

House View

House View Update: Fed hikes back in focus



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Persistent inflation, shifting Fed projections and Kevin Warsh's likely priorities point to a renewed tightening cycle.

Our overall thesis of a resilient outlook for the global economy remains intact. But as outlined in our [House View Q3 2026](#), published on 22 June, inflation is still above target in most major economies, and renewed market volatility could test our base case of an economy bending but not breaking.

Against this shifting backdrop, we have now revised our US interest rate forecast to reflect a move in the balance of risks from further cuts towards renewed tightening. We now expect the US Federal Reserve (Fed) to raise the federal funds target range by 50 basis points in total during the second half of the year. Previously, we had anticipated the incoming Fed Chair Kevin Warsh to move more cautiously before lifting rates.

Our expectation is for hikes in September and December. However, we recognise that there is a low probability that the Fed front-loads the tightening cycle with moves in July and September.

Three reasons the Fed may need to tighten

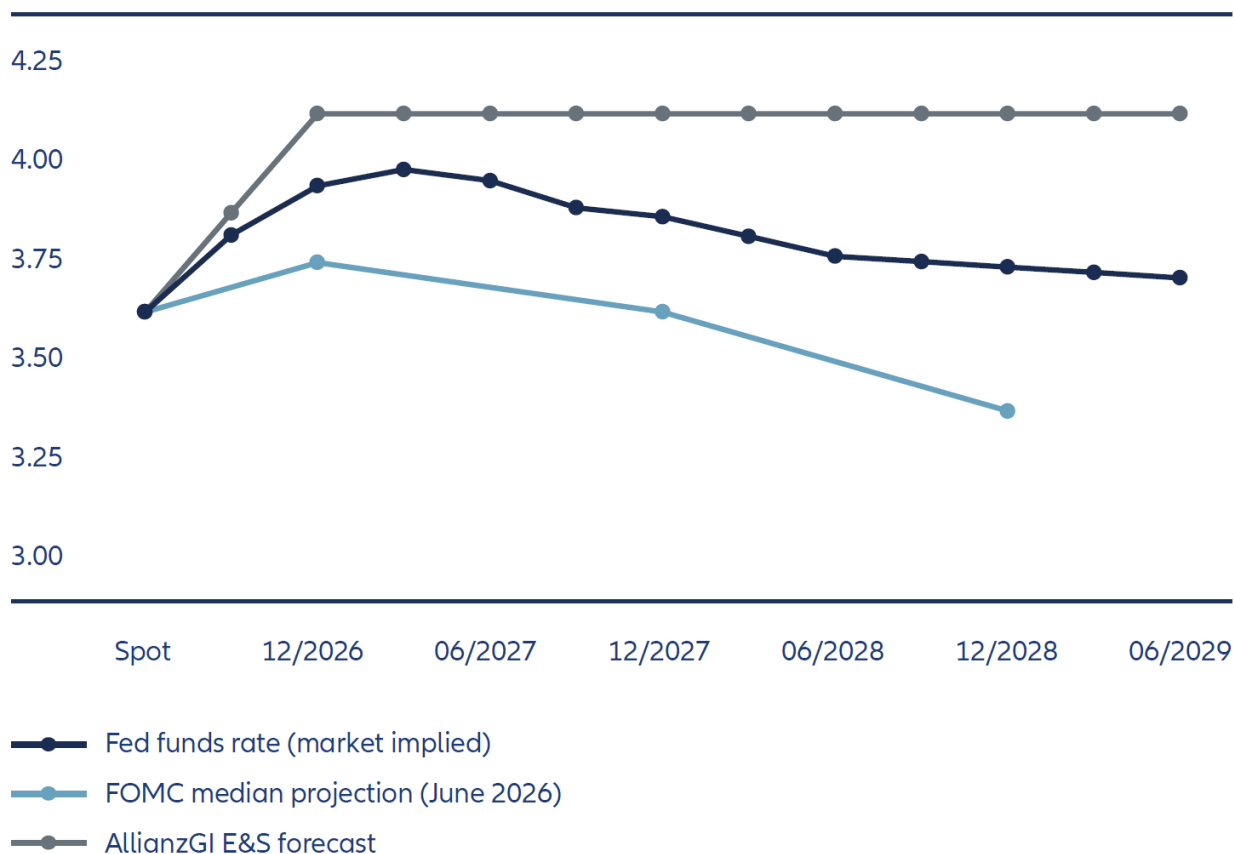
Three developments have explained our change in view:

- 1 Sticky inflation shows no sign of reversing:** Inflation has remained above target for more than five years, while core personal consumption expenditures (PCE) inflation has

reaccelerated to 3.4% year over year in May. The reacceleration in inflation is broadly consistent with our long-held scepticism that underlying inflation would return sustainably to target without a more pronounced weakening in the labour market and broader economic activity. Instead, the US economy has remained remarkably resilient despite repeated supply shocks, reinforcing the risk that inflation remains structurally above target.

- 2 The Fed's inflation outlook conflicts with its policy stance:** In its June statement of economic projections, Federal Open Market Committee (FOMC) participants expected core PCE inflation to average 2.5% in 2027 and 2.1% in 2028, implying that underlying inflation is expected to remain above target throughout the forecast horizon. Consistent with this outlook, the committee's dot plot – a scatter chart showing where Fed officials expect interest rates to be in the future – has shifted noticeably towards a tightening bias, with nine of the 19 participants now projecting between 25 and 75 basis points of interest rate hikes this year. Despite Mr Warsh's efforts to downplay forward guidance, we see this as an important hawkish signal.
- 3 Markets have misread the Fed leadership change:** During Mr Warsh's nomination process, many investors assumed he would prioritise supply-side solutions to inflation – supporting growth by expanding the economy's capacity rather than restraining demand through higher rates. They also expected him to be more willing to cut rates under White House pressure. This led markets to see his appointment as a signal of easier monetary policy, even in the near term. [We took a different perspective](#). In our view, Mr Warsh is both an orthodox inflation hawk and a believer in AI- and productivity-led disinflation. These positions are complementary rather than contradictory: he may first need to tighten monetary policy to contain the current inflation overshoot before structural productivity gains can potentially help to limit longer-term inflationary pressures. Since the June FOMC meeting, markets have changed their view, increasing their expectations for rate hikes (see Exhibit 1).

Exhibit 1: Money markets are now pricing in the first Fed rate hike in more than three years



Source: Allianz Global Investors Global Economics & Strategy, Bloomberg (data as at 26 June 2026).

The Fed's next steps: tighten policy before pushing for reforms

In terms of next steps, policy sequencing will be critical. Before the Fed can credibly lean into a more optimistic long-term supply-side story, it must first restore its inflation-fighting credibility. Letting inflation stay above target while arguing that future productivity gains will solve the problem would only further weaken that credibility. Therefore, we expect Mr Warsh to take a “first things first” approach: tighten policy in the near term to address the current inflation overshoot, rebuild the Fed’s anti-inflation credentials, and then pursue broader institutional reforms, confident that stronger productivity growth will ultimately support a more benign medium-term inflation outlook.

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