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Fed governor Michael Barr said the central bank should raise rates this month unless new data show price pressures easing.
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Iran War Complicates the Fed's Next Move

Rate decision in two weeks is a close call as elevated prices for energy persist

BY NICK TIMIRAOS

Note

Rising oil prices are forcing central banks to decide how long they can treat the Iran war's effect on inflation as temporary. For the Federal Reserve, investors increasingly think the answer is not much longer.

Note

Treasury yields have climbed alongside crude prices in recent days, with rates on the benchmark 10-year note reaching the highest levels of President Trump's term. Rising energy costs tend to lift yields either way: Investors expect either higher inflation or the Fed to raise rates to prevent it.

Note

Fed governor Michael Barr said Tuesday that the central bank should begin raising rates this month unless new data show price pressures are easing. "If inflation appears not to be moderating sufficiently, then I think we should act decisively to raise rates," he said during a speech in Washington. He said the Fed had brought inflation down to a bit above 2% by 2024 but that progress stalled last year under the weight of tariffs, the conflict in the Middle East and the artificial- intelligence build-out.

The comments underscore how close a call the Sept. 15-16 meeting has become. The decision will turn on developments over the next two weeks, including the August inflation report due Sept. 11. Three of Barr's colleagues voted to raise rates when the Fed held steady in July.

Fed Chairman Kevin Warsh said last week that he was watching more than the data releases.

Note

In explaining the July decision to hold steady, he said the majority of officials wanted to assess new information, "especially given possible developments in supply chains, investment flows, and geopolitics." By that standard, a conflict that keeps going and sustains higher energy prices is the kind of development that would shape their thinking.

Note

Warsh offered a broader assessment of the moment on Monday. Speaking as co-host of the G-20 finance leaders' summit in Asheville, N.C., alongside Treasury Secretary Scott Bessent, Warsh said that the era of a global savings glut—the idea that capital would sit idle for want of opportunities— had given way to "a global investment surge."

While the comment implies long-term rates should sit higher than they did over the past decade for reasons that have little to do with the Fed, investors nonetheless read it as supporting expectations for higher rates, said strategists at JPMorgan Chase.

Note

Central banks have generally let energy shocks pass rather than respond to them, on the theory that the price increase fades and raising rates would only slow an economy that the shock itself is already slowing. The problem for the Fed is that this one hasn't faded. The war with Iran began at the end of February, when officials and investors assumed the disruption would be measured in weeks. Six months later it is unresolved.

The shock hit an economy where inflation already has run above the Fed's 2% target for five years. The longer that continues, the more likely it is that businesses and workers start building higher prices into their plans.

The European Central Bank raised rates in June and is expected to do so again at its meeting next week, treating the run-up in energy prices as a risk to those inflation expectations.

Fed officials have been watching so-called core inflation, which strips out volatile food and energy prices. That measure had been firmer than expected for the first five months of the year, and even though June and July looked better, Warsh said last week that they hadn't convinced him the underlying trend was improving.

On Monday, Bessent treated recent data as evidence the Fed should stay put. "It is my belief that we've seen a supply shock," he said on CNBC. "Traditionally, you don't raise [rates] into a supply shock unless you see second- or thirdorder effects, and we are seeing the core inflation has remained very, very restrained."

Note

Warsh hasn't said how the Fed will respond, in keeping with his view that the central bank should take cues from markets rather than guide them. He has said that investors left to draw their own conclusions produce a more useful signal than one shaped by Fed forecasts.

Markets think the Fed will raise rates, if not in September, then by December, raising the stakes no matter what the central bank does this month. If it lifts rates, investors will want to know whether additional increases are coming, which could push long-term rates higher still.

Note

If the Fed holds, they will want to know how that squares with a chairman who said inflation isn't improving and that borrowing and lending conditions aren't restraining the economy.

