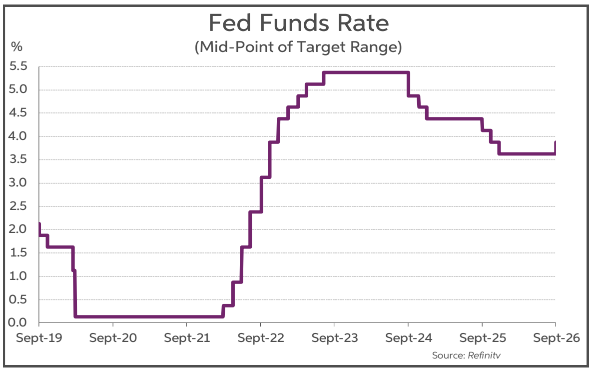
Fed Watch

AIB Treasury Economic Research Unit

17th September 2026

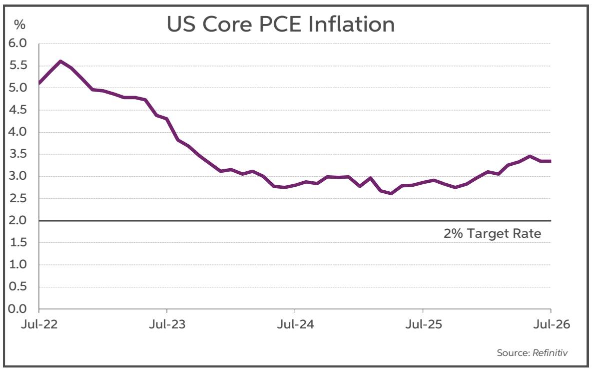
Fed hikes and adopts a hawkish tone

The September meeting of the US Federal Reserve Open Market Committee (FOMC) saw the central back deliver a 25bps rate hike. The target range for the Fed funds rate was raised to 3.75-4.00%. The policy change was widely anticipated and the FOMC was unanimous in its decision. It marked the first rate change from the Fed in six meetings. Its most recent policy amendment prior to this, was a 25bps rate cut in December'25. However, the onset of the conflict in the Middle East and subsequent energy price shock meant the Fed had to pause its rate cutting cycle. The decision to hike this month, marks the first rate increase from the Fed since July 2023.



The September meeting statement was once again concise and absent of any forward guidance. It described the economy as "expanding at a solid pace", amid "resilient" domestic spending, "strong" productivity growth and "robust" capital investment. It also noted that "job gains have kept pace with the workforce". However, it stated that "inflation remains elevated" and that the decision to hike was to "support a timelier return to the Committee's 2 per cent goal".

The September meeting included the publication of the Fed's updated interest rate projections (i.e. the dotplot). Similar to June, Chair Warsh did not submit any dots. The September dots imply an increased hawkish bias within the FOMC. 16 of the 18 FOMC participants now expect to tighten policy further before the end of the year. 12 members expect another 25bps rate hike, while four anticipate 50bps of tightening. The median projection for 2026 was raised to 4.1% (from 3.8% in June). Meanwhile, for 2027 the median projection is for rates to remain at 4.1% (compared to 3.6% in June). Eight members expect to hike again next year, another eight envisage rates remaining unchanged, while four anticipate at least 50bps of easing. Meantime, the updated macro economic projections saw core-PCE revised modestly higher to 3.4% for 2026 (was 3.3%), while the forecast for 2027 was left unchanged at 2.7%.



Chair Warsh's press conference struck a hawkish tone. He consistently talked up the strength of the US economy and labour market, while at the same time emphasising the unfavourable inflationary environment. However, he refrained from offering forward guidance. He noted that "inflation is too high and has been for too long" and given the "underlying strength of the economy" and labour market, the Fed's "predominant focus is on the price stability side of our mandate" He said that he "would deliver stable prices" and the rate hike decision was "consistent with that". Crucially, Chair Warsh also commented that the 25bps hike removes a "dose of accommodation" and he "found it difficult to describe financial conditions as restrictive". This suggests that he is open to the potential for further tightening if underlying inflation dynamics warrant it.

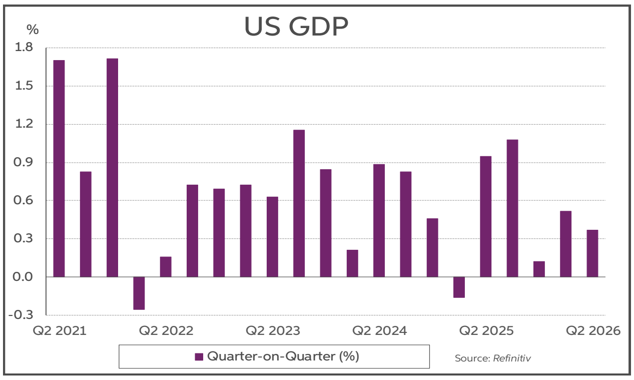
Market rate expectations have firmed considerably over recent weeks. This followed a confluence of developments, including Warsh's Jackson Hole speech, other FOMC members hawkish remarks, as well as solid US labour market and activity indicators, inflation metrics remaining elevated and renewed upward pressure on energy prices. Futures contracts firmed a little more following last night's update from the Fed. The market is fully pricing in an additional 25bps rate hike by the end of year and envisages rates getting up towards a 4.50-4.75% range over the course of 2027. Given the updated dots, which show a majority of FOMC members anticipate another hike this year and Chair Warsh's hawkish comments, a 25bps rate hike by year end, which would see the fed funds rate in a 4.00-4.25% range, seems likely. However, we think the market is overly aggressive in its rate expectations for 2027. The Fed's own dots suggest no rate changes. Chair Warsh is also likely to have the reports from the various task forces he established by then, which may allow him to set out a decision framework to allow the Fed to start to cut rates next year. Of course the evolution of the Middle East conflict, energy prices and subsequent impact on inflation will remain a key determining factor in the Fed's policy deliberations.

David McNamara
Chief Economist
david.g.mcnamara@aib.ie

John Fahey
Senior Economist
john.j.fahey@aib.ie

Daniel Noonan
Economist
daniel.x.noonan@aib.ie

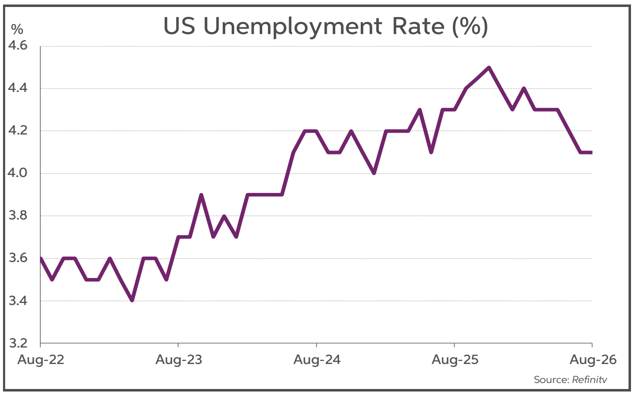
US economy characterised by solid growth and high inflation



Having expanded by a solid 2.1% in 2025, the US economy has continued to grow at a decent pace in the first half of 2026. GDP rose by 2.1% annualised in the first quarter, supported by increases in personal consumption and investment. Growth slowed to 1.5% annualised in Q2, but the underlying picture was stronger than the headline figures suggest. Personal consumption and investment remained the main drivers of growth in the second quarter also. The former rose by 0.8%, while the latter jumped by 1.7%, boosted once again by investment in AI related infrastructure. Together, these two components contributed 3.5 percentage points (p.p.) to GDP. Meantime, government expenditure contracted by 0.3% in Q2 amid a sharp decline in non-defence spending, clipping 0.2 p.p. from the total. Elsewhere, imports outpaced exports, meaning that net trade subtracted 1.1 p.p. from growth. Inventories knocked a further 0.7 p.p. from GDP in the quarter.

Meanwhile, survey data for Q3 have been solid. The services PMI jumped to 53.6 in July and to 56.5 in August, its highest level since December 2024. At the same time, the manufacturing PMI has remained firmly in expansion territory, printing at 53.9 in each of the last three months. Consumer confidence has remained at a weak level though, with the Conference Board and University of Michigan measures of sentiment deteriorating recently. **However, despite weak confidence levels, consumer spending has been strong.** The control group measure of retail sales (a key core sales metric) rose by 1.4% in August.

In terms of the labour market, the data have been volatile. Overall, it appears that conditions have firmed in recent months following a weak second half to last year. Payrolls fell for a fifth time in nine months in February, but then increased in the following six months. Between March and August, payrolls expanded by 107k per month on average. Elsewhere, the unemployment rate declined to 4.1% in July and stayed at that level in August, having oscillated between 4.3-4.5% throughout the previous 12 months. Meantime, wage growth has slowed. Average earnings growth printed at +3.1% year-on-year in August, its lowest level since May 2021. However, the wages component of the Employment Cost Index - the Fed's preferred measure of wage inflation - rose by 0.9% in Q2, up from 0.8% in Q1.



Elsewhere, inflation remains elevated following the surge in energy prices arising from the Middle East conflict. CPI inflation jumped higher, peaking at 4.2% in May, up from just 2.4% in January/February. The core rate also increased, albeit at a slower pace. It rose to 2.9% in May, having printed at 2.5% at the start of the year. However, both rates have eased by more than anticipated over the summer. The headline rate fell to 3.4% in July and remained at that level in August, while the core rate has declined in the last three months, printing at 2.4% in August, its lowest level since March 2021. Meantime, core-PCE - which has proven to be quite sticky, was already on an upward trajectory in the months before the conflict - has continued to move higher. It printed at 3.5% in May, before edging back marginally to 3.4% in June and July. This is up from 3.0% at the end of 2025, and a low of 2.6% last April.

In summary, the US economy has continued to perform solidly year-to-date. Labour market conditions have strengthened following a weak end to 2025. Meanwhile, AI-related investment is likely to remain a key driver of growth. Furthermore, lower taxes may be providing some support to consumer spending. However, a sustained period of elevated inflation remains a key concern for policymakers, with inflation remaining above 2% for over five years now. US trade and tariff policy have contributed to sticky price pressures, and the war in the Middle East has added further upside risks to the US inflation outlook. A sustained Fed tightening cycle will weigh on growth, and may provide additional pressure on an already substantial government deficit. However, the US economy is still expected to grow at a robust pace over the next few years. The IMF is projecting GDP will rise by 2.3% this year and by 2.2% in 2027.

AIB, 10 Molesworth Street, Dublin 2 Tel: 353-1-6600311 https://aib.ie/investorrelations/economic-research-unit