USA: FOMC Minutes Note "Most" Participants Saw Another Increase as Likely "Appropriate by Year End," but Committee Will Approach

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BOTTOM LINE: The minutes to the FOMC's September meeting showed that "all" participants supported raising the target range for the federal funds rate by 25bp to 3.75-4%, judging that progress on lowering inflation had not been "sufficient." "Almost all" participants assessed that risks to inflation were "tilted to the upside," while risks to the labor market had "diminished" and were now "broadly balanced." "Many" participants framed the hike as "prudent on risk-management grounds" against inflation remaining "persistently above target," while "a number" viewed it as "necessary under their modal outlook rather than for risk-management reasons." "Most" participants assessed that another increase would likely be "appropriate by year end," though they stressed the Committee would approach each meeting with "an open mind," as future decisions "would depend on incoming information." Following the August core PCE data and recent speeches by Fed Vice Chair Jefferson and New York Fed President Williams, we expect the second Fed hike in December, though we see a strong chance the FOMC ultimately concludes further tightening is unnecessary.

MAIN POINTS:

1. The minutes to the FOMC's September meeting noted that "all" participants supported raising the target range for the federal funds rate by 25bp to 3.75-4%, as inflation "remained elevated" and "they had not seen sufficient progress on lowering inflation in recent months." "Almost all" participants assessed that risks to inflation were "tilted to the upside," while risks to the labor market had "diminished" and were now "broadly balanced."

2. "Several" participants described the pre-hike policy rate as "not restrictive or only mildly restrictive." "Many" framed the hike as "prudent on risk-management grounds" against inflation remaining "persistently above target," while "a number" viewed it as necessary under their modal outlook rather than for risk-management reasons. "Some" noted a higher rate would curb the risk of persistently high inflation "unanchoring inflation expectations," and "a couple" said it would help prevent "sector-specific price increases... from broadening out."

3. Regarding the outlook for monetary policy, "most" participants assessed that another increase would likely be "appropriate by year end." Participants emphasized, however, that they approached each meeting with "an open mind" and that future decisions "would depend on incoming information."

4. Participants pointed to "ongoing geopolitical developments" and "surging AI-related investments" as sources of inflation pressure. "Several" noted that core goods inflation remained elevated as "the effects of the AI buildout appeared to

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increase while the effects of tariff increases waned," and "some" warned the AI buildout could push "aggregate demand to outpace aggregate supply… putting upward pressure on inflation." "A few" noted that software and portfolio management fees had made outsized contributions to recent PCE readings, though these would likely fade with the BEA's upcoming methodology changes. Participants judged medium- and longer-term inflation expectations as "consistent" with the Committee's 2% objective.

5. "A few" participants linked the recent rise in longer-term Treasury yields to "a stronger economy, increased expectations for AI-related borrowing, and geopolitical developments." "Many," however, judged that financial conditions remained "supportive of economic growth," citing substantial equity gains and narrow corporate spreads despite higher yields. This is consistent with our view that the change in overall financial conditions has only been a small drag on 2026 GDP growth and that it should weigh only modestly on 2027 growth.

6. The staff's September inflation forecast was "somewhat higher" for 2026-2028 than in July, with inflation seen stepping down as tariff, geopolitical, and AI-related effects wane, and reaching 2% in 2029. Risks to the inflation forecast remain "skewed to the upside." By contrast, the growth and labor market outlook strengthened: real GDP was projected to "pick up over the second half of this year and to outpace potential through 2028," and the unemployment rate was expected to "remain below the staff's estimate of the longer-run rate through 2029."

7. Following the August core PCE data that incorporated the BEA's methodological changes, and recent speeches by Fed Vice Chair Philip Jefferson and New York Fed President John Williams, we expect the second Fed hike in December, though we see a strong chance the FOMC ultimately concludes further hikes are unnecessary.

Disclosure Appendix

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