2026-7-13

ECO

WSJ Print Edition

image

Warsh's First Big Call: Whether to Undo 2025 Cuts

BY NICK TIMIRAOS

At his first meeting as Federal Reserve chairman in June, Kevin Warsh presided over a unanimous decision to leave interest rates unchanged. Consensus was easy, with little appetite on the policymaking committee to move.

Holding that consensus together will be trickier in the weeks ahead. Some of his colleagues' inflation worries have sharpened since, and they could push to entertain a rate increase when the Fed meets July 28-29.

Warsh has an opportunity to steer that consensus when he testifies to Congress this week. He will do so with fresh June inflation data in hand, the last major data points before the meeting.

The roots of today's tension go back to last year, when the Fed cut rates three times over worries about the labor market. A bloc of officials never thought the last two reductions were warranted, and some will now argue, in effect, for undoing them.

Note

What changed is the economy, and in particular, the labor market—the source of last year's worries—which now look fundamentally steadier. A growing number of officials fear that resilience could keep inflation lodged above their 2% goal.

The oil-price surge tied to the Iran war tilted the Fed's concerns away from the economy to inflation. Oil is down sharply from wartime peaks, but that has been of limited comfort. The officials favoring a rate increase are no longer looking mainly at energy. Prices have been driven up by tariffs on imported goods, energy and fertilizer disruptions from the war, and, increasingly, the AI boom.

Note

The Fed has rarely faced sticky inflation of this sort, where the drivers are idiosyncratic. The models it normally leans on assume inflation is a broad-based phenomenon, with the labor market central to the story.

Note

"Most of the analytical tools that we have to try to analyze inflation start in the labor market. Yet the labor market is not causing the inflation," said Minneapolis Fed President Neel Kashkari at a panel discussion in June. "That makes it a particularly challenging moment for us."

Note

The Fed's monetary-policy report, released on Friday, judged wage growth roughly consistent with 2% inflation— the semiannual report's first such assessment since inflation shot up five years ago. If pay isn't the problem, the inflation is coming from somewhere the Fed's usual models aren't built to predict.

The June consumer-price index report, to be released on Tuesday, could tilt the debate. Firm readings this summer on "core" inflation, which excludes volatile food and energy items, would hand the hawks evidence that price pressures require a response. A soft one would strengthen the case for waiting.

Advocates for rate increases start from a shared premise: Policy may be looser than the Fed intended it to be even after cutting last year, and the economy no longer needs the support.

Note

When the Fed cut rates last year, its leaders expected inflation to run just above their 2% target; instead it has been between 3% and 4%. That makes the Fed's current rate target of 3.5% to 3.75% close to zero or negative in real terms. Since it is real rates that matter for spending, monetary policy is stimulating the economy more than the Fed ever meant it to.

And the labor-market slump it worried about never came. That argues for a modest correction rather than a full-fledged campaign of increases: The Fed would take back insurance that is no longer needed, then stop and re--assess.

"It's simply reflecting welcome, positive news from the labor market and some issues with inflation that need to be taken into account," said James Egelhof, chief U.S. economist at BNP Paribas, who expects the Fed to raise rates three times beginning no later than December.

Note

That some officials who once pushed for cuts are now entertaining increases shows how the ground has shifted. Fed governor Christopher Waller worried the job market was faltering when he led the case for last year's reductions. Last week, he declared the risks had "completely flipped" and, with them, his sense of where rates should go.

Note

The case for patience says that if inflation is the product of a series of one-time shocks, it is precisely the kind of pressure a central bank is sup--posed to look through as long as households and businesses expect inflation to subside.

The pressure hardest to look through could be the artificial- intelligence build-out. There isn't much the Fed can do about price shocks from tariffs and oil, but the hundreds of billions flowing into data centers are a continuing source of demand, which interest rates can restrain.

Note

The prices of semiconductors and electrical gear, which usually inch along, look like "hockey sticks" on a chart, New York Fed President John Williams said last week. "If this creates a sustained impulse to demand relative to supply and inflation, I do think that's the kind of situation where you don't 'look through,' " he said.

Williams has said interest rates are "well positioned," suggesting little urgency to change them. But he tied that to inflation cooling over the second half of the year. In particular, he said he is looking for monthly core inflation readings of 0.2% or lower as tariff effects wane. That pace, annualized, runs near the Fed's 2% goal. "I'm actually hoping that it might even be lower," he said.

Note

Anything faster would signal inflation is more persistent, and demand outstripping supply. "Monetary policy would need to respond to that," he said. "If things play out in a more benign way, I do think that monetary policy would continue to be well-positioned."

