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Chairman Kevin Warsh won't tip his hand, leaving observers unsure of the Fed's rate direction. TOM WILLIAMS/ CQ ROLL CALL/ ZUMA PRESS

Unpredictability Is at Top of the Fed's Agenda

BY NICK TIMIRAOS

Note

Next week's Federal Reserve meeting is shaping up as one of the least predictable in years. A renewed oil shock and a hawkish faction pressing to raise rates have collided with cooler inflation data that helps the case for a hold. Presiding over it is a new chairman who has revealed nothing about which way he leans.

Warsh has vowed to restore price stability, to disabuse investors of the idea the Fed has implicitly accepted higher inflation. He hasn't spelled out how current interest rates will accomplish that.

The officials pressing to raise rates are the more insistent, and a few of them are candidates to dissent if rates stay on hold. Some influential policymakers last week suggested they were inclined to hold, but could support tighter policy this year. A hold would potentially settle little by pushing the debate to September.

At the Fed's latest meeting, half of Warsh's 18 colleagues expected they would need to raise rates this year. The other half thought they wouldn't.

On Wednesday, futures markets put the chance of a rate increase at roughly one in three when the Fed meets July 28-29, up from about one in 10 late last week, according to CME Group. The jump tracked a renewed run-up in energy prices as Middle East conflict has flared again.

"I can make a good case for either raising rates or not," said William English, a former senior Fed economist now at Yale. The deciding factor, he said, is largely out of the Fed's hands: whether the Iran conflict eases and oil falls back, or worsens and leaves the Fed with a more stubborn inflation problem. If the Iran situation pushes prices up, "they'll wish they raised rates," he said. "They're just kind of stuck."

The case for waiting rests on recent economic data: Energy prices declined in June, and underlying prices were flat in the consumer-price index. The June employment report gave no sign of a tight labor market pushing prices higher.

"The data have been more favorable than what the Fed had in front of them in June," said Dean Maki, chief economist at hedge fund Point72 Asset Management. "It would be strange for the Fed to respond to that set of data by hiking when it chose not to in June."

Officials who are more patient argue that this year's inflation has been driven by a series of one-off shocks—first, tariffs, and later, higher energy prices from the war with Iran— that a central bank is supposed to look through rather than fight with interest rates. Some point to signs that the impulse from tariffs on imported goods prices has finally run its course.

"There are encouraging reasons to expect that inflation has peaked and should edge down in coming quarters," New York Fed President John Williams said last week.

More officials worry their interest-rate setting, at 3.5% to 3.75%, is too low for an economy that keeps defying fears of a slowdown, with inflation still above its 2% target and new price shocks in play.

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Even after stripping out one-off shocks, they argue, underlying inflation has been stuck near 2.5% for roughly a year—a sign the current setting isn't restrictive enough. Lofty stock markets and easy borrowing conditions for companies suggest the economy could absorb higher rates without much difficulty. "Better modest restriction now than severe restriction later," Dallas Fed President Lorie Logan said in a speech last week.

With an increase, Warsh would be able to define his chairmanship on his own terms. Raising rates over a president who has demanded lower ones would dispatch the idea, pressed by Democrats during his confirmation, that he is Trump's "sock puppet." Delivering on his vow before the rest of the committee forces the issue would show him leading it rather than trailing it. "One hike gets you more than you might think for your reputation when you are new to the job," said Marc Sumerlin of Evenflow Macro.

Several Fed officials who had suggested they wouldn't push for a July increase—including governors Lisa Cook, Christopher Waller, and Philip Jeffer -son— have said one will become harder to postpone if the inflation outlook doesn't improve.

Some officials willing to hold steady next week may genuinely think an increase is unneeded, or they might simply be reluctant to force the hand of a chairman who hasn't shown it. "Right now, the data's moving in his direction, where he can probably sit tight and buy time," said Michael Gapen, chief U.S. economist at Morgan Stanley.

Note

In the absence of guidance from Warsh, investors have taken their cues from wherever they can find them.

Warsh, Williams and Jefferson form the Fed's policy steering group, known internally as the troika. Under Warsh's predecessor, Jerome Powell, the two vice chairs helped build support for a policy proposal they workshopped ahead of the meeting, giving markets a read on their thinking. The troika has continued to meet under Warsh, but he has said he wants "messier meetings" whose outcomes aren't settled in advance.

