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Rare Uncertainty Marks This Fed Meeting

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By the time the Federal Reserve meets, Wall Street usually already knows the outcome. Not this time.

Two weeks ago, the picture pointed toward the central bank extending its hold on rates. Remarks from senior officials who have often helped shape expectations had laid out what would push them to raise rates—and June's cooler inflation readings came in below that bar, shifting the debate over a possible rate increase to September.

Then around last week, as the collapse of the U.S.-Iran ceasefire sent energy prices higher, market talk of a July increase began to feed on itself. Suddenly, the September debate was live for July. On Tuesday, futures markets pointed to a one-in-three chance of a rate increase, while probabilities in prediction markets were slightly lower.

The case for a surprise increase rests less on anything members of the rate-setting committee have signaled than on whether Chairman Kevin Warsh supports one for reasons of his own.

Here are three things to watch:

The decision

A hold would be the conventional move. It is what the data pointed to after June's soft inflation reading. It is what officials who usually signal the Fed's thinking had steered markets toward. It is also, by most readings, where Warsh himself pointed in testimony two weeks ago, when he did nothing to prepare markets for a move.

If the Fed holds, watch for any dissents. A vote or two against a hold would highlight how pressure to move is building inside the committee.

If the Fed increases rates, it would represent a big change. It would mean overriding the officials who had signaled comfort with the Fed's current stance, diminishing the value of anything they say next time. It would also have political repercussions. The White House spent much of the last year insisting rates were too high and that inflation was under control. A rate increase by Trump's own nominee would say the opposite and put to rest any notion that Warsh is doing the president's bidding.

The strategy

An increase, above all, would lay down a marker. Warsh has cast himself as the chairman who ends five years of inflation above the Fed's 2% target, and moving where his predecessors would have waited would prove it in a way no speech could.

This strategy also remains contested. An increase to prove something relies on logic that New York Fed President John Williams, the vice chair of the rate-setting committee, rejected earlier this month. "The way you maintain the credibility that's been built up over decades is by making the best decisions you can given the data," he said, "rather than trying to use monetary policy to affect credibility." Note

An increase would create a further puzzle: Warsh hasn't explained how tighter policy would address the current pressures.

The explanation

Whatever the Fed does, watch how Warsh explains it.

He has spent two months vowing to restore price stability and declaring that the Fed is responsible for inflation. If the Fed holds steady, as most analysts expect, the question is why he passed on this chance to prove the vow was more than words—and what would it take to move him.

If the Fed increases rates, the reason Warsh gives could determine which direction markets go. Cast as a response to the Fed's long miss on its inflation target, it would signal the first of several increases; some analysts expect long-term yields to fall on the view that the Fed finally means to bring inflation down. Cast instead as a one-off reaction, it carries less of a signal.
