14 Sep 2026 07:58:49 ET | 10 pages

US Economics

FOMC Preview – One hike, not a cycle

CITI'S TAKE

The combination of slightly stronger than expected core CPI and the renewed rise in energy prices is likely just enough to push consensus toward hiking 25bp at this week's meeting. The decision to hike could be unanimous, but we would not be surprised by up to two dissents in favor of a hold. The rate increase is likely to be presented as a "calibration" and not the start of a cycle of hikes. Core PCE inflation projections should be revised lower as officials take into account upcoming methodological revisions. With growing evidence that underlying inflation is slowing and that energy prices are not passing through to broad consumer prices, our base case is for the Fed to hike just once and then return to cuts in June 2027.

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We expect the FOMC to raise policy rates by 25bp to a range of 3.75-4.00% at this week's meeting. We would not be surprised by a unanimous decision or up to two dissents in favor of holding policy rates steady. The median "dot" will likely show one additional 25bp policy rate increase this year. In our base case, after this hike the Fed would stay on-hold through the remainder of this year and into 2027, before cutting rates again in June 2027.

Data received over the last three months has increased our confidence that underlying inflation is slowing – as summarized by core CPI inflation falling to 2.4%YoY, its lowest reading in five years. But the optics of core PCE registering 0.25%MoM in July (even if 11bp of this was due to portfolio management fees – an imputed price that is about to be revised lower) and 0.29%MoM in August (even if 10bp was due to the largest ever rise in cellphone plan prices) will probably be enough to convince a majority that a 25bp increase in the policy rate is prudent. The renewed rise in energy prices (even if there is no evidence this has passed through to broad consumer prices) and global repricing of more hawkish central-bank policy will also make a rate hike harder to resist.

In our base case, Chair Warsh will be able to bring most if not all Fed officials along. Given a stable labor market, many officials who might be on the fence about hiking can still support the move as a kind of "risk management" hike that will have only a modest effect on the economy and can always be unwound if and when inflation moves lower or the unemployment rate rises. However, to forge a consensus Warsh would likely be expected by his committee to explain in the press conference that this week's hike is more of a "calibration" and should not be read-through to a series of further hawkish policy actions. He could potentially communicate this as consistent with his preference for limited guidance and a meeting-by-meeting approach to policymaking.

Hiking with relatively dovish messaging could help Warsh achieve a unanimous vote in favor of a hike. NY Fed President Williams did not appear to be leaning toward a hike in recent comments, but left options open and might be willing to support the Chair in this case. Given the differences across the committee as many as two dissents in favor of holding policy rates steady would not be surprising.

Updates to the summary of economic projections for Q4 2026 should be on balance dovish. The unemployment rate should be nudged 0.1-0.2pp lower and real GDP growth left about where it was in June at 2.2%. But core PCE inflation should see a material shift lower (~30bp) given recent data and methodological revisions that will be released September 30th. Waller referenced these upcoming revisions and we think most governors (and probably some regional fed presidents) will be including them in their Q4/Q4 forecasts for core PCE in the SEP.

Figure 1. Citi's expectation for Fed Summary of Economic Projections (SEP)

	2026	2027	2028	Long run
GDP	**2.2**	**2.3**	**2.2**	**2.0**
June	2.2	2.3	2.2	2.0
Unemployment	**4.2**	**4.2**	**4.2**	**4.2**
June	4.3	4.3	4.2	4.2
PCE inflation	**3.4**	**2.3**	**2.0**	**2.0**
June	3.6	2.3	2.0	2.0
Core PCE inflation	**3.1**	**2.5**	**2.1**	
June	3.3	2.5	2.1	
Fed funds rate	**4.1**	**3.9**	**3.4**	**3.1**
June	3.8	3.6	3.4	3.1

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Source: Citi Research

"Dots" showing officials' forecasts for the appropriate level of policy rates will likely be submitted by all governors and presidents excepting Chair Warsh as occurred in June. With just two FOMC meetings left this year we would expect most "dots" to advocate for either staying on hold or raising rates by another 25bp. Only a few (perhaps 3) will likely think raising rates again in both October and December is prudent. That would leave the median dot showing one additional 25bp rate hike this year.

In 2027 and beyond, the committee is likely to continue to expect cooling inflation and pencil in gradual rate cuts. The fact that most Fed officials plan to reduce rates next year after raising them this year would help underline the message that this week's rate hike is not a signal that policy rates will continue to rise or be held at significantly higher levels.

Chair Warsh is likely to give little additional guidance on the path of policy rates, consistent with earlier statements. He will probably repeat now-familiar phrases: "inflation is a choice" and there is "work to do" until it returns to target.

Given our read of the recent inflation data as pointing to a cooler underlying trend, we expect benign upcoming inflation readings to keep the Fed on hold in October and December. Residual seasonality may deliver stronger core inflation readings in early 2027 which in our base case prevents cuts from resuming until mid-2027. Risks are balanced toward earlier cuts should this residual pattern not repeat in the inflation data, the labor market weaken or sentiment around AI and equity valuations decline.

Expected changes to Fed statement

The Federal Open Market Committee approved the following statement for release by a ~~**9 – 3**~~ **12-0** vote:

The Committee decided to ~~**maintain**~~ **increase** the target range for the federal funds rate ~~**at 3-1/2 to 3-3/4**~~ **to 3 3/4 to 4** percent, in support of the Federal Reserve's dual mandate. The Committee is continuing its policy of maintaining ample reserves in the banking system.

Economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East. Productivity growth and capital investment are strong. Job gains have kept pace with the workforce, and the unemployment rate has changed little.

Inflation remains elevated relative to the Committee's 2 percent goal, in part reflecting supply shocks that have driven price increases in certain sectors, including energy. The Committee will deliver price stability.

~~**Voting against the monetary policy action were Beth M. Hammack, Neel Kashkari, and Lorie K. Logan, who preferred to raise the target range for the federal funds rate by 1/4 percentage point at this meeting.**~~

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