes this year are a foregone conclusion. But the SEP projections may signal an additional hike this year on top of the September one as historically the Fed is rarely in a "one and done" cycle; thus, the median FOMC member may pencil in another hike this year even if a substantial minority will signal no further hikes after September.
- **Policy Discussion**: *Warsh's Jackson Hole speech marked a hawkish shift in the Fed's reaction function, from holding unless the data justified a hike to hiking unless the data justified a pause.* Since then, stronger-than-expected employment and persistent inflation (PPI and CPI) together with rising oil and energy prices have reinforced the case for tightening. Headline CPI rose 0.4% in August and remained at 3.4% year-on-year, while core CPI increased a stronger-than-expected 0.3% on the month. Producer prices also rose 0.4%, pushing annual PPI inflation to 5.4%.

  The renewed surge in energy prices has further complicated the outlook, with Brent now exceeding USD 100 as Middle East tensions intensified, contributing to higher Treasury yields. Markets have consequently shifted toward a 25bp September hike and are pricing further tightening over the coming months (at least 3 more hikes). However, a pause remains possible given broadly in-line inflation data that are gradually declining and uncertainty over the persistence of the energy shock and second round effects. The key question is what happens after a possible September hike: since a one-off move may or may not make any sense, the Fed may increase rates also in December (our view) or (much less likely) back-to-back in October and December. Markets are pricing four rate hikes ahead; in our baseline there are only two hikes, one in September and one in December.

  There will be many ways for Warsh to signal the policy path ahead without any explicit forward guidance. Since the Jackson Hole speech was hawkish he will not want to signal that, after the now likely September hike, more hikes are likely. He will use the FOMC statement, the SEP projections and his presser to provide a slightly more dovish signal than the one at Jackson Hole. The statement and presser could signal that, while the progress on the inflation front has not been significant to prevent the September hike, some progress has occurred and policy ahead will depend on how much additional progress will occur. The SEP forecasts could also show a large minority of FOMC members preferring no additional hikes later this year. Warsh will make sure that markets do not interpret the September hike as either for sure hawkish (more hikes are needed for sure) or dovish (i.e. it is "one and done" hike in September).

- **Changes to Economic Forecasts:** *The September SEP is expected to leave growth and unemployment forecasts broadly unchanged,* while inflation could be revised slightly lower despite upside risks from energy prices. The main change is likely to be a higher rate path for this year with the median voter signaling one more hike this year (likely in December as a hike in October before the mid-terms elections is unlikely). We expect a small majority of FOMC members penciling in an additional rate hike this year as one hike in September will not be sufficient to reduce inflation at the pace desired by the FOMC. But we do expect that a significant minority of more dovish FOMC member to pencil in no more hikes this year beyond the one in September. We also expect that the median FOMC member will expect two rate cuts next year (to be delivered in our view in H2 2027) as the medium term inflation path will likely lead to a moderation of inflationary pressures, as long as the conflict with Iran doesn't escalate further farther after the mid-term elections. We also expect that the September SEP will already show the median FOMC member to expect a higher terminal Fed Funds rate or r* by 25 bps.

Key Picture: US Federal Reserve Forecasts – 2025-2028

	2026f			2027f		2028f		Longer Run	
	Latest Reading	September Report	June Report	September Report	June Report	September Report	June Report	September Report	June Report
GDP *(real growth, y-o-y)*	2.1	2.3	2.2	2.3	2.3	2.1	2.1	2.0	2.0
Unemployment rate *(%, y-o-y)*	4.1	4.2	4.3	4.3	4.3	4.2	4.2	4.2	4.2
PCE Inflation *(%, y-o-y)*	3.7	3.4	3.6	2.3	2.3	2.0	2.0	2.0	2.0
Core PCE Inflat. *(%, y-o-y)*	3.3	3.2	3.3	2.5	2.5	2.2	2.0	-	-
Federal Funds Rate *(%)*	3.75	4.1	3.8	3.6	3.6	3.4	3.6	3.4	3.1

Source: Federal Reserve '*Summary of Economic Projections' March and June 2026. Note:* 1. GDP reading for Q2-2026; 2. Unemployment rate as of August 2026; 3. PCE and core PCE inflation as of July 2026; 4. Projections reflect the median of FOMC projection.

Analysis

- **EXPECTED DECISION**: *On September 16, we expect the US Federal Reserve's FOMC to increase its Fed funds range by 25bps to 3.75% - 4.00%.* At the July meeting, the Fed voted 9-3 to hold rates at 3.50–3.75%, with three policymakers already favoring a 25bp hike. Since then, resilient economic data, persistent inflation and Warsh's hawkish Jackson Hole message have strengthened the case for tightening.

  There is a 80% probability of a rate hike, as core inflation remains above 3% and has shown little progress toward the Fed's 2% target. However, a 20% probability of no change suggests the decision is not a foregone conclusion as some meaningful progress has occurred on the inflation front and inflation is likely to fall further in the months ahead.

  Regarding *balance sheet policies*, the Fed in May last year decided to slow down the pace of QT from June. The Committee will continue reduce the size of its balance sheet made of Treasury securities, agency debt, and agency mortgage-backed securities holdings. Starting in April, the Committee slowed the reduction of its securities holdings by lowering the monthly Treasury redemption cap from $25 billion to $5 billion, while keeping the agency debt and mortgage-backed securities cap at $35 billion. In the last few weeks, the Treasury has conducted a series of enhanced buyback operations in order to stem the rise in long-term yields. While initially these operations helped stabilise the market, lately they have proved ineffective, because the market is less convinced of the Fed's anti-inflationary credentials.

- **POLICY DISCUSSION**: *Warsh's Jackson Hole speech marked a hawkish shift in the Fed's reaction function, suggesting that the September decision had moved from holding unless the data justified a hike to hiking unless the data justified a pause*. His emphasis on persistent inflation and relatively loose financial conditions has since been reinforced by stronger-than-expected employment data and continued price pressures. Headline inflation remained at 3.4% in August, while producer prices rose 0.4% on the month, pushing annual PPI inflation to 5.4%.

  CPI rose 0.4% month-on-month, driven partly by a 3.9% increase in gasoline prices, while annual inflation remained at 3.4%. Core CPI increased a stronger-than-expected 0.3% on the month, although the annual rate eased to 2.4%. Combined with strong producer-price and employment data, the report pushed market-implied odds of a 25bp September hike.

  The renewed surge in energy prices has further complicated the inflation outlook. Brent moved recently above USD 100 as Middle East tensions intensified, contributing to higher Treasury yields and tighter financial conditions. Against this backdrop, markets have increasingly shifted toward a September hike and are also pricing further tightening over the coming months.

  However, the September decision is not entirely settled. Inflation data have been broadly in line with expectations, leaving some economists arguing that the Fed could still pause, particularly given uncertainty over how persistent the energy shock will prove. With PCE inflation expected to remain above the 2% target for an extended period, the key question is increasingly not only whether the Fed hikes in September, but what happens after September, i.e. if the Fed will hike rates also in October or will wait until December (our view).

  We cannot disregard the elephant in the room, which is the complicated political economy of this process. Warsh was hired by Trump to cut, not hike, rates. And even recently Trump has advocated for much lower rates. In June and July, while the conditions for a hike were already in place (with the ECB and even the BoJ already tightening their policy stances) Warsh managed to keep rates steady, at the cost of increased "family fights" – as he called them – withing the FOMC. Somehow, he convinced Trump that "hold is the new cut" and therefore keeping rates steady when economic conditions required a rate increase was already a big favour to the President. But this position is becoming untenable, as an increasing number of FOMC members is dissenting, and would further increase if Warsh does not vote for a rate increase in September. At that point the risk is ending in a minority camp, behind the curve, and unable to steer the committee in the direction he wants.

  So, Warsh faces a difficult choice, if push comes to shove. On the one hand, disappointing the President, who hired him with another mandate, in his mind. On the other hand, disappointing market participants (who would intensify the sell off at the long end of the curve) and the rest of FOMC members, who would perceive Warsh's decision as politically motivated. We believe that, between the two evils, eventually Warsh will prefer facing the relative ire of President Trump, rather than the consequences of losing credibility on inflation by not hiking when markets expect him to.

- **CHANGES TO ECONOMIC FORECASTS:** *The September SEP is expected to show relatively limited changes to the economic outlook, with GDP growth and unemployment projections broadly unchanged.* Inflation forecasts could be revised slightly lower than June, although the recent surge in energy prices creates upside risks. The more significant change is likely to be the policy-rate path, with stronger data and persistent inflation increasing the likelihood of a higher end-2026 rate projection.

- **MACROECONOMIC ANALYSIS:** *Higher imports and a modest decline in government spending weighed on overall GDP growth.* The US economy expanded at an unrevised 1.5% annualized rate in Q2, slowing from 2.1% in the first quarter. However, the underlying picture was stronger than the headline figure suggested. Consumer spending was revised up to 3.4%, while nonresidential fixed investment rose 8.5%, supported by continued investment in AI-related infrastructure. Final sales to private domestic purchasers, a measure of underlying private demand, grew 4.2%, the strongest pace in more than three years. Meanwhile, higher imports and a 1% decline in government spending weighed on overall GDP growth.

Annual inflation held at 3.4% in August, while core inflation eased only slightly to 2.4%. Gasoline prices were 27.4% higher than a year earlier and accounted for more than a third of the monthly increase, while fuel oil surged 52%. Persistent inflation and rising energy costs have strengthened expectations that the Fed could raise rates at its September meeting. Persistent price pressures, combined with stronger jobs data and a renewed oil surge, have strengthened the case for further tightening.

The U.S. labor market rebounded sharply in August, adding 162,000 jobs, well above expectations of 65,000, while the unemployment rate remained at 4.1%. June and July payrolls were also revised up by a combined 55,000 jobs, strengthening the picture of labor-market resilience. However, wage growth slowed to 3.1%, its weakest pace since May 2021, and overall job creation remains below pre-2025 levels. The stronger-than-expected report also reinforced expectations of a Fed rate hike, as resilient employment gives policymakers more room to focus on persistent inflation.

- **MARKET IMPLICATIONS:** *A hike appears largely priced into markets, with Treasury yields little changed following Friday's CPI report and equities ending the week higher*. Attention will therefore focus on Warsh's press conference and signals about the path ahead. Beyond the Fed, investors will watch manufacturing and industrial production data for further evidence of how the AI investment boom is supporting the economy. US Treasury yields have risen sharply in September, with the 10-year surpassing 5%, as stronger economic data, sticky inflation and Warsh's hawkish stance have increased expectations of Fed tightening. To put things into context, *in the fixed-income space*, as of 11 September, and since the last meeting in July, the 2y UST rose by 41 bps to 4.64% (+117 bps y-t-d) and the 10y UST also edged up 35 bps to 4.98% (+80 bps y-t-d). *In the currency space*, the Dollar Index ended the week near 99.00, recovering losses following the inflation report as attention shifted to Wednesday's Fed decision. The dollar index fell to 99.12 (+0.7% y-t-d, modestly firmer since the June meeting), while EUR/USD increased by 1.1% to 1.16 (-1.2% y-t-d). *In the equity space*, major US stock indexes fell as Brent crude climbed above USD 100 amid escalating Middle East tensions, raising inflation concerns ahead of key CPI and PPI data. The S&P 500 declined 0.48%, the Nasdaq 0.64% and the Dow 0.77%, while energy stocks gained as oil prices surged. As of 11 September, the S&P 500 increased by 4.7% since the July meeting to 7,656.98 (+11.6% y-t-d).

- **APPENDIX (Macro Background):** *US GDP growth slows as imports surge offsets consumer spending.* In Q2, the US economy decelerated to an annualized 1.5% (*c*: 1.5%; *p:* 2.1%). Personal consumption rose 3.4%, its strongest increase since Q3 2025, while fixed investment jumped 7.0%, supported by AI-driven equipment and intellectual property spending. Residential investment returned to growth, while lower government spending and a surge in imports weighed on the expansion. The GDP expanded by 2.1% y-o-y (*p:* 2.7%).

  Private-sector growth accelerated for a third consecutive month, reaching a 52-month high. In August, *the S&P Global US Composite PMI* rose to 56.0 (*p:* 54.5). The Manufacturing PMI was at 53.9 (*c:* 53.2). Service PMI edged up to 56.5 (*c:* 56.8; *p:* 54.6).

  The US labour market rebounded. In August, *the unemployment rate* remained to 4.1% (*c:* 4.1%; *p:* 4.1%). NFP added by 162K (*c:* 56K; *p:* 21K). Wage growth increased by 3.5% in July (*p:* 4.2%). The U-6 unemployment rate, which includes those marginally attached to the labour force and those working part-time for economic reasons, fell to 7.7% (*p:* 7.9%).

  US inflation held at 3.4% in August, while monthly prices rose at their fastest pace since May. In July, the *personal consumption expenditures* (*PCE*) – the Fed's preferred inflation gauge – stood at 3.7% y-o-y (*c:* 3.6%; *p*: 3.7%). The *core-PCE* – which excludes volatile energy and food prices – remained to 3.3% y-o-y (*c:* 3.3%; *p:* 3.3%). In August, headline inflation rate steadied to 3.4% y-o-y (*c:* 3.4%; *p:* 3.4%), while core inflation eased off to 2.4% y-o-y (*c:* 2.4%; *p:* 2.5%).