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Policy Watch

Global Markets Research
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Economics - North America

September FOMC Preview – We now expect the Fed to hike

- We now expect the FOMC to raise rates by 25bp at their September meeting next week, followed by another hike in December.
- Chair Warsh's hawkish turn in his *Jackson Hole speech*, elevated August core PCE inflation estimates, and the recent spike in crude oil prices justify policy tightening.
- The dot plot is likely to be revised higher than in *June*, with the median 2026 rate expectation suggesting two rate hikes in total this year.
- We expect officials to revise down only sightly their 2026 inflation expectations due to *upcoming methodology adjustments* for PCE inflation. By contrast, changes to the median forecasts for real GDP and the unemployment rate will likely be hawkish.
- Warsh is unlikely to provide forward guidance on the next policy action at his press conference. We expect the reaction function will remain "data-point dependent," with a high sensitivity to monthly inflation surprises.

We expect the Fed to raise rates at the September meeting (*Fig. 1 & 2*). Recent inflation data showed little progress towards the Fed's 2% target. Our estimate for August core PCE inflation points to 0.278% m-o-m, up from 0.246% in July and 0.147% in June.

Chair Warsh downplayed the relatively benign inflation prints for June and July at his *Jackson Hole speech*. A reacceleration in August will likely lead him to take a hawkish action. Recent spikes in crude oil prices also pose an upside risk to the inflation outlook. In addition, *media reporting in early August* suggested that Warsh would be prepared to raise rates if market expectations for tightening rises significantly. The market pricing for a hike in September is around 90% at the time of writing, meaning a dovish surprise could add to volatility for a rates market which already appears sensitive to inflation risks and Fed credibility concerns.

Research Analysts

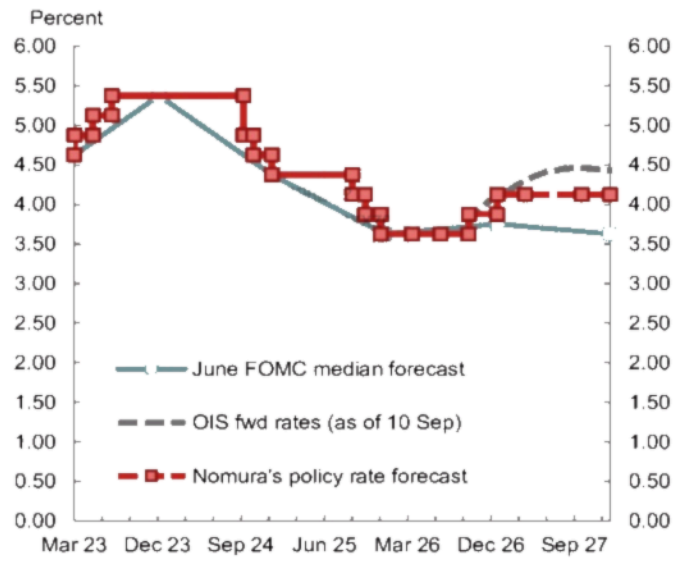
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Fig. 1: We now expect the Fed to raise rates by 25bp at the September FOMC meeting



Source: FRB, Bloomberg, Nomura

Fig. 2: We expect another rate hike in December

Nomura's monetary policy outlook

Tool	Key assumptions
Policy rate	
2026	2x25bp hikes in September and December, EOP 4.125%
2027	Rates on hold, EOP 4.125%
Terminal	4.00 - 4.25%
Balance sheet policy	
Size	Reserve management purchases of $10bn/month. The NY Fed is actively managing reserve management purchases in response to seasonal liquidity demand and market conditions. We expect balance sheet growth to average $20bn per month in the medium term.
Composition	MBS rundown to continue, with proceeds reinvested into Treasuries. Both reinvestments and eventual reserve management purchases will be skewed towards Treasury bills.

Source: FRB, Nomura

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

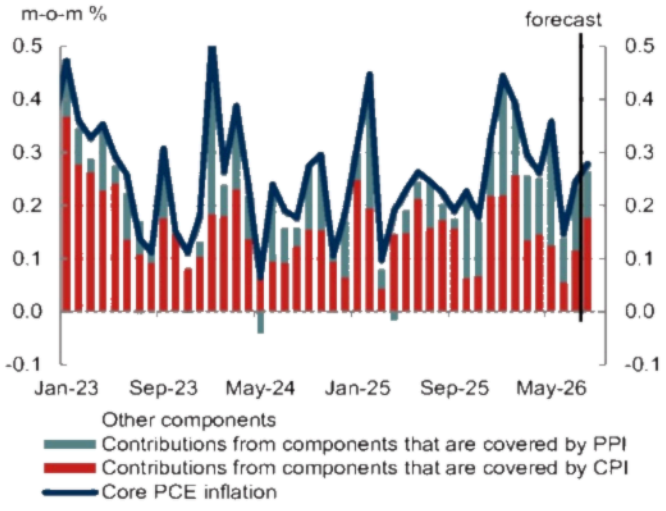
We expect no dissent at the meeting. There is some risk of Governor Bowman dissenting in favor of staying on hold, but we expect she would prefer to support Warsh if he pushes for a hike. The median 2026 dot will likely be revised up to 4.125%, corresponding to another rate hike in the final two meetings of the year.

Recent inflation data and our revised monetary policy outlook

Based on CPI and PPI data, we estimate August core PCE inflation accelerated to 0.278% m-o-m, a significant acceleration from prior months (*Fig. 3*). Although *upcoming methodology changes* will likely lower y-o-y core PCE inflation by about 20-30bp, the recent trajectory of monthly prints suggests that inflation progress has stalled (*Fig. 4*). Forward-looking details from recent data were also concerning, with PPI data pointing to pickup in input costs for manufacturers.

Fig. 3: We estimate August core PCE inflation accelerated to 0.278% m-o-m, a significant acceleration from prior months

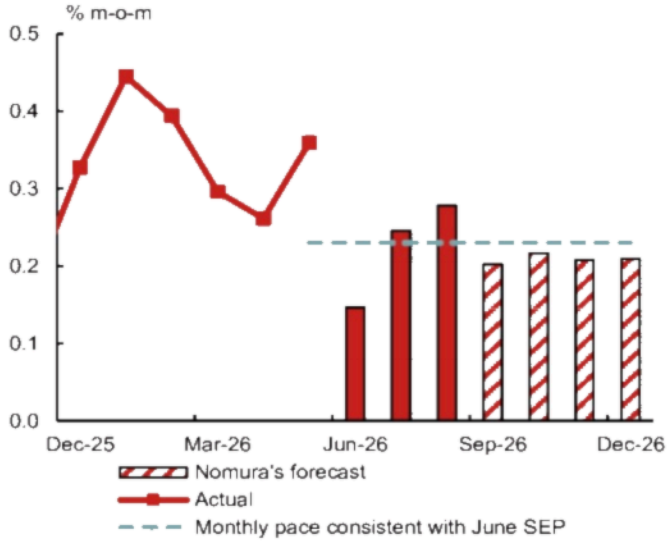
Decomposition of m-o-m core PCE inflation by data source



Source: BLS, BEA, Haver, Nomura

Fig. 4: The recent trajectory of monthly prints suggests that inflation progress has stalled

Monthly core PCE inflation



Source: BLS, BEA, Haver, Nomura

Recent geopolitical events have also increased upside inflation risks. Tensions in the Middle-East have re-escalated. *President Trump also suggested* that gasoline prices are unlikely to decline until after the mid-term elections. Higher for longer crude oil prices could lead to second round effects on consumer prices. Note, that even Governor Waller, who has been dovish lately, cautioned about potential spillover effects from higher energy prices into a wide range of products.

In addition, Warsh is also likely to take into account market pricing for the next meeting. An *FT article* in early August cited "people familiar with" Warsh's thinking, suggesting that he would be prepared to raise rates in September if inflation data come in hot, and markets ratchet up their expectations for a rate hike. Currently, futures markets suggest that the market-implied probability of a rate hike next week stands at ~90%. Delivering a dovish surprise in this context could hurt his credibility, especially following the *July FOMC* and recent volatility in long-term interest rates.

Against this backdrop, we expect the Fed to raise rates by 25bp next week (vs our call for hold previously). We believe policymakers are likely to follow this up with another 25bp rate hike in December. Recent data suggest inflation is elevated with risks skewed to the upside, which will likely justify another 25bp rate hike in December. The anticipated cumulative 50bp rate hike would reverse some excess policy easing in 2024-25.

Following policy tightening in 2026, we expect the Fed to remain on hold in 2027. We believe that once external shocks start to fade, core inflation will likely decelerate in the medium term, considering waning impact from tariffs (and *reported price cuts* from tariff refunds), moderating wage growth, and softening housing markets. The Fed's conviction in disinflation would likely increase early next year, when we expect y-o-y core PCE to decelerate as strong Q1 2026 readings drop out of a twelve-month window.

Dot plot to suggest two hikes in 2026

We expect the median rate expectation for 2026 is likely to tick up to 4.125%, or two 25bp hikes (the June dot plot had a split median of 3.750% in 2026, indicating a 0.125% increase) (*Fig. 5*). We expect the median dot to be 4.125% in 2027, suggesting policy on hold. We think that a majority of FOMC participants are reluctant to forecast aggressive rate hikes as they anticipate gradual deceleration in core inflation in the long run.

Beyond 2027, we expect the dot plot medians to show one and two rate cuts in 2028 and 2029, respectively, gradually converging toward the median longer-run projection of 3.125%, which we believe is likely to remain unchanged from June.

Fig. 5: Revisions to economic projections are likely to be hawkish on net

Nomura's forecast for Summary of Economic Projections

		2026	2027	2028	2029	Longer-run
Change in real GDP	***Sep-26***	***2.4***	***2.3***	***2.2***	***2.1***	***2.0***
	Jun-26	2.2	*2.3*	*2.2*		*2.0*
Unemployment rate	***Sep-26***	***4.2***	***4.1***	***4.1***	***4.2***	***4.2***
	Jun-26	4.3	4.3	4.2		4.2
PCE inflation	***Sep-26***	***3.7***	***2.4***	***2.0***	***2.0***	***2.0***
	Jun-26	3.6	2.3	2.0		2.0
Core PCE inflation	***Sep-26***	***3.2***	***2.6***	***2.1***	***2.0***	
	Jun-26	3.3	2.5	2.1		
Projected appropriate policy path: Median						
	Sep-26	***4.125***	***4.125***	***3.875***	***3.375***	***3.125***
	Jun-26	3.750	3.625	3.375		3.125

Note: Red denotes hawkish revisions, green denotes dovish revisions.
Source: FRB, Nomura

Hawkish revisions on net to the summary of economic projections

Despite recent upside surprises to core PCE inflation, the 2026 median estimate is likely to decline in September as officials incorporate *upcoming methodological changes*. We estimate these adjustments will contribute 20-30bp of downward adjustment to y-o-y core PCE inflation. These methodology changes were announced after the June FOMC meeting and were likely not considered in the SEP projections then.

Accounting for this technical update, revisions to economic projections are likely to be hawkish (*Fig. 5*). We expect the median core PCE inflation for 2026 will be revised down only by one-tenth to 3.2% from 3.3% previously. The median 2026 headline PCE inflation projection will likely be revised up to 3.7% due to higher crude oil prices. Beyond 2026, we expect a slight upward revision to both headline and core PCE inflation forecasts for 2027, reflecting slower progress toward the inflation goal and evidence of forward-looking inflation pressure.

On the median forecasts for real GDP growth and unemployment rate, we expect slight hawkish revisions to the near-term projections. Specifically, the median 2026 real GDP projection will likely be revised up to 2.4% from 2.2% previously, reflecting a strong GDP tracking estimate for Q3. We expect the median 2026 unemployment projection to be revised down to 4.2% from 4.3% previously, which is sort of mark-to-market adjustment.

Fedspeak

Chair Warsh's Jackson Hole speech was hawkish, emphasizing the importance of the "speed" of disinflation. He downplayed recent signs of progress in inflation data and was dismissive of the disinflationary signal from wage growth. Warsh also cast recent growth and labor market data in a positive light. Warsh's speech omitted some of his past dovish talking points. Warsh also toned down his criticism of official statistics, reiterating that the Fed targets PCE inflation.

Other officials have not pivoted along with Warsh, but doves and centrists have laid out a data-dependent reaction function, with the decision to tighten depending on near-term inflation momentum. Governor Waller suggested his decision in September would depend



on August inflation data, and Governor Barr suggested he would support tightening unless he saw evidence of disinflation. NY Fed President Williams was more dovish, saying he continued to see the trend in inflation as improving, but he also emphasized the importance of continued progress towards the 2% target.

Press conference

Following criticisms of his July press conference, we expect Chair Warsh to be more cautious around his messaging in September.

We expect Warsh will reiterate many of his hawkish talking points from his Jackson Hole speech. He will likely say that growth and the labor market appear resilient, leading the FOMC to remain focused on upside inflation risks.

Warsh is likely to indicate that the committee is ready to act again if inflation is not slowing at a sufficient pace. However, we do not expect him to clarify a threshold for inflation data which would lead the committee to deliver another rate hike. We also think it is unlikely that Warsh would provide an estimate of what policy rate he might see as sufficiently restrictive to put downward pressure on inflation.