Special Coverage: The Fed raises rates as inflation remains stubborn

Key takeaways

- The Federal Reserve unanimously raised the federal funds target range by 0.25% to 3.75%–4.00%, its first increase since July 2023, as higher energy prices have forced the Fed's hand to tighten in an effort to control any further inflationary escalation. The median projection in the Summary of Economic Projections (SEP) points to one additional 0.25% hike this year, while inflation is expected to return to the 2% target much more gradually by 2029.
- The Fed raised its 2026 and 2027 growth forecasts, lowered its unemployment projections and modestly raised its inflation forecasts for 2026. Chair Warsh described the economy as strengthening, the labour market as around full employment, while remaining "hard-pressed" to characterise broad financial conditions as restrictive. At the same time, he said inflation remains too high and underlying trends haven't improved sufficiently.
- We similarly expect one further 0.25% hike in December and then rates to remain at 4.00%–4.25% throughout 2027, while markets are pricing in a somewhat higher path. We remain constructive on US equities, supported by continued AI investment, resilient earnings and broader market participation, and maintain a neutral fixed income stance with an active, medium-duration and income-focused approach. We expect the US dollar to remain broadly supported.

Jose Rasco
Chief Investment Officer, Americas, HSBC Private Bank and Premier Wealth

Michael Zervos
Investment Strategist, HSBC Private Bank and Premier Wealth

What happened?

- The Federal Reserve raised the federal funds target range by 0.25% to 3.75%–4.00%, marking its first rate hike since July 2023. The decision was unanimous, 12–0, compared with July's 9–3 vote to leave rates unchanged.
- The updated SEP continued to show resilient economic activity alongside persistent inflation. Median real GDP growth for 2026 was revised up to 2.3% from 2.2%, while 2027 growth increased to 2.4% from 2.3%.
- The unemployment rate projection was lowered to 4.1% in 2026 from 4.3% and remains steady through 2029. Inflation projections moved modestly higher.
- Changes to the September statement were limited, but the Fed placed somewhat greater emphasis on economic resilience and returning inflation to the 2% target.
- Chair Warsh's opening statement reinforced the view that the US economy has strengthened enough for the Fed to focus primarily on inflation. He continued to describe productivity growth as strong, while changing its description of capital investment from "strong" to "robust."

The Fed sees stronger growth and higher rates

Variable %	Summary of Economic Projections September 2026				
	2026	2027	2028	2029	Longer run
Change in real GDP	2.3	2.4	2.2	2.1	2.0
June projection	2.2	2.3	2.2		2.0
Unemployment rate	4.1	4.1	4.1	4.1	4.2
June projection	4.3	4.3	4.2		4.2
PCE inflation	3.7	2.3	2.1	2.0	2.0
June projection	3.6	2.3	2.0		2.0
Core PCE inflation	3.4	2.5	2.2	2.0	
June projection	3.3	2.5	2.1		
Memo: Projected appropriate policy path					
Federal funds rate	4.1	4.1	3.9	3.6	3.2
June projection	3.8	3.6	3.4		3.1

Source: Federal Reserve, HSBC Private Bank and Premier Wealth as at 16 September 2026. Forecasts are subject to change.

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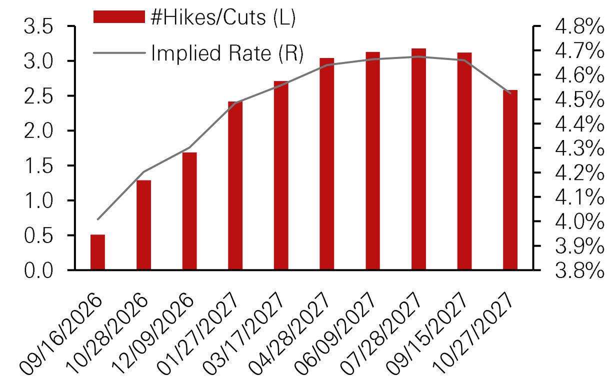
- The more meaningful change came in the inflation language. In July, the Fed said inflation remained elevated relative to its 2% goal and partly attributed those pressures to supply shocks, including energy. That explanation was replaced by "inflation remains elevated" and "today's policy action will support a timelier return to the Committee's 2% goal."
- Chair Warsh said inflation has been too high for too long, and that summer inflation readings had not shown meaningful improvement in underlying trends. He returned to his Jackson Hole standard that inflation needs to be moving towards 2% clearly and at sufficient speed.
- He also highlighted improvements in hiring, private-sector earnings, capital investment and credit flows, while emphasising resilient domestic spending, strong productivity and robust investment.

Markets price in further tightening through 2027



Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 16 September 2026. Forecasts are subject to change.

- On the labour market, he said conditions remain consistent with full employment. With unemployment around 4.1% and other labour indicators remaining healthy, he argued that the Fed can focus more directly on the price stability side of its mandate.
- AI was also a notable theme. Chair Warsh specifically cited heavy financing demand from hyperscalers as a key factor intensifying competition for capital. He said the Fed is closely assessing its implications for both the demand and supply sides of the economy, including investment, productivity, labour markets, potential growth and inflation.

Investment implications

- The Fed's median projection implies one additional 0.25% hike in 2026 and no net change in rates during 2027. We also expect one more hike this year, with rates remaining at 4.00%–4.25% throughout 2027, while markets are pricing in a somewhat higher path.
- For equity investors, despite any potential cyclical slowing due to marginally higher policy rates, the US equity outlook remains constructive, supported by strong earnings growth, healthy revenues and increasingly broad market participation. AI-related investment continues to support the technology and communication services sectors, while earnings strength is broadening beyond the largest growth companies into smaller caps and cyclical areas. Industrial activity, infrastructure spending and reindustrialisation are also widening the opportunity set. Against a backdrop of higher policy rates and elevated long-term yields, selectivity remains important, with a focus on companies with stronger earnings visibility and healthy balance sheets.
- In fixed income, current yields continue to offer attractive income opportunities, but uncertainty around inflation and the policy path argues against aggressively extending duration. We maintain a neutral stance and favour an active, medium-duration, quality-focused approach. With markets already pricing in a meaningful amount of further tightening, there may be less room for short-term bond yields to rise sharply from here. Longer-dated yields could remain more volatile though, given ongoing concerns around government borrowing, Treasury supply and inflation, reinforcing the case for staying flexible on duration.
- The Fed's hawkish message, resilient US growth and the prospect of further tightening remain supportive of the US dollar. The currency is also relatively less exposed than the euro, sterling and yen to the drag from elevated energy prices. However, with other major central banks also considering tighter policy and only a modest gap between the Fed's projected path and market expectations, any further dollar gains are likely to be gradual rather than sharp.

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