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Warsh signals a period of watchful thinking

Blog

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The Fed kept rates on hold for the fifth consecutive meeting, maintaining its 3.5% to 3.75% policy rate range. The little-changed Fed statement and Chair Warsh's post-meeting press conference were consistent with the current view that the Fed stays on hold through 2026 as inflation trends improve.

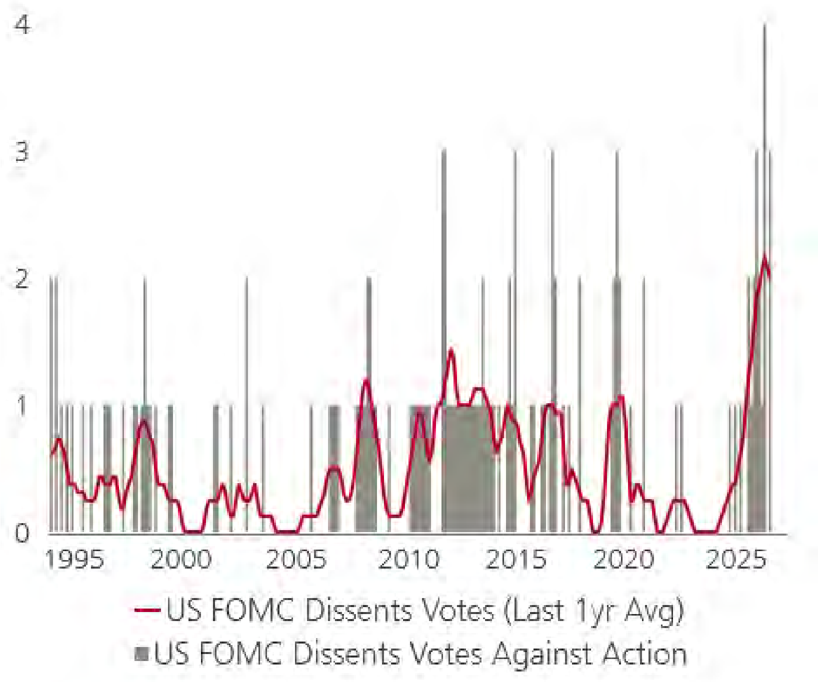
As expected, given the well-known division of views entering the meeting, the statement reflected three hawkish dissents from regional Fed Presidents (Hammack, Kashkari, and Logan) who advocated for a 25bps rate hike. The dissents were not surprising given their recent comments and prior hawkish dissents in April. The lack of dissents beyond these three suggests the FOMC leadership—the Chair, Governors, and NY Fed President—remain more willing to watch and wait for further improvement in inflation. Chair Warsh referred to being in a "period of watchful thinking." The statement lacked any hawkish changes that could have signaled inflation/supply risks were rising due to the changes in the Middle East conflict.

Chair Warsh made a point to highlight two developments in the intermeeting period, higher yields and strong capex trends, while he downplayed the nascent improvement in inflation trends. In his prepared comments, Chair Warsh noted the large increase in real and nominal yields. The tightening in financial conditions beyond the policy rate could allow the Fed to remain on hold for longer while they monitor inflation progress. Warsh noted the strong 20% annual growth rates in AI-linked capex which would support the supply-side of the economy. Both of these developments have a dovish undertone.

Similar to his first meeting, Chair Warsh declined to provide much forward guidance, but many of his comments suggested little urgency to hike at upcoming meetings unless inflation worsens. The Chair described the key questions debated by the FOMC without elaborating on specific policy scenarios. These included whether inflation persistence from the last five years continues to influence the current outlook, how recent supply shocks affect output and employment, whether sector-specific price increases tied to AI investment signal broader inflation pressures, and the role of policy tools—including the balance sheet—in achieving price stability. Many of the topics were already featured in the June minutes.

While the market interpreted Chair Warsh's comments and the FOMC statement dovishly and December pricing fell around 13bps, declining to provide detail on his policy reaction function or strategy for lowering inflation may have contributed to the sell-off in longer maturity bonds and higher breakeven inflation. In contrast to the impact of pre-July FOMC hawkish comments by Fed officials, the market response to today's meeting signals some investor concern about the FOMC commitment to meeting its 2% inflation target in the near term. Markets still price a more hawkish path than our view in 2026, around 1.3 hikes compared to our view of unchanged policy through year-end. We expect further goods disinflation as tariff effects fade to set up more 2H disinflation in core PCE. The main risk to our unchanged Fed call is disinflation stalls in the coming months or increasing inflation risks related to the Middle East conflict, tariffs, or AI-demand.

Fig. 1: Three dissents signal a divided FOMC
FOMC meeting dissents against decision



Source: Bloomberg, UBS

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid and commonly known indices, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.
Attractive: We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral: We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive: We consider this asset class to be unattractive. Consider alternative opportunities
Note: For equities, we have a five-tier rating system with two additional preferences
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."

Appendix

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