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Fed Review: FOMC Hikes Rates in a Unanimous Decision

by

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Executive Summary

- **Decision Made**: *The Fed raised US interest rates in September.* The The FOMC voted unanimously to increase the federal funds rate by 25 bps to 3.75%-3.40%.

  The Federal Reserve delivered its first rate hike in more than three years to curb elevated inflation, following three dissents in favour of tightening at the July meeting. The widely expected move aims to accelerate inflation's return to 2%, while updated projections signal another hike later this year.

  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**: *Warsh described the hike as a "sober" and "responsible" decision, driven by stronger economic and labour-market data, persistently elevated inflation and increased geopolitical risks.* The Fed had been on hold throughout the year, but these developments supported the unanimous decision to tighten policy.

  Inflation remains the Fed's primary concern. Warsh said it remains "too high," with little improvement in underlying trends and many CPI and PPI categories still rising above 3%. The Fed revised 2026 headline PCE inflation to 3.7% and core PCE to 3.4%, with inflation not expected to return to the 2% target until 2029. Updated projections showed most officials expect another hike this year, although Warsh avoided forward guidance.

  Warsh repeatedly framed the decision as a response to the strength of the US economy and declined to discuss President Trump's calls for lower rates or their conversations. The press conference was unusually brisk, with limited follow-ups. Warsh also said the Fed should "stay in its lane" on broader AI risks, while attributing higher bond yields to stronger growth, heavy private-sector borrowing and geopolitical pressures, particularly higher oil prices.
- **Changes To Economic Forecasts:** *Updated projections showed most officials expect another hike this year,* with 16 of 18 participants seeing further tightening and four projecting two more increases. No additional hikes are projected thereafter, with rate cuts beginning in 2028. Headline PCE inflation is forecast at 3.7% in 2026, easing to 2.3% in 2027 and reaching the 2% target only in 2029. Core PCE is expected to decline from 3.4% in 2026 to 2.5% in 2027 and 2.0% by 2029. Growth forecasts were slightly upgraded to 2.3% in 2026 and 2.4% in 2027 before moderating, while unemployment is projected to remain at 4.1% through 2029, below previous forecasts.

Key Picture: US Federal Reserve Forecasts – 2026-2029

	2026f			2027f		2028f		2029f	Longer Run	
	Latest Reading	September Report	June Report	September Report	June Report	September Report	June Report	September Report	September Report	March Report
GDP *(real growth, y-o-y)*	2.1	2.3	2.2	2.4	2.3	2.2	2.2	2.1	2.0	2.0
Unemployment rate *(%, y-o-y)*	4.1	4.1	4.3	4.1	4.3	4.1	4.2	4.1	4.2	4.2
PCE Inflation *(%, y-o-y)*	3.7	3.7	3.6	2.3	2.3	2.1	2.0	2.0	2.0	2.0
Core PCE Inflat. *(%, y-o-y)*	3.3	3.4	3.3	2.5	2.5	2.2	2.1	2.0	-	-
Federal Funds Rate *(%)*	4.00	5.1	3.8	5.1	3.6	3.9	3.4	3.6	3.1	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

- **DECISION MADE**: *On September 16, the US Federal Reserve voted 12-0 to raise its Fed funds range by 25 bps to 3.75% - 4.00%.* The Federal Reserve approved its first rate hike in more than three years, signaling another increase as it moves to curb inflation fuelled by surging oil prices and other pressures. The July decision exposed significant divisions, with three FOMC members dissenting from the hold in favor of a 25bp hike.

  The Fed said inflation remains elevated and the hike would support a faster return to its 2% target. Markets had priced in a more than 90% chance of the increase despite mixed signals from policymakers and speculation over potential dissents. Updated projections showed most officials expect another increase later this year.

  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:** *Warsh avoided giving forward guidance, calling the hike a "sober" and "responsible" decision based on the strength of the economy, employment and inflation outlook.* The Fed had been on hold throughout the year until expectations shifted toward a hike in late August. Warsh said three developments drove the shift from July's hold: stronger economic and labour-market data, persistently elevated inflation and increased geopolitical risks. Together, these factors supported the Fed's unanimous decision to tighten policy.

  Inflation remains the Fed's primary concern. Warsh stressed that inflation remains "too high" and has persisted for too long, while recent readings do not show a meaningful improvement in underlying trends. Many CPI and PPI categories are still rising above 3% on both six- and 12-month measures. The Fed's projections reinforced the case for tightening, with headline PCE inflation revised up to 3.7% and core PCE to 3.4% in 2026, while inflation is not expected to return to the 2% target until 2029. Warsh also highlighted the distributional impact of inflation, arguing that lower-income Americans have the most to gain from sustained growth, a strong labour market and stable prices.

  Updated projections showed most officials expect another increase later this year. However, Warsh avoided giving forward guidance, calling the hike a "sober" and "responsible" decision based on the strength of the economy, employment and inflation outlook. He also stressed that the move reflected the Fed's own assessment rather than market expectations.

Warsh declined to discuss his interactions with President Trump, who has pushed for lower rates. Warsh repeatedly framed the decision as a response to the strength of the US economy and avoided questions about his conversations with the President.

The press conference was unusually brisk, with Warsh limiting follow-up questions and keeping his responses brief. He also avoided weighing in on broader AI risks, saying the Fed should "stay in its lane," although he has created a task force to assess AI's economic implications. On rising bond yields, he pointed to stronger economic growth, heavy private-sector borrowing for capital allocation and geopolitical pressures, particularly higher oil prices. He refused to link it to market participants doubting the Fed's resolve on inflation.

- **CHANGES TO ECONOMIC FORECASTS:** *Updated projections showed most officials see another hike later this year.* The dot plot showed 16 of 18 participants expect another hike this year, with four seeing two more as possible. No further increases are projected thereafter, while one cut is indicated for 2028 and at least one for 2029. The statement underlined that economic activity remains solid despite elevated geopolitical uncertainty, supported by resilient domestic spending, strong productivity and robust investment. The labour market remains stable, with job gains keeping pace with workforce growth and little change in unemployment, while inflation remains elevated.

  Officials also raised their 2026 inflation forecasts slightly, to 3.7% for headline, with inflation not expected to return to target until 2029. PCE inflation is expected to fall sharply to 2.3% in 2027, before easing to 2.1% in 2028 and finally reaching the 2% target in 2029. Underlying inflation pressures are also expected to persist. Core PCE inflation is projected at 3.4% in 2026, slightly above June's 3.3%, before declining to 2.5% in 2027, 2.2% in 2028 and 2.0% in 2029. Growth forecasts remained broadly stable, with GDP forecast at 2.3% in 2026 and 2.4% in 2027, slightly above the June projections. Growth is then expected to moderate to 2.2% in 2028 and 2.1% in 2029, converging toward the 2.0% longer-run rate. The labour market outlook has improved. Unemployment is projected at 4.1% throughout 2026-29, compared with June forecasts of 4.3% in 2026-27 and 4.2% in 2028, and below the 4.2% longer-run estimate.

- **OUR TAKE:** *Another hike possible in December*. In spite of no forward guidance from Warsh, the market knows that rarely central banks do "one and done." So another hike in December is likely, while a rate increase in October is unlikely, as this would be very close to the critical mid-term elections.
- **MARKET REACTION AND IMPLICATIONS:** *The unanimous hike was widely expected by the market amid persistent inflation*, low unemployment and resilient consumer demand. *In the fixed-income space,* the 10-year Treasury yield climbed back above 5% as Warsh spoke, reflecting concerns that the Fed may still be behind the curve on inflation despite the hike, while the 2-year Treasury yield jumped 10bp to 4.7%. *In the currency space,* the Dollar Index rose above 100 as Warsh's comments pushed markets to price in three further 25bp hikes through 2027. *In the equity space,* the markets initially moved little following the rate hike, suggesting the decision was largely priced in. However, Warsh's hawkish comments on inflation subsequently pushed rate expectations higher and erased earlier equity gains, leaving the S&P 500 fluctuating between small gains and losses.

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