At the July meeting, the U.S. Federal Reserve Open Market Committee voted to keep the Fed funds rate unchanged at the current range of 3.50-3.75%. The vote was 9-3, with dissents from Hammack, Kashkari, and Logan, all of whom preferred to raise rates by 0.25%.

The formal statement was brief, as was the one in June, in keeping with Fed Chair Kevin Warsh's streamlined communication style that investors are still getting used to. In fact, the lack of communication is a bit of a throwback to the Alan Greenspan era, or even earlier. In fact, the only change in wording was that the committee is "continuing" (as opposed to "reaffirmed") its policy of maintaining ample reserves.

CME Fed funds futures settled in expecting no change, but odds of a hike had risen from around 15% to 35% over the past week, with that much uncertainty being unusual so close to the meeting (this echoed Polymarket which showed similar betting odds). A hike is still the highest-expected base case for the next meeting in September, with one more expected in December, but no action in 2027, which would take the policy level to 4.00-4.25% by Dec. 2027. That remains a percent higher than the ~3.00% or so Fed best estimate at a nominal long-term 'neutral rate.'

Economy. The final U.S. GDP growth figure for Q1 came in at 2.1%, around the long-term trend pace, while the Atlanta Fed GDPNow indicator for Q2 points to a growth rate of 1.5%. Private sector economists have pegged growth at a rough range of 1.5-2.5% for the quarter and for the rest of 2026. Consumer spending remains strong, although a larger proportion has come from higher-income households, which have been feeling a bit of 'wealth effect' from a strong stock market. Lower-income groups have been under pressure from higher prices for gasoline and food, serving to potentially crowd out other spending. Infrastructure building related to the ongoing AI boom has also been strong, accounting for up to a full percentage point of GDP growth, although that might also be taking some resources from homebuilding, where higher supply is certainly needed. As growth is expected to proceed along such a trend-like pace for now, the current growth pace alone wouldn't seem to push the Fed toward either hiking or easing.

Inflation. For June, headline CPI decelerated to 3.5% over the trailing 12 months, while core CPI ex-food and energy rose 2.6%, being helped by a decline in oil prices, which remain volatile this month as U.S.-Iran military tensions have continued to escalate and deescalate. Core PCE for May continued to run above-target at 3.4% (June data out tomorrow), being an index where some AI-related inputs like memory and electricity have made more of an impact than in CPI. Despite having made some progress before the U.S.-

Iran conflict, inflation continues to run hot, with "frustrated" FOMC members putting blame on a few factors: current geopolitical tensions affecting oil/supply chains, last year's tariffs, as well as strong forces on the tech investment demand side. In his recent testimony to Congress, Chair Warsh noted that the Fed's job is to ensure individual price spikes "don't broaden out." However, petroleum touches a lot of sectors. Taken at face value, higher inflation has tended to prompt central banks toward hawkish policy and hikes, although the post-pandemic period has also depended on how "transitory" these inflation surges have been expected to be and whether they can be "looked through." The surges have all lasted longer than first assumed, which runs the risk of potentially further raising embedded consumer inflation expectations.

<u>Employment</u>. Labor markets have been less newsworthy than earlier in the year, with various revisions in nonfarm payrolls, but also a drop in the size of the labor force, complicating the calculations. Other metrics have provided similarly neutral data, including job openings perhaps bottoming out, and jobless claims staying range-bound—neither pointing to layoff activity broadly. Firms have discussed AI's potential to replace some entry-level work, but also perhaps using that as a convenient scapegoat to shift budget priorities toward tech capex, as opposed to already seeing dramatic productivity benefits. Many have shared a more optimistic backdrop of using AI as a tool to enhance productivity of existing employees, with such impacts being a research focus of a Warsh-led Fed. (Other research shows that dramatic productivity enhancements can take many years to unfold, at least based on prior technological revolutions.) The lack of immediate trouble in labor also reiterates the call of no-action by the Fed.

Much of the interest rate policy discussion remains tied to the path of inflation, reiterated by FOMC members in the June minutes and in recent comments. And that immediate path remains hinged on impacts from the Middle East, commercial traffic in the Strait of Hormuz (and perhaps the Red Sea as well), and global oil supply levels. The positive case, assuming a quicker resolution to the conflict, sees oil flowing freely, bringing down prices fairly quickly (even if not to pre-conflict levels), and thereby easing embedded inflation back toward a tolerable path. A more negative case implies the opposite, with a drawn-out conflict, uncertain outcome and timeline, and oil scarcity situation that could spike petroleum and derivative product prices that sustain inflation readings for longer, acting as a headwind to global economic growth. The uncertainty is the part that financial markets have historically disliked the most, more so than even outright bad news, although growth in other parts of the economy has kept the negativity at bay this year.

The inflation component points to higher rates in the simplest analysis, but that depends on the magnitude of damage to the economy and labor markets, which normally implies an eventual contrary easing response. Such a situation could put the Fed between a rock and a hard place again, with potentially complicated trade-offs of needing to prioritize one of their mandates over another. The 10-year U.S. Treasury note yield has continued to creep up, to now over 4.6%, and the 30-year at 5.1%, with market concerns about inflation's persistence and high deficits/debt levels, but also less transparent Fed communications and perhaps reflecting extended economic growth, although rising yields can weigh on equities. For now, decent growth and hopes of improved geopolitics have fueled generally positive sentiment for risk assets.

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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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