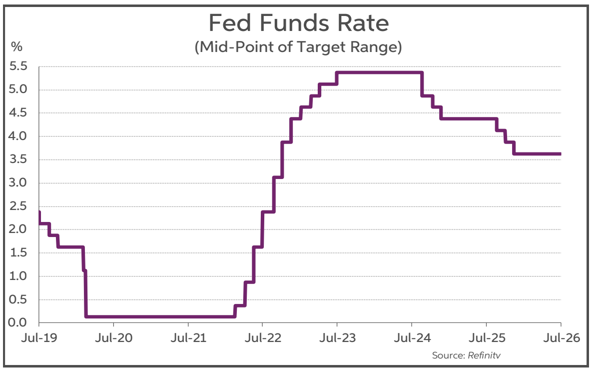
Fed Watch

AIB Treasury Economic Research Unit

30th July 2026

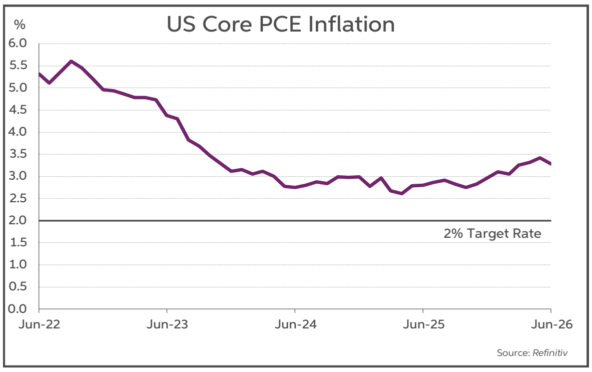
Fed on hold and refrains again from offering guidance

The Federal Reserve Open Market Committee (FOMC) for July saw the central back leave its key interest rate unchanged. The target range for the Fed funds rate was maintained at 3.50-3.75%, for a fifth consecutive meeting. The July meeting outcome was in line with market expectations. Nine of the twelve voting FOMC members were in favour of the 'no-change' decision with three 'hawkish' dissenters (Hammack, Kashkari and Logan), preferring a 25bps rate hike. Chair Warsh stated that there was an "active, robust discussion" within the FOMC on the policy outlook.



The July meeting statement was once again very concise and absent of any forward guidance, in keeping with the 'succinct' communication strategy of the new Fed Chair. It also contained minimal changes from the June version. The Fed continued to note that the economy was "expanding at a solid pace" despite "elevated uncertainty", job growth "kept pace with the workforce", while inflation remains high in part due to supply shocks. The statement also reaffirmed that the FOMC "will deliver price stability".

The most recent detailed update on the Fed's assessment of the economic outlook was published at its previous meeting in June. These forecasts indicated that it expects inflation to remain elevated for longer. The median projection is for inflation to stay above its 2% target throughout the forecast period. Meantime, the Fed is pencilling in a slightly more modest pace of GDP growth in the near term (2.2% by end year). The unemployment rate forecasts were little changed from March, with the jobless rate expected to remain between 4.2-4.3% in the years ahead. **The June meeting also saw the publication of the Fed's updated interest rate projections (i.e. the dotplot).** Nine members of the FOMC are pencilling in rate hikes for this year, while, eight officials that think policy will be left unchanged, while one expects a rate cut. Overall, the median projection for 2026 is at 3.8% (was 3.4%). Further out, the projection is for Fed Funds rate to be at 3.6% (was 3.4%) in 2027, falling back to 3.4% in 2028 (was 3.1). However, Fed Chair Warsh did not submit any dots in June, so these projections are less relevant as a result.



The post-meeting press conference was uneventful and offered no insight on the direction of monetary policy, which is exactly the way Fed Chair Warsh wants it. Overall, his comments delivered a balanced message. On the one hand and similar to June, he espoused some hawkish rhetoric by emphasising the Fed's commitment to price stability, commenting that there is "no soft inflation target" and that there is "only a target and its 2%" and the Fed "will not waiver" in this regard. On the other hand, his comments suggested that he was content to let the market do the 'tightening' for the Fed. He stated that the Fed will continue to monitor the "market information and see how it responds to incoming events" which can "help inform our decision-making" for their September meeting. Chair Warsh also stated that he had yet to decide if he would use his upcoming Jackson Hole (27th-29th August) appearance for a "big picture speech" or a more "traditional set up" for what to expect from the Fed over the remainder of the year.

Current futures pricing indicates the market now sees a 70% chance of a Fed rate hike in September. Prior to the meeting this was nearer to 90%. This suggests the market may have been anticipating some level of guidance, which was unrealistic given Warsh's 'vague' signalling style. The market envisages around 50bps of policy tightening by Q1 2027. **We remain of the view that the Fed will keep rates unchanged throughout this year.** The longer the war in Iran persists and the associated higher energy prices are sustained, the greater the risk there is that the Fed hikes rates. However, Fed Chair Warsh has a well stated preference for lower rates. This combined with the potential for some softening in labour market conditions and inflation over the coming months should enable the Fed to stay in a holding pattern into year end and give the Chair time to build consensus for some policy easing in 2027.

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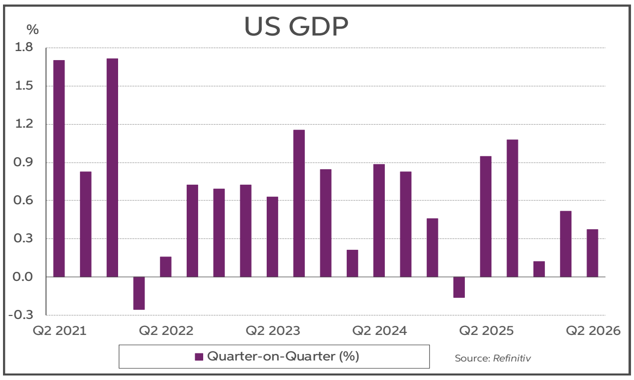
US economy characterised by solid growth and high inflation

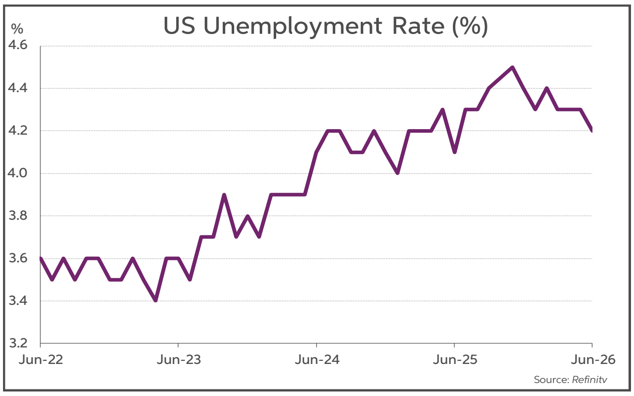
Having expanded by a solid 2.1% last year, the US economy has continued to grow at a decent pace in the first half of 2026. GDP rose by 2.1% annualised in the first quarter, supported by increases in personal consumption and investment. Growth slowed to 1.5% annualised in Q2, but the underlying picture was stronger than the headline figures suggest. Personal consumption and investment remained the main drivers of growth in the second quarter also. The former rose by 0.8%, while the latter jumped by 1.7%, boosted once again by investment in AI related infrastructure. Together, these two components contributed 3.3 percentage points (p.p.) to GDP. Meantime, government expenditure contracted by 0.2% in Q2 amid a sharp decline in non-defence spending, clipping 0.1 p.p. from the total. Elsewhere, imports outpaced exports, meaning that net trade subtracted 1.0 p.p. from growth. Inventories knocked a further 0.7 p.p. from GDP in the quarter.



Meanwhile, the very limited available survey data at the beginning of Q3 have been mixed. The services PMI improved for a second consecutive month, jumping to 53.6 in July, its highest level since last November. At the same time, the manufacturing PMI remained firmly in expansion territory, at 53.8 in July. Furthermore, consumer confidence has gathered some upward momentum recently, although it is recovering from a low base. The Michigan measure of consumer sentiment moved higher in July, albeit the Conference Board indicator declined, having improved in four of the last seven months. In contrast, NAHB Homebuilder sentiment deteriorated for a second successive month.

In terms of the labour market, conditions appear to have firmed in recent months following a weak second half to last year. Payrolls fell for a fifth time in nine months in February, but they have since increased sharply in the three months thereafter, and again, by a more modest amount in June. Indeed between March and June, payrolls expanded by 137k per month on average. This compares to an average of just 12k per month last year. Elsewhere, the unemployment rate declined to 4.2% in June, having oscillated between 4.3-4.5% since July. Meantime, wage growth has slowed. Average earnings growth printed at +3.5% year-on-year in June, compared to +3.9% y/y in the same month last year. However, the wages component of the Employment Cost Index - the Fed's preferred measure of wage inflation - rose by 0.8% in Q1, up from 0.7% at the end of last year.

On the inflation front, consumer price inflation was trending lower before the war in the Middle East broke out. However, amid the spike in energy prices, CPI inflation has jumped higher in recent months, peaking at 4.2% in May, up from just 2.4% in January/February. The core rate also increased, albeit at a slower pace. It rose to 2.9% in May, having printed at 2.5% at the start of the year. However, both rates fell by more than anticipated in June, with the headline rate easing to 3.5% and the core rate to 2.6%. Meantime, core-PCE - which has proven to be quite sticky, and was already on an upward trajectory in the months before the conflict - has continued to move higher. It printed at 3.4% in May, before edging back marginally to 3.3% in June. This is up from 3.0% at the end of 2025, and a low of 2.6% last April.



In summary, headline figures suggest the US economy has continued to perform solidly in the first half of 2026. Labour market conditions look to have strengthened, following a weak end to 2025. Meanwhile, AI-related investment is likely to remain a key driver of growth in the near-term. Furthermore, lower taxes may be providing some support to consumer spending. However, a sustained period of elevated inflation remains a key concern for policymakers. High levels of uncertainty, especially regarding US trade policy, have contributed to sticky price pressures, and the war in the Middle East also adds further upside risks to the US inflation outlook. Another bout of sustained price rises could force the Fed to tighten policy, which would weigh on growth, and add further pressure on an already substantial government deficit. However, the US economy is still expected to grow at a robust pace over the next few years. The IMF is projecting GDP will rise by 2.3% this year and by 2.2% in 2027.

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