

## Fed Chair Warsh to push back against calls for rate hikes

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- Fed widely expected to keep policy on hold next week, but traders to look to its communication for clues about path of rates this year.
- Fed chair Kevin Warsh likely to strike a dovish tone, while FOMC projections may drop 2026 rate-cut forecast made in March.
- We expect Fed to keep rates unchanged through 2026; rate rise would require meaningful acceleration in inflation.

The Federal Reserve is widely expected to keep interest rates unchanged when it meets next week, on June 17th, but traders will watch closely for clues about its plans for the rest of the year. We expect Kevin Warsh, the new Fed chair, to push back against market calls for rate rises in 2026, and the fed funds rate to remain steady through year-end.

This will be Warsh's first meeting at the helm of the Federal Open Market Committee (FOMC). The new chair appears to lean dovish, but he has little chance of persuading the rest of the committee to cut rates this year.

The bar for rate rises is also high. Warsh's dovish tendencies will make it hard for him to get on board with rate hikes. Inflation would have to accelerate meaningfully for Warsh to side with hawkish voices that want to keep the possibility of tighter policy open.

Market attention will focus on two pieces of communication after next week's rate-setting meeting: Warsh's press conference and updates to the quarterly Summary of Economic Projections (SEP). He will probably try to strike a dovish tone, although markets are unlikely to unwind the rate rise priced in this year.

FOMC members will update their forecasts in the SEP, which is published after every other rate meeting. The median projection in the previous SEP, released in March, pointed to one rate cut this year. We would not be surprised to see this revised to a central expectation of unchanged policy in 2026.

US economic data have been strong. Job creation is running well above economists' estimates of

equilibrium levels, credit growth is robust—supported by AI-related infrastructure spending—and surveys point to expanding output across manufacturing and services. Data from March and April suggest that consumers have not cut back on other spending in response to higher energy prices.

Further strong activity figures and high inflation readings may prompt the market to increase expectations for rate rises in the short term. Traders currently anticipate one 25-basis-point increase this year, and this expectation could move closer to 50bps if the data continue to show strength.

Lower-than-expected growth in core consumer prices, excluding food and energy, released on 10 June, offered some respite from calls for higher rates. Producer-price data published on the following day also suggested that cost pressures may be more subdued than economists had forecast. But over the summer, markets could test the Fed's resolve to keep rates unchanged.

Several structural factors may have lifted the "neutral" fed funds rate, which neither stimulates nor slows activity. Stronger borrowing demand, boosted by the funding needs of data-centre construction, raises equilibrium interest rates. US President Donald Trump's protectionist trade policies reduce the scope for imports to put downward pressure on consumer prices. We think these forces will offset the effect of AI-driven productivity gains, which could otherwise lower equilibrium interest rates.

Moreover, inflation looks sticky above the Fed's 2% target. Annual price gains in goods and services are each about one percentage point above pre-Covid



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averages. In the current environment, core consumer-price inflation may remain closer to 3%, strengthening the case for tighter policy over the coming years.

The SEP indicates that FOMC members think the neutral policy rate is just above 3%, about 50bps below the current fed funds rate. Even if inflationary forces recede and the Fed is able to cut next year, we doubt it will have room to reduce rates significantly, barring a sharp slowdown in the US economy that calls for a looser monetary stance. Furthermore, the fed funds rate is likely to be higher on average over the next several years than it has been in the post-GFC era.

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