Bank of Nassau
SINCE 1982

Economy Macro Update

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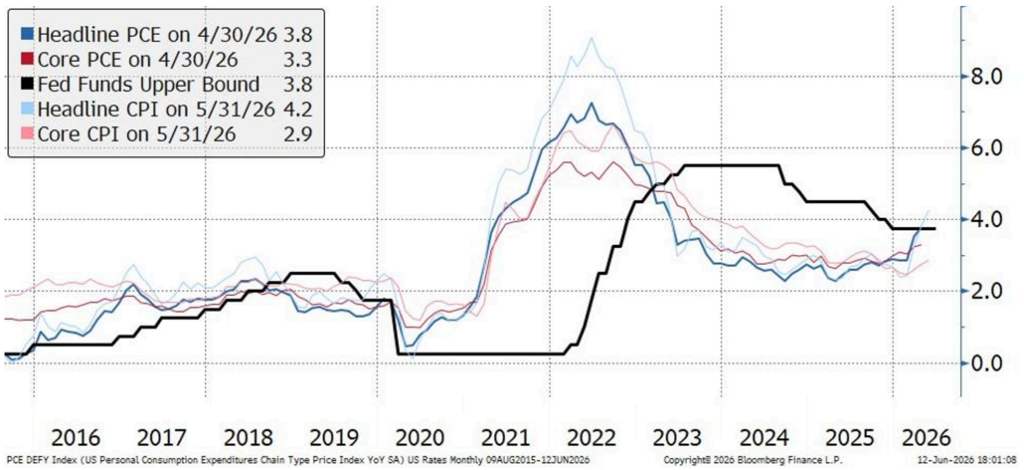
"Patience is bitter, but its fruit is sweet."
Jean-Jacques Rousseau

The Decision

The two-day FOMC meeting ends Wednesday with an expected hold. The easing bias is likely to be removed but with oil prices back to early March levels, we do not expect any dissents in favor of a 25 bp hike. On the other hand, Miran is no longer on the Board of Governors and so we do not expect any dissents in favor of a 25 bp cut (which is what Miran did at his last meeting April 28-29). The policy statement is likely to highlight accelerating inflation risks as well as a stabilizing labor market as per the Beige Book report, which will allow the Fed to focus singularly on its inflation mandate for the time being.

US Rates



The Press Conference

This will be Chair Warsh's meeting and so his post-decision press conference will be very important. Warsh is inheriting a much different situation than what was in place just a couple months ago, with inflation pressures much higher due to the Iran conflict. While Warsh should welcome the deal opening up the Strait of Hormuz, he should still acknowledge that patience is needed until the uncertainty regarding the economic outlook clears up. Given his stated preference for trimmed mean measures of inflation, Warsh may highlight that the Dallas Fed trimmed mean is relatively low at 2.3% y/y in April. Given his stated distaste for forward guidance, we do not expect Warsh to tip his hand on future policy and so he is likely to deliver a balanced, non-committal message to the markets.

The Summary of Economic Projections

Updated macro forecasts and Dot Plot will be released in the SEP. With headline and core PCE running well above its March forecasts, we would expect the median 2026 and 2027 inflation forecasts to be revised upwards. Given the resilient US economy, growth and unemployment forecasts are likely to remain largely unchanged. With regards to the Dot Plot, we expect a hawkish shift in the median 2026 Dot to show no cuts vs. one seen in March. The median 2027 Dot may continue to show one cut, but we see risks of a hawkish shift to no cuts next year as well.

Fed Summary of Economic Projections March 2026 (December)

	2026	2027	2028	Longer Run
GDP Growth	2.4% (2.3%)	2.3% (2.0%)	2.1% (1.9%)	2.0% (1.8%)
Unemployment	4.4% (4.4%)	4.3% (4.2%)	4.2% (4.2%)	4.2% (4.2%)
PCE Inflation	2.7% (2.4%)	2.2% (2.1%)	2.0% (2.0%)	2.0% (2.0%)
Core PCE	2.7% (2.5%)	2.2% (2.1%)	2.0% (2.0%)	n/a (n/a)
Fed Funds Rate	3.4% (3.4%)	3.1% (3.1%)	3.1% (3.1%)	3.1% (3.0%)

The New Inflation Regime

Fed Chair Warsh has in the past called for a new inflation regime for the Fed. Among other things, this would include using alternative measures of inflation to help guide policy. During his Senate confirmation hearing in April, Warsh said that "The measures I prefer are looking at things that are called trimmed averages. We take out all of the tail risks, all of the one-off items, and we ask ourselves whether the generalized change in prices is having second-order effects on the economy." This is why we expect him to address trimmed mean inflation in his press conference.

From what we can tell, Warsh is not arguing for a change in the Fed's inflation target of 2% for headline PCE. Rather, he is advocating for the Fed to put more weight on other measures of underlying inflation in order to improve the decision making process. Moving to a trimmed mean target would be a rarity. In fact, there is only one major central bank that targets something other than headline inflation: Sweden's Riksbank targets 2% for CPIF, which excludes the direct effects of changes in mortgage rates.

Any change in the Fed's inflation target would require an extensive review process as well as final approval by the FOMC. As we have noted time and time again, Warsh is only one of twelve members of the FOMC and so he would have to convince a majority in order to change the Fed's inflation target. We don't see that happening anytime soon.

The Monetary Policy Outlook

The Fed is likely on hold for the foreseeable future. Oil prices have fallen back to early March levels after the extension of the Iran-US ceasefire and this will give the Fed some breathing room to keep rates steady for the time being. The ECB has come under criticism for hiking rates this month rather than waiting for the uncertainty to clear but only time will tell if this was a policy mistake.

With oil prices down sharply after the announcement of the ceasefire extension, the expected timing of a Fed hike has been pushed out to March from December seen at the start of June. In addition, the market is no longer pricing in a second hike. We had always been skeptical that the Fed would hike rates in response to the inflationary impact of the Iran conflict. Now that the conflict has de-escalated, there is simply no need to rush into a tightening cycle.

As we noted before, Warsh faces a very different situation than what was in place before the Iran conflict began. Coming off a year of very weak job growth, Warsh in the past was rightfully concerned about monetary policy perhaps being too tight. After average monthly jobs growth of 10k in 2025 and basically zero net job growth in January and February combined, however, the economy has added an average of 188k jobs over the past three months through May. GDP growth appears to be running close to 3% SAAR in Q2, which would represent a solid improvement from 1.6% SAAR in Q1. As such, Warsh should not be as concerned about policy being too tight.

If the economy were to slow and the labor market were to crack, the Fed's job would become much more difficult. For now, there does not appear to be any risks to the economy from keeping rates at current levels. Even if Warsh were to believe that a rate cut was warranted, he would have to convince many others on an FOMC that has become increasingly more hawkish.

US NFP, 000s