July's Fed decision: "watchful thinking", not "watchful waiting"

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PRIVATE BANKING

- The Federal Reserve left its key rate at 3.50–3.75%, with no change to its policy statement.
- Unlike June's unanimous vote, three members dissented this time, leaving only nine in favour.
- Fed Chair Warsh stressed the decision was deliberate, not inertia: the committee remains firmly committed to its 2% target, and market forces have already delivered a degree of tightening on the Fed's behalf.
- We still expect the Fed to avoid raising rates before November's mid-terms, though rising energy prices, strong US demand and the dissenting votes now cut against that view.
- We continue to monitor Middle East developments, energy prices and US data closely, and will revise our outlook as needed.

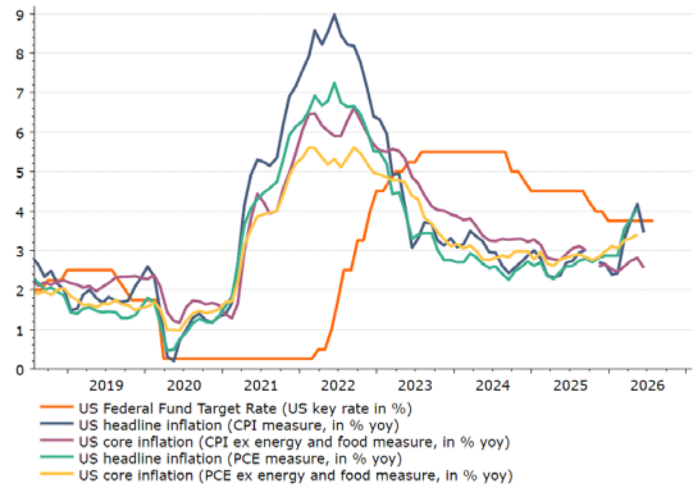
The FOMC held rates at 3.50–3.75%, with the statement unchanged: economic activity continues at a "solid pace" amid "elevated uncertainty", productivity and capital investment remain strong, and job creation has kept pace with the workforce. Inflation, still above the 2% goal, was again attributed partly to Middle East conflict and supply shocks, with the Committee reaffirming its commitment to price stability and to managing its balance sheet under an "ample reserves" policy.

The only real change was in the voting record: three regional presidents, from Minneapolis, Cleveland and Dallas, dissented in favour of a quarter-point hike, versus a unanimous decision in June.

Warsh: this was "watchful thinking", not "watchful waiting"

Fed Chair Kevin Warsh was keen to frame the decision as active, not passive, following what he called a comprehensive debate on four themes: the legacy of five years of above-target inflation; how repeated supply shocks have altered inflation dynamics; whether price rises in the hardest-hit sectors (energy, transport, semiconductors, materials) reflect broad-based pressure or isolated effects; and how the FOMC should best deploy its tools. He offered no new detail on implementation, reiterating that the federal funds rate remains the primary instrument, with further discussion still to come on the balance sheet's role.

The FOMC keeps its monetary policy rate stable in July

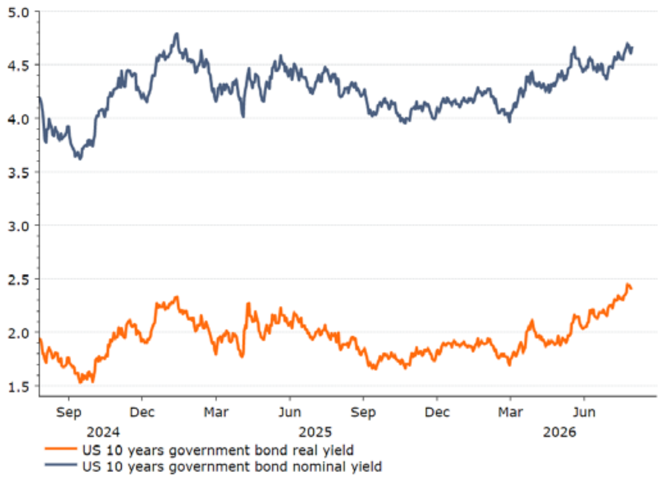


Source: LSEG Datastream, Syz Group

Will the markets do the Fed's work?

Warsh reaffirmed the committee's full commitment to price stability, acknowledging public impatience after five years above target. Still, he noted this Fed has been in place only eight and a half weeks and pointed to improving "family fights" within the committee as a path towards the right decisions. He also argued that reduced forward guidance has produced clearer, less Fed-influenced market signals, and that rising nominal and real Treasury yields since June already amount to meaningful tightening. Despite this, Warsh repeatedly stressed the Fed was not in wait-and-see mode and would act if needed, adding that a strong labour market and near-target inflation need not be conflicting goals.

Nominal and real 10-year US government bond yields did rise in the past weeks

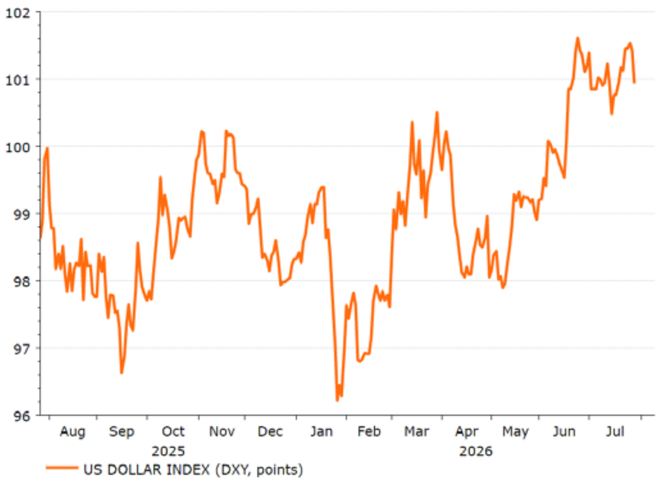


Source: LSEG Datastream, Syz Group

How did markets react?

The dollar index fell from around 101.50 to 100.80. Two-year yields dropped from 4.33% to 4.23% before partially recovering, while ten-year yields rose from 4.62% to just under 4.70%. US equities traded lower following the decision.

US dollar index weakened after the FOMC decision

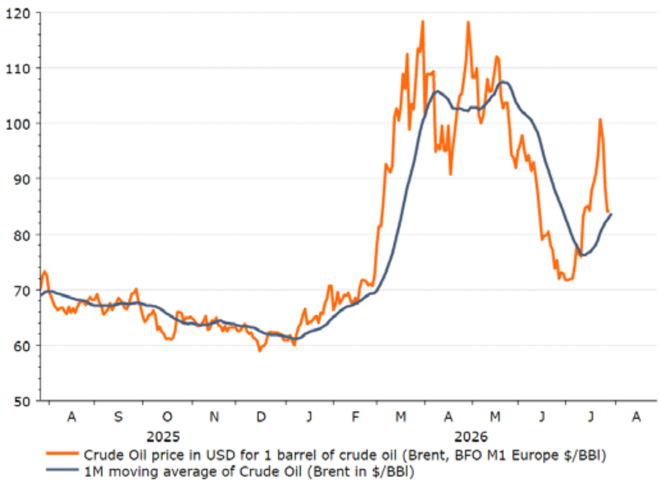


Source: LSEG Datastream, Syz Group

And now?

The three dissents and the renewed emphasis on the 2% target suggest the Fed has edged closer to a hike since June. Inflation data must show continued easing in the coming months, or a rate rise becomes likely. We still expect the Fed to hold off before November's mid-terms, but the odds of a hike have risen. Strong domestic demand, driven partly by AI investment, a resilient labour market, and renewed Middle East escalation, along with petrol prices back above $4 a gallon, are not yet supporting a swift drop in inflation. We expect accumulated price pressures to weigh on household demand as the year progresses, though the data has yet to confirm this. We will watch inflation figures and Fed commentary closely, particularly at Jackson Hole, alongside Middle East developments and energy prices, and will adjust our outlook as required.

The new escalation in the Middle East conflict let energy prices surge again in July



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