

Macro Signposts | September Fed Hike May Be More Than a Risk Management Exercise

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The U.S. Federal Reserve delivered on consensus expectations by raising its policy rate by 25 basis points (bps) at its September meeting. The Federal Open Market Committee (FOMC) also shared updated forecasts in the Summary of Economic Projections (SEP), sending a strong signal that September's rate hike will very likely be followed by another hike this year, and possibly an additional hike in 2027 if inflation doesn't moderate quickly enough.

The FOMC statement explained the move as an action to “support a timelier return to the Committee's 2 percent goal.” While a range of underlying inflation measures suggest that inflation is moderating back to target, the Fed's preferred measure – core Personal Consumption Expenditures (PCE) – has reaccelerated and is currently running above a 3% annual pace. Headline inflation has also risen along with higher energy prices.

The outlook for energy is unusually uncertain, as geopolitical tensions continue to keep energy prices elevated and volatile. However, unless energy prices increase materially, headline inflation is likely to be much closer to target by next spring, as the initial energy price shock at the outset of the Iran conflict begins to drop from the year-over-year calculation. (This is referred to as the base effect.) Going forward, this may alleviate some pressure on the Fed.

In his press conference, Chair Kevin Warsh described the move as removing a “dose” of accommodation to achieve a timelier return to 2% inflation. Warsh's description is a departure from other FOMC members' characterizations of policy as neutral to slightly restrictive, and it suggests that he views rate hikes as something more than purely managing the risk that inflation expectations drift higher. When asked to reconcile the FOMC's goal of a timelier return to 2% inflation with the median SEP projection that core PCE inflation will not return to target until 2029, Warsh responded that the projections were not his forecast, and that he is serious about delivering on the price stability objective. In other words, Warsh may favor a more restrictive policy stance than the SEP projection of two 25-bp hikes by the end of 2027 (including this hike just announced in September) in order to return inflation to 2%.

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