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Fed Holds Rates In Split Decision As Iran War Hampers Inflation Fight

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The Federal Reserve opted for no action on its benchmark rate for the second time in as many meetings under Chairman Kevin Warsh, who arrived at the Fed in May promising a new chapter but has faced the same old challenges that have defined central bank policy during President Donald Trump's second administration.

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Federal Reserve Chairman Kevin Warsh

Members of the Federal Open Market Committee voted 9-3 to hold rates flat. Three members, Beth Hammack, Neel Kashkari and Lorie Logan, voted for a quarter-point rate hike.

Stubbornly high inflation and an uncertain jobs market are pressuring either side of the central bank's dual mandate for price stability and maximum employment, leading members of the committee not to touch the Fed's benchmark rate for the fifth consecutive meeting.

Warsh said the FOMC engaged in a healthy debate about "the big questions that matter to the conduct of monetary policy" and said it was "a real family fight," using a favorite term.

"There was a lot of agreement that I heard that we have the powers, the tools, also the authority to deliver stable prices, no walking back from our responsibilities," he said. "The path to central bank heaven requires delivering on our remit. These days, that means delivering on price stability."

Markets generally expected the move. Futures markets were priced with two-thirds odds of no change as of Tuesday afternoon, according to CME Group's FedWatch tool. But the other third tilted toward a rate hike, marking the first time since the pandemic recovery that traders had priced in an upward shift.

It's a meaningful shift for capital markets and commercial real estate, which started the year expecting rate cuts and looser monetary policy but now see that prospect clouded by shifting macroeconomics and geopolitics.

"It comes down to Kevin Warsh staying above the political noise and holding rates steady," Louis Puopolo, the division head of New York City commercial at Douglas Elliman, said in an email. "Whether the next move is up or down, I'd rather see the Fed be patient now than have to correct course later."

The conflict in Iran continues to weigh heavily on the global economy, with its impact on pricing influencing the committee's decision. The war has pushed the price of crude oil sharply higher, raising transportation and production costs across the economy and slowing consumer spending

Warsh said the FOMC members debated four key questions around the rate decision: the implication of high inflation on current policy, the current macroeconomic and geopolitical backdrop, price increases arising from shocks to the system, and the monetary policy tools available to members.

"The broader discussion, to my ear, over the course of the last two days, showed a lot of agreement on the hard questions," he said.

Inflation data for June was an improvement on the prior month but still far off the Fed's long-stated 2% target, and Warsh reiterated the Fed's commitment to getting to that rate.

“There is no soft inflation target, there is no soft implicit target, not on this committee's watch. There's only one target, and it's 2%,” he said. Later in the press conference, he said hitting that target was “the definition of price stability.”

The lagging macroeconomic picture has been a brake on growth, giving the Fed little incentive to cut rates and create a backdrop that could reignite inflation, and tightening labor conditions giving the central bank cover not to tighten monetary policy.

The U.S. added just a net 57,000 jobs in June, the lowest reading in four months, the jobs report from the Bureau of Labor Statistics showed. Unemployment decreased by 0.1% from the prior month to 4.2%, with the most jobs added in professional services, social assistance and healthcare, while 61,000 hospitality jobs were lost.

The weak report and a downward revision by 43,000 jobs for May add to concerns that economic growth is stalling despite the massive investments in artificial intelligence and related infrastructure.

Warsh unveiled five task forces at his first FOMC meeting that are reviewing every aspect of Fed policymaking and the tools at its disposal, and he said Wednesday those groups continued their work.

“In the next couple weeks, I'm going to be doing a check back in, giving them time to think hard about their agenda, their debate, their schedule, and when they might be ready for primetime,” he said. The first reforms could come as soon as the Fed’s annual Jackson Hole Symposium at the end of August, Warsh said.

The Consumer Price Index posted a 3.5% rate of inflation for June, down from 4.2% in May, driven by lower oil prices. Data for the Core Personal Consumption Expenditures, the Fed’s preferred inflation metric that excludes volatile food and energy costs, lags the CPI reporting but sat at 3.4% in May.

“The path of least resistance for June is no change from the FOMC,” Core Industrial Realty Managing Broker Noel Liston said. “There are more pressure points for a rate increase than decrease, and leaving their preferred rate unchanged gives the Fed more time to assess the long-term trajectory of inflation in this country. There are opposing forces in the economy right now that need resolution before a rate change is warranted.”

Warsh came to the top of the Fed after criticizing the central bank under Chairman Jerome Powell for its verbose forward guidance that offered a generally robust assessment of the U.S. economy that has been stripped out under Warsh.

The shift has caused markets to react more to the events than to Fed policy, Warsh said.

"I was comforted that markets in the intermeeting period weren't reacting to us, they weren't reacting to dots or to speeches. They appeared more than ever to be reacting to real-time events," Warsh said.

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