MARKET SIGHTLINES

The Fed Raises Rates to Combat Inflation

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As we started 2026, the Federal Reserve was in a rate cut cycle. After raising the federal funds rate more than 5% between March 2022 and July 2023, the Fed cut six times across 2024 and 2025, reaching a target range of 3.50%-3.75% last December. Since then, the conflict with Iran has pushed energy prices higher and inflation has followed: Core personal consumption expenditures (PCE) inflation hit 3.3% in July. Renewed engagement with Iran has lifted oil again, with Brent crude reaching $108 this month, putting further pressure on inflation. While relief could come if the conflict eases and oil retreats, the Fed hiked rates 0.25% at its September meeting, and the Summary of Economic Projections (SEP) points to a higher path from here. While **longer-term market rates have decoupled some from the funds rate this year**, today's move reinforces our expectation for higher-for-longer rates. In this Sight|Lines, we unpack the Fed's decision and what it means going forward.

THE TAKEAWAY: THE FED RESPONDS TO AN ENERGY-DRIVEN INFLATION SETBACK

The easing cycle was interrupted this year by renewed inflation pressures, and Wednesday's decision and projections point to a higher funds rate near term. In summary:

- The funds rate had peaked at 5.25%-5.50% in July 2023, and the Fed then cut 175 basis points (bps) across six moves in 2024 and 2025, reaching 3.50%-3.75% last December.
- At the end of April, Fed funds futures priced in no change in the funds rate through this meeting, but these futures reflected an over 90% probability as the meeting concluded.
- The Fed raised its target range by 0.25%, and the Committee was unanimous.
- The Fed statement changed but carried forward its commitment to price stability.
- The SEP shows projections for continued economic growth and a positive job market.
- The SEP also shows projections for firmer inflation and the potential for more hikes.
- Chair Kevin Warsh once again provided no forward guidance in his press conference, reinforcing resolve on inflation and the work of the Fed's five task forces.
- Perhaps influenced by this expected move, long market rates have moved higher this year, with the 10-year Treasury yield at 5.00% and the 30-year at 5.36%, both at multidecade highs.

IN-DEPTH: WITH OIL PRICES UP AND INFLATION FIRMING, THE FED RESPONDS WITH A RATE HIKE

While the Fed had been on an easing cycle into last year, this was paused in 2026 given renewed inflation pressures, and the Fed took a further step by hiking rates this week. Going deeper:

- The Fed hiked rates in the wake of higher inflation fueled by the pandemic reopening, and then had been in an easing cycle:
    - Rate hikes totaled more than 5% between March 2022 and July 2023, taking the target range to 5.25%-5.50%.
- The Fed has kept rates steady this year, but market expectations for a hike began to rise as we approached the summer:
    - In early June, Fed funds futures implied a 24% probability of a rate hike, rising to over 50% in mid-June.
    - Just before the Fed's policy announcement this week, the probability for a 0.25% hike sat above 90%.
- The decision to raise the Fed funds rate was unanimous:
    - The Committee raised the target range by 0.25% to 3.75%-4.00%, its first increase since July 2023.
- The Fed statement did change, dropping the caveat that inflation was "in part" a supply-shock story:
    - New language tied the hike to a "timelier return" to 2% inflation, while growth was upgraded – spending "resilient," and investment "robust."
    - July had tied elevated uncertainty specifically to "the conflict in the Middle East," while September broadened that to "geopolitical developments."
- The SEP showed officials' expectations for continued growth and a healthy job market:
    - The median participant projected 2026 growth in real gross domestic product was 2.3% and an unemployment rate of 4.1%, both little changed from June.
    - No participant now sees GDP growth risks tilted to the downside – a notable shift from June, with the balance moving toward "broadly balanced" and "weighted to upside."
- SEP projections also provided insights on officials' views for lower inflation further out but higher-for-longer rates:
    - 2026 PCE inflation was marked at 3.7%, with core at 3.4%, easing toward 2.3% and 2.5%, respectively, in 2027.
    - The "dot plot" suggests officials expect one additional 25-bp rate hike in 2026, and eight of the 18 participants that submitted a projection believe another hike in 2027 is appropriate.
- In his press conference, Chair Warsh presented thoughtfulness and resolve, rather than forward guidance:
    - Warsh said that "trends matter" and the three things that have changed since July are the strength of the economy, inflation trends, and geopolitics.
    - Bond yields have risen from economic strength, competition for capital (hyperscalers), and geopolitics.
- Long rates followed their own path this year:
    - The 10-year yield began 2026 at 4.19%, fell to 3.97% in late February, and climbed to 5.00%, its highest since 2007.
    - The 30-year moved from 4.86% in early January to a 4.64% low in February, recently peaking at 5.37%, a 19-year high.

WHAT WE THINK

After historic rate hikes in the wake of the pandemic reopening and related elevated inflation, the Fed had made its way back to an easing cycle. But an energy shock that began in March with the Iran war meant the Fed would pause those cuts, and they finally decided it was time to raise rates in the face of firming inflation. The 0.25% hike may not be the last, especially as officials reinforce their commitment to getting inflation under control. The Fed and investors alike continue to adjust to Kevin Warsh's approach in his role as chair, and much will be learned as the appointed Fed task forces conclude their work later this year or early next. While other forces are also **keeping market rates elevated**, this latest Fed move may contribute to keeping market rates elevated.

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Core personal consumption expenditures (PCE) is the PCE Price Index excluding volatile food and energy prices, revealing underlying inflation trends.

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