Fed Holds Steady as Oil Prices Climb

Scott McIntyre, CFA
HilltopSecurities Asset Management
Co-Head of Investment Management
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Co-Head of Investment Management
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

Matt Harris, CFA
HilltopSecurities Asset Management
Senior Portfolio Advisor
Senior Vice President
512.340.1845
matt.harris@hilltopsecurities.com

By a 9-3 count, Fed officials voted to hold the overnight target range steady at 3.50%-3.75% for the fifth straight FOMC meeting. The three dissenters, all regional presidents, favored an immediate 25 bp increase. The official statement, released at the conclusion of the meeting, was nearly identical to the barebones statement released after the June meeting, with the exception of a single word. The unchanged focal point of the statement was "Inflation remains elevated relative to the Committee's 2 percent goal, in part reflecting supply shocks that have driven price increases in certain sectors, including energy. The Committee will deliver price stability." *This suggests an ongoing tightening bias.*

Between now and the next FOMC announcement on September 16, Fed officials will see the July and August employment and inflation reports from the BLS. Whatever policy decision is made in September will be data dependent.

Current price pressure is supply-driven. If the committee choses to hike rates, it will be targeting the demand side. Any significant effect on demand would entail multiple increases over a prolonged period and would inherently lower economic growth.

In his second post-meeting press conference, Chair Warsh sounded purposely hawkish in his prepared statement, reiterating that the Fed is fully committed to bringing inflation down to its 2% target. Despite the unchanged policy vote today, Warsh said the committee "would not hesitate to act" and was "unwavering" in its commitment. Although the new chairman has repeatedly deemphasized forward guidance, these words strongly imply the Fed still expects its next move will be a rate hike.

In the Q&A portion of the press conference, Warsh said the bond market has already done quite a bit of tightening, as yields have risen significantly over the past several months. There was some discussion of persistently elevated core PCE, which the chairman pivoted around by saying the committee considers a broader set of inflation data.

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The financial markets reacted wildly this afternoon, with the DOW reclaiming 350 points of loss immediately after the meeting concluded, before plunging roughly 850 points on Warsh's hawkish press conference assertions. Bond market reaction was split. The long end of the curve sold off dramatically with the 30-year Treasury yield reaching 5.20% *for the first time since 2007*, while the short end rallied.

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On that note, President Trump responded to an Iranian attack on a U.S. military base in Jordan with threats to further intensify bombings. This development suggests efforts to restart stalled negotiations will be further postponed. Oil prices spiked today with WTI topping $85 after closing around $79 yesterday.

As the conflict continues with little resolution in sight, supply concerns are once again growing. Just a month ago, with the administration's *memorandum of understanding* offering hope for an extended ceasefire, many experts cautioned of a near-term *supply glut* as more than 300 vessels, anchored or holding position, were expected to exit the Strait of Hormuz. Over the past week, just nine oil tankers have crossed.

The most recent weekly update from the U.S. Energy Information Administration showed U.S. oil stockpiles at their lowest level in 43 years. With the nation's Strategic Petroleum Reserve at 316.5 million barrels, emergency supply is well below half of the maximum storage capacity.

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The global market excess supply tallied 400 million barrels at the start of the war, *excluding strategic government reserves*. By mid-July, according to the director of market intelligence at Energy Aspects, that stockpile is nearly depleted (Financial Times).

The nationwide price for unleaded gasoline reached $4.10 today (AAA), up $0.23 from a month ago, while the cost of diesel fuel has jumped from $4.86 last month to $5.33.

The futures market has effectively reduced tightening expectations with the probability of a September hike falling from 99% yesterday to 58% this afternoon.

Market Indications as of 3:30 P.M. Central Time

DOW	Down -1153 to 51,594 (HIGH: 53,056)
NASDAQ	Down -434 to 24,443 (HIGH: 27,094)
S&P 500	Down -113 to 7,316 (HIGH: 7,610)
1-Yr T-bill	current yield 4.03%; opening yield 4.07%
2-Yr T-note	current yield 4.26%; opening yield 4.29%
3-Yr T-note	current yield 4.33%; opening yield 4.32%
5-Yr T-note	current yield 4.42%; opening yield 4.38%
10-Yr T-note	current yield 4.69%; opening yield 4.61%
30-Yr T-bond	current yield 5.22%; opening yield 5.10%