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Instant Thoughts

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The Hawk Flies

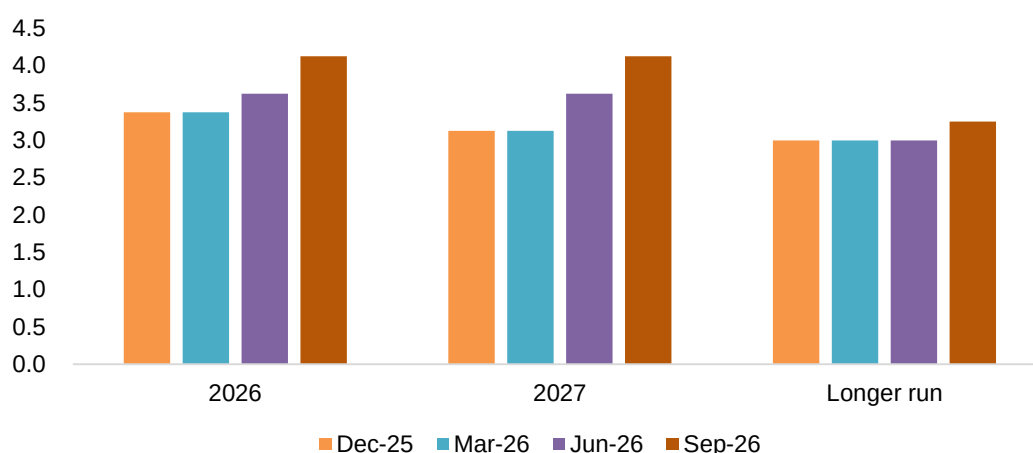
- The updated dot plot points to one more hike before year-end and on-hold decision in 2027. Stunningly though, 8 of 18 Fed members are expecting the policy rate midpoint to be lifted further 4.375% by end-2027.
- The key takeaway for us is that Warsh, a Fed Chair supposed to be orthodox, doesn't seem minded to reverse the chain of causality from the Fed leading the market. The Fed will stick to its "regret minimization" approach, whereby the cost of hiking to quell inflation risks outweighs any negative growth consequences. Another rate hike, possibly in December, looks more like an inevitability here than a forecast.
- The Fed's commitment for tighter policy calms the flighty back end and raises the bar for debasement trades.

September is living up to its billing as a tricky month. After months of repeated tough talks, the Fed finally backed up its stern warnings with action, lifting policy rates by 25bp to 3.75% to 4.00% unanimously.

Why can't they wait until the noise from tariffs and oil shock dissipates? In the presser, Fed Chair Warsh suspected that the economy was strengthening. The Fed isn't satisfied that the disinflation will continue on its own. This slow-burning backdrop warranted an unwind of the risk-management rate cuts the Fed delivered last year.

And it may not end up being an “one and done” move, an outcome similar to Greenspan’s call in March 1997. ‘Timelier return to 2%’ with 2027 core stuck at 2.5% is not one-and-done language. The updated dot plot points to one more hike before year-end and on-hold decision in 2027. Stunningly though, 8 of 18 are expecting the policy rate midpoint to be lifted further 4.375% by end-2027. The bifurcated dot plot highlights the degree of disagreement among FOMC members behind the unanimous decision today.

Exhibit 1: Median Rate Forecast (%)



Source: Federal Reserve, Shanghai Commercial Bank

The upward adjustment of inflation projections this year, in spite of BEA’s revision, totally caught us off guard. But the key takeaway for us is that Warsh, a Fed Chair supposed to be orthodox, doesn’t seem minded to reverse the chain of causality from the Fed leading the market. Me against the world no longer. The Fed will stick to its “regret minimization” approach, whereby the cost of hiking to quell inflation risks outweighs any negative growth consequences. Another rate hike, possibly in December, looks more like an inevitability here than a forecast.

Just as encouraging: Bond traders starts playing the ball, as featured by the flattening yield curve post meeting. Fed’s commitment for tighter policy calms the flighty back end and raises the bar for debasement trades. It should set a firmer floor to the greenback.

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