

Fed buys time to assess policy path

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Warsh's remarks pointed to supply shocks as the main inflation concern, rather than a broadening of demand-driven pressures

The FOMC voted in a split decision to keep the fed funds target range unchanged at 3.75–4.00%. Governor Cook and Cleveland Fed President Hammack dissented in favor of a 25bp hike. The statement upgraded its assessment of economic activity from expanding at a “solid pace” to a “strong pace,” while reiterating that “domestic spending has been resilient.” The assessments of capital investment, productivity growth and the labor market remained unchanged. More importantly, while the Committee reiterated that “inflation remains elevated,” it introduced an explicit rationale for waiting at this meeting, arguing that “the accumulation of more information” before the next meeting in December “will help the Committee determine the policy stance appropriate to ensure a timely return” of inflation to its 2% goal. This suggests the Fed will maintain a data-dependent stance, seeing little in the balance of risks to justify deviating from a gradual approach. Yet it may also have served to justify holding rates steady at this meeting despite elevated inflation.

Warsh struck a less hawkish tone at his press conference than the upbeat assessment of the economy initially suggested, though supply-side inflation risks remain central to his concerns. He acknowledged that financial conditions have “tightened a bit” since September, but was “unwilling and unable to call [them] tight,” leaving the door open for further restraint, but offering no guidance on how much. More importantly, his remarks suggested that neither he nor a majority of FOMC officials think the economy is running too hot, and stressed that above-target inflation still mostly reflects successive supply shocks, particularly energy prices amid the prolonged Middle East conflict. He appears primarily focused on preventing second-round effects (“our job is to ensure that relative price changes in some sectors do not broaden out across the economy”) and avoiding any de-anchoring of inflation expectations, rather than responding to widespread demand-driven pressures. Warsh repeated that “inflation is too high,” yet stressed the importance of “interrogating reality” before adjusting the policy stance, signaling that he and most Board members prefer a measured path for the reference rate. Well-anchored inflation expectations have allowed Warsh and the Committee to feel comfortable signaling today’s pause ahead of the blackout period despite persistent inflation. Overall, his remarks kept the door open to further tightening and signaled that the “information rich” intermeeting period will allow the FOMC to be better positioned to determine the right policy decision in December.

Separately, Warsh announced the FOMC will vote on rates in 7 out of the 8 meetings next year, and in six in 2028, with the no-policy meetings used for strategic discussions, possibly an initial step toward reforming Fed communication and forward guidance.

We still expect a 25bp hike in December, when incoming data and updated SEP projections will test our baseline of unchanged rates through 2027. As expected, the FOMC favored a measured tightening pace, given limited evidence of broad-based demand-driven inflation pressures and still well-anchored inflation expectations. Although Warsh challenged the notion that AI investment is relatively insensitive to interest rates, we continue to believe that rapid or excessive tightening could increase vulnerabilities in rate-sensitive sectors more than it would cool the AI boom, particularly if technology-related stock valuations correct sharply. Still, strong growth supports some additional tightening. The question is whether the Fed will move to the sidelines after another rate hike this year. Much will depend on how the Middle East conflict evolves after next week's midterms and whether evidence mounts that the AI investment boom is generating broader demand-driven inflation pressures across the economy. Another risk heading into 2027 is that the post-pandemic inflation experience has heightened policymakers' and market participants' sensitivity to the Fed falling behind the curve. December's SEP should help clarify whether the Committee anticipates extending tightening into 2027 or considers the next hike sufficient to restore sustained disinflation.

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