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Fed announcement: a divided vote provides only a little solace

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Today's stand pat decision by the Fed provided only a little solace for those hoping to avoid a rate hike this year. A no-hike decision was mostly anticipated investors. But the fact that there were three dissenting votes in favor of a hike, a rare degree of divergence, after a unanimous decision to hold rates in June, should keep the market on alert for a hike in September, particularly with war clouds pushing up energy prices again. This wasn't a meeting with an accompanying forecast, and the bare bones statement, virtually identical to June's, reflects Warsh's distaste for forward guidance.

That same strategy of keeping his cards close to his chest carried over into today's press conference, saying that doing so is prudent, particularly given the degree of uncertainty. He repeated his resolve to hit the 2% inflation target, and denied that was a soft target. He noted the rise in both nominal and real yields since the last meeting as an unfiltered response to events, as a signal that growth is strong. But he didn't say anything about whether higher real yields are a substitute for policy rate hikes, or agree with the questioner's suggestion that it is a signal for where policy rates ought to be.

According to Warsh, the most recent, softer CPI print didn't influence them much in terms of today's decision, because it's just one data point, and not yet the trend. But they are looking at how much of inflation is tied to various supply shocks and are trying to refine their views about the underlying trend. It's not a "pause" in Warsh's view, but instead a period of "watchful thinking rather than watchful waiting" and we'll leave it to readers to decide how long that "thinking" process might take.

Re: Economic forecast — While our own forecast currently has the Fed on hold over the balance of the year, that call in part rests on an end to disruptions in Middle East oil traffic, which is far from a sure thing at this point. September's meeting could readily see a quarter point rate hike if energy prices continue to escalate due to a more protracted conflict in the Gulf, raising the risk of spillovers into core inflation or inflation expectations.

The most recent monthly core CPI number was encouraging, but after a half year of firm monthly core PCE readings was not yet much of a marker for a new more moderate trend. Late this year some revisions to the inflation methodology could lop off a decimal place here or there, but that could easily be countered by upward pressure from energy costs on airline fares, trucking fees for goods and other inflation components. In contrast, a cooler oil price environment would be one chip on the side of watchful waiting by the Fed, particularly if some of the recent softness in core components persists in upcoming readings.

Re: Markets — Yields eased somewhat after climbing earlier in the day, and the USD weakened as the Fed eschewed a hike that had been partially priced in by markets. The market was putting nearly 60% odds of a hike in September, down from a hike that was essentially fully priced for either today or September. Equity markets climbed, partially reversing declines from earlier in the day.