UBS

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What does the Warsh era mean for Fed policy?

UBS House View Briefcase

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Key message

Kevin Warsh's tenure as chair of the Federal Reserve began on a hawkish note. But while US inflation risks are likely to keep the central bank on hold for the rest of the year, we believe market pricing for rate hikes is somewhat aggressive. We see an opportunity for investors to lock in yields by adding to short- and medium-duration quality bonds.

01 The June Fed meeting was more hawkish than expected.

- The Fed kept the federal funds rate unchanged at 3.50-3.75% in June, underscoring a cautious stance amid persistent inflation and a still-resilient economy in the US.
- The easing bias was removed from the statement, while inflation projections were revised higher. Roughly half of the officials anticipate at least one rate increase before year-end.
- Structural changes to Fed communications and the launch of multiple task forces suggest a more cautious policy approach.

02 But we believe the Fed is more likely to keep rates on hold than to hike them.

- The combination of a new chair regime and a wide dispersion of views among FOMC members implies a higher bar for near-term action in either direction. We expect the Fed to keep rates on hold for the rest of the year.
- Likely slower economic growth trends and disinflation in the second half should help support a pivot toward lower policy rates in 2027.
- If supply disruptions tied to the Middle East conflict ease, some of the June meeting's hawkish tone could fade.

03 We continue to like short- and medium-duration quality bonds.

- Current market conviction around Fed rate hikes in 2026 appears somewhat too aggressive, in our view.
- We see an opportunity to lock in yields on short- to medium-duration quality bonds. Investors looking to enhance or diversify portfolio income can also consider emerging market bonds, and equity income and yield-generating strategies.
- We believe Fed policy overall will remain supportive for US equities, and we favor a balanced and diversified approach to the asset class.

New this week

US personal consumption expenditures (PCE) inflation for May came in slightly softer than expected, easing some of the recent pressure on the Fed to raise interest rates. Headline PCE rose 0.4% month over month, below the +0.5% consensus estimate, while core PCE increased 0.3% month over month and 3.4% year over year.

One liner

We believe the Fed is more likely to keep policy rates on hold this year than to raise them.

Did you know?

- The FOMC's June statement removed both the easing bias and forward guidance, reinforcing the idea that the committee is no longer attempting to guide market expectations explicitly. The post-meeting statement was significantly shortened, offering only a high-level assessment of economic conditions.
- Chair Warsh did not submit rate projections, consistent with his earlier criticism of the dot plot framework, while another participant did not provide longer-term projections. This partial participation highlights growing skepticism toward the dot plot framework and raises questions about its role over time.
- Cash tends to underperform other assets over time: Stocks have outperformed cash in 86% of all 10-year periods and 100% of all 20-year periods since 1926.

Investment view

We believe current market conviction around Fed rate hikes this year appears somewhat too aggressive. We see an opportunity for investors to lock in yields, particularly in short- and medium-maturity quality bonds. We also expect Fed policy to remain broadly supportive for equities.

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