

At the June meeting, the U.S. Federal Reserve Open Market Committee voted to keep the Fed funds short-term policy rate unchanged in the range of 3.50-3.75%. There were no dissents. (New Fed Chair Kevin Warsh assumed the committee position of interim member Stephen Miran, who had been the primary dissenter in recent meetings.)

The formal statement was completely rewritten for June, and was two-thirds shorter, at a brief 130 words. The 'easing bias' that several dissenters complained about in April was removed, as was the wordier forward guidance discussion completely, for that matter. It was noted that the economy continued to expand at a "solid pace," despite the uncertainty surrounding the Middle East. Job gains were upgraded from "remained low" to "kept pace with the workforce," and inflation remaining "elevated." It was also noted that the "Committee reaffirmed its policy of maintaining ample reserves in the banking system." The Summary of Economic Projections (SER) or 'dot plot' noted an expected Fed funds rate of 3.8% for year-end 2026 (up from 3.4% in March), 3.6% for year-end 2027 (up from 3.1%), and 3.4% for year-end 2028 (from 3.1%), respectively, along with an unchanged expected long-term rate of 3.1%. The dots over the next two years have solidified between 3% and 4%. Warsh has alluded to some 'regime change,' particularly in terms of communications, and not being a fan of member forward-looking estimates like dot plots, due to their low reliability to later Fed actions, so the future of such detailed published estimates might be in doubt. Accordingly, it appeared Warsh didn't register a dot in today's plot.

CME Fed funds futures overwhelmingly expected the no change, but through last week there was still a slim chance of a rate cut (!). But the drift in thinking over the past few months has been stark. From January through March, expectations alluded to about two cuts in 2026, until oil price inflation impacts from the U.S.-Iran conflict became too much to ignore. Odds have now completely flipped to one hike by December, with the assumption that inflation will remain sticky, although last weekend's preliminary peace agreement seems to have removed the tail risk of a drawn-out worst-case scenario. Also interestingly, the 30 iterations of the Atlanta Fed's Taylor Rule average out to an ideal policy rate of 5.5%, a somewhat unusual full 2% higher than today's actual rate.

Economy. U.S. GDP growth was revised down from 2.0% to 1.6% for Q1, while the Atlanta Fed GDPNow indicator for Q2 lies at 3.0%, with still-large contributions from consumer spending and non-resi fixed investment, the latter buoyant from the immense AI-related data center buildout. The SER noted growth expectations of 2.2% for year-end 2026 (down from 2.4% in March), 2.3% for 2027 (unchanged), and 2.2% for 2028 (up 0.1%), along with an unchanged 2.0% expected long-term trend growth pace. As long as GDP growth remains robust, all else equal, a bias would be towards higher rates, rather than lower. A strong

corporate earnings environment fueled by AI-spending hopes for productivity gains has only added to optimism in equity markets. That's only based on a snapshot in time, though, as a longer-lasting Middle East conflict and even-higher oil ran the risk of eroding demand and economic activity, flipping economic strength into weakness, and a bias to easing if that had lasted long enough. However, the above-trend growth pace today does not appear to warrant policy support.

Inflation. For May, headline CPI rose 4.2% over the trailing 12 months, while core CPI ex-food and energy rose 2.9%. Core PCE through April continued to run above-target at 3.3%. The SER noted core PCE expectations of 3.3% for year-end 2026 (up from 2.7%), 2.5% in 2027 (up from 2.2%), and 2.1% for 2028 (up from 2.0%), along with a consistent long-term target rate of 2.0%. Although inflation is assumed to be high due to short-term Strait of Hormuz supply impacts, the bias for rates would be towards higher than lower. At the same time, the lessons from the pandemic have made some policymakers cautious of too many assumptions about how sticky inflation can be. The more persistent inflation is perceived, the greater the chances of rate hikes (per the rationale used by the ECB in their vote to hike last week).

Employment. Labor dynamics have improved relative to concerns earlier in the year, with conditions having leveled out in recent months. This is despite some ongoing difficulty in measuring large workforce changes due to immigration, retirements, and continued slow demographic growth, all of which may have lowered what's considered the 'normal' breakeven payroll growth pace. The SER noted an unemployment rate of 4.3% for year-end 2026 (down from 4.4%), unchanged 4.3% for 2027, and unchanged 4.2% for 2028, matching the long-term expected rate of 4.2%. If labor markets look threatened again, due to the Fed's unique second mandate solely focused on employment, odds of a cut could rise again (or at least reduce chances of a hike).

The most closely-watched component of the meeting was that it was Warsh's first, with financial markets interested in getting a better handle on his policy stances. Finetuning communication may also take a few meetings, if past leadership changes are any guide. Historically, stocks have tended to discount such uncertainty to some degree, with weaker returns around the time of the initial meeting of a new Fed chair. Warsh's past views have been on the hawkish side, with resistance to policies of stimulative quantitative easing and expansions of the Fed's balance sheet. Such views have been cheered by folks on the side of a smaller, less intrusive Fed. Though, at the same time, the current U.S. administration has continually pressured the Fed to lower interest rates to juice the economy, which puts Warsh on a bit of a tightrope. Some parallels have been made to the predicament of Fed

Chair Arthur Burns in the 1970s, who found himself in the political crosshairs of Pres. Richard Nixon, which was ironically another period when inflation frustrations were starting to flare.

While the chair sets the tone on the committee, he's only one voting member, with the rest of the group seemingly looking at conditions from a data-dependent lens. For now, data seems to be balancing out on both sides of the dual mandate. This has been reflected in recent comment from Gov. Waller advocating to "simply sit and watch [Iran conflict and data]," and New York Fed President Williams, in that he doesn't "see an obvious direction where [policy rates] would go in the future," as well as being not "that worried about dramatic, second-round effects or persistent inflation." Those seem to sum up current Fed sentiment well for now.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FocusPoint Solutions calculations.

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