Federal Funds Rate Forecast

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Abstract

This paper forecasts of the federal funds rate using Fed funds futures, CME FedWatch probabilities, overnight index swaps, event-contract markets such as Kalshi and Polymarket, and macroeconomic variables. Across these markets, pricing indicates a broadly hawkish outlook, with a rate hold as the minimum expected outcome and a 25 to 50 basis point hike appearing most likely through late 2026 and early 2027. Based on the current macroeconomic and geopolitical conditions, including persistent core inflation, volatile energy prices, tariffs, and resilient domestic demand, further supports a forecast where effective federal funds rate remains at or above its current range.

Financial markets' forecast of the Fed Fund Rate

Certain markets—such as derivatives and prediction markets—are designed around predicting the Federal Funds Rate. One example is Fed Fund Futures (ZQ=F), which are publicly traded on the Chicago Board of Trade. Per the effective market hypothesis, these platforms reflect the market's best guess/consensus of what the Fed Fund Rate—which will be abbreviated as FFR in this paper going forward—will be. Fed Fund Futures paint a hawkish future with rate hikes going into late 2026 and early 2027. Refer to Figure 1 below for further details.

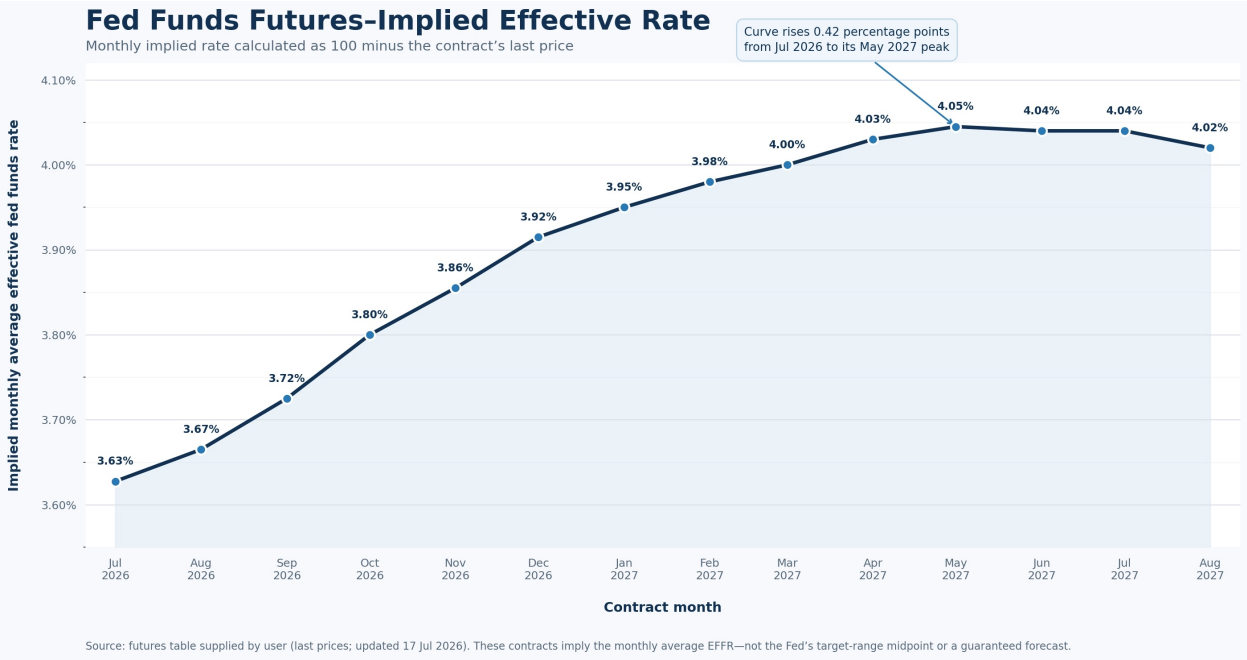

Figure 1: Depiction of 100 minus Fed Funds Futures, providing the implied effective rate of the Fed Funds Rate. Source: https://www.cmegroup.com/markets/interest-rates/stirs/30-day-federal-fund.quotes.html

Regardless of how confident the graph's slope may appear, the trading volume beyond November 2026 significantly drops because of the uncertainty of the economic landscape in the future—reference Figures 2 and 3 below. This indicates that beyond October/November 2026, the Fed Funds Futures value should be taken into less consideration.

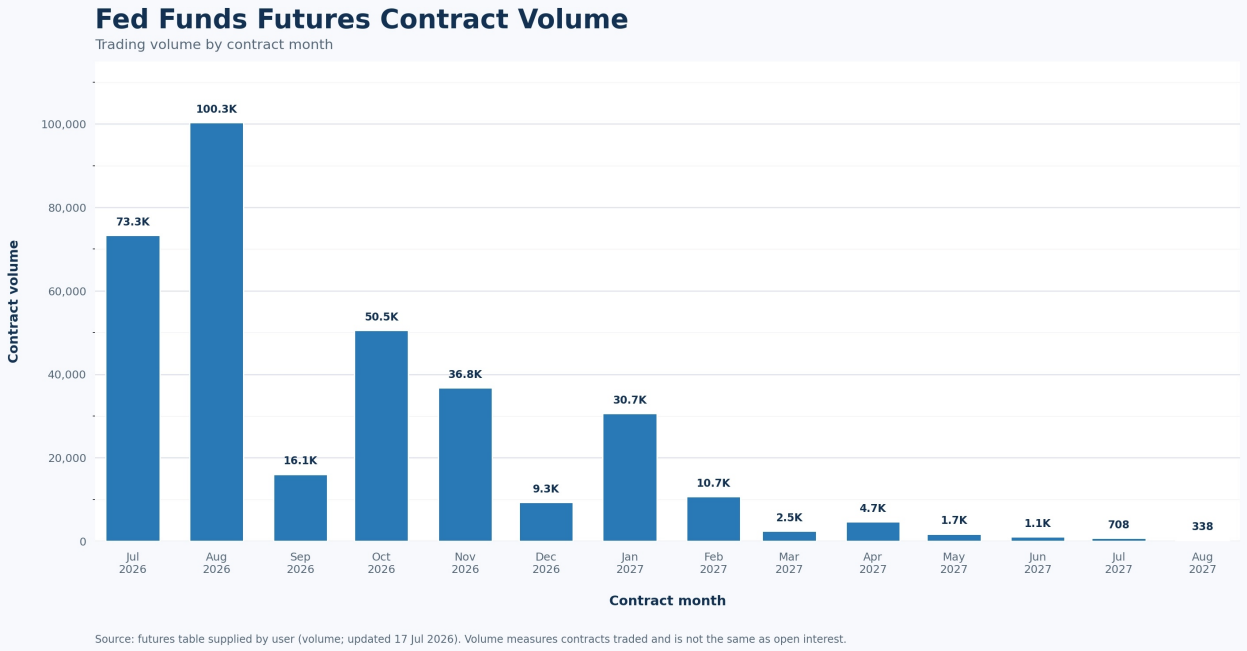

Figure 2: Fed Funds Future Contract Volume between Jul 2026 and Aug 2027. Source: https://www.cmegroup.com/markets/interest-rates/stirs/30-day-federal-fund.quotes.html

The CME Group (formerly known as Chicago Mercantile Exchange Holdings Inc.) operates a platform known as "FedWatch," which is an aggregate probabilistic model for forecasting the FFR based on futures prices and contract numbers. The current probability table, as of July 27th, 2026, is shown below in Figure 3. Suffice it to say, the market believes—and is pricing in—a rate hike, with Figure 3 displaying a 0.00% chance of the FFR remaining in the current 3.50–3.75 range. Figure 4 displays the same data in a bar graph.

	CME FEDWATCH TOOL - AGGREGATED MEETING PROBABILITIES		
MEETING DATE	350-375	375-400	400-425
9/16/2026	42.57 %	57.43 %	0.00 %
10/28/2026	16.00 %	84.00 %	0.00 %
12/9/2026	0.00 %	69.81 %	30.19 %
1/27/2027	0.00 %	48.00 %	52.00 %
3/17/2027	0.00 %	18.29 %	81.71 %
4/28/2027	0.00 %	14.00 %	86.00 %
6/9/2027	0.00 %	13.18 %	86.82 %
7/28/2027	0.00 %	1.00 %	99.00 %
9/15/2027	0.00 %	28.30 %	71.70 %
10/27/2027	0.00 %	26.00 %	74.00 %
12/8/2027	0.00 %	39.48 %	60.52 %

Figure 3: Figure 3 displays FedWatch's aggregate probabilistic model for the FFR between 7/29/2026 and 12/8/2027 in a table format.

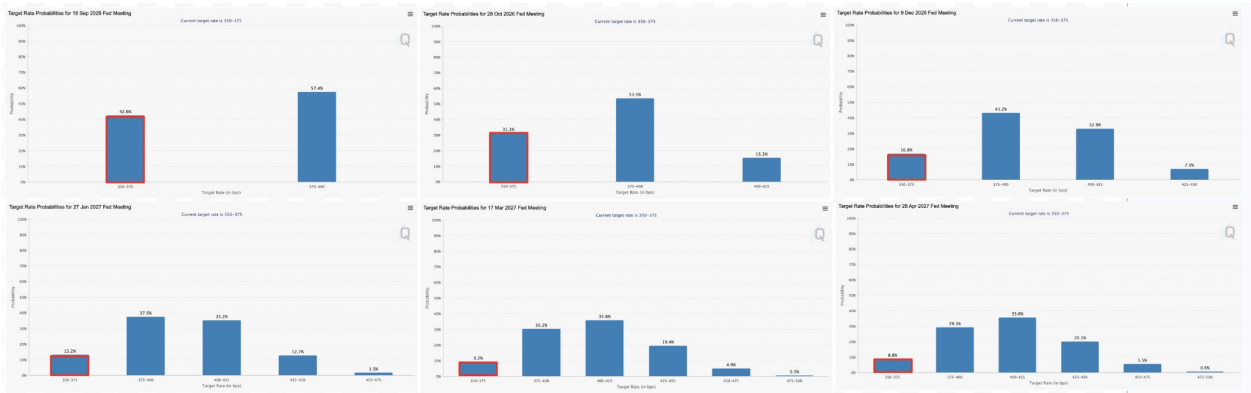

Figure 4: Figure 4 displays FedWatch's aggregate probabilistic model for the FFR between 7/29/2026 and 12/8/2027 in a bar graph format. Note that the current effective FFR—3.5–3.75 as of July 28th, 2026—is highlighted in red.

Historical data on Fed Fund Futures from January 16, 2011, through June 7, 2026, were extrapolated

from the CME website. An analysis was conducted that matched each contract's implied rate with the realized monthly effective federal funds rate and used 180 monthly observations per horizon from 2011 to 2025. Accuracy within +25 basis points declined from 100% for projections one month in advance to 75.6% for seven months in advance, while mean absolute error increased from 1.05 to 23.72 basis points. Quite notably, no horizon showed a statistically decisive hawkish or dovish bias, and the fitted relationship was

$$absoluteerror(bps) = -0.72 + 3.87 \times horizonmonths \qquad (R^2 = 0.119).$$

Therefore, the current hawkish indicator from Fed Fund Futures is not due to any systemic or mechanistic bias.

Overnight index swaps forecast the federal funds rate by pricing the market's expected average overnight rate over each contract period, rather than the rate on the contract's final date. In the July 17 graph, the OIS curve rises from 3.66% at one month to 3.83% at six months and 3.96% at one year, indicating a moderately hawkish outlook in which markets expect roughly one rate increase within six months and assign a meaningful probability to another over the following six months. Thus, the market is forecasting that the FFR will move toward approximately 4% and remain elevated into 2027, although the quoted OIS rates also include risk premiums and are not exact point forecasts.

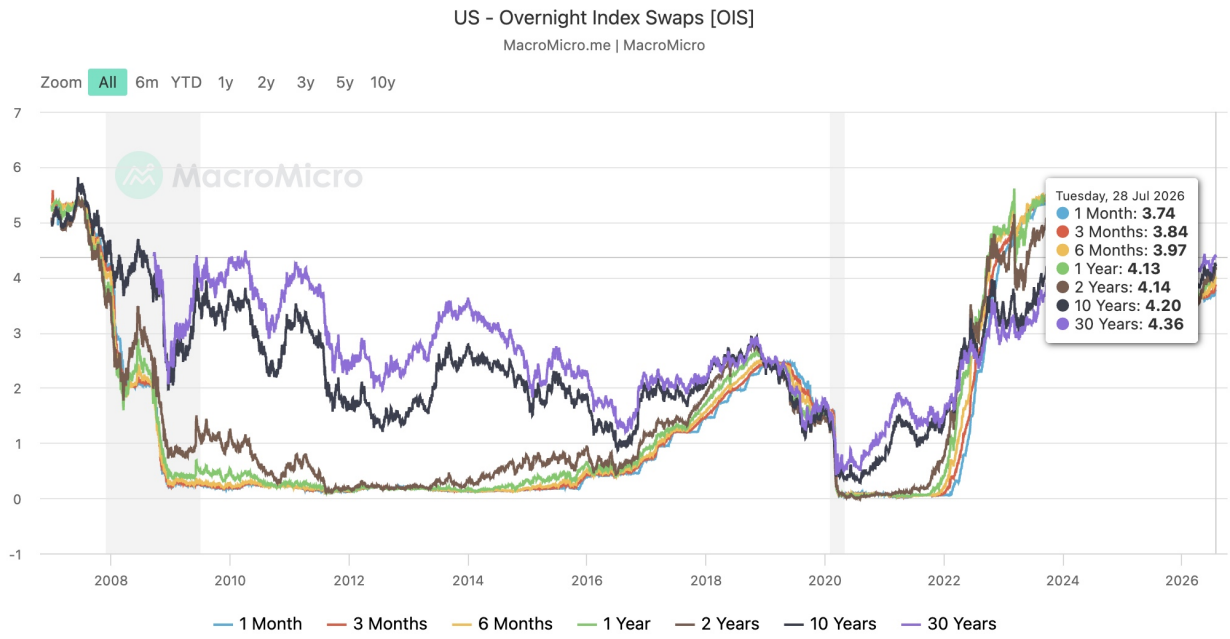

Figure 5: Figure 5 depicts the overnight index swaps (OIS) between 2007 and 2026. Source: https://en.macromicro.me/collections/9/us-market-relative/115044/us-overnight-indexed-swaps

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Event-contract trading on platforms such as Polymarket and Kalshi involves both a large number of traders and predictions about the Federal Reserve's actions. See Figures 6–15 below for further details on Kalshi markets. Note that the volume traded on this platform exceeds 73 million USD, and the platform includes several institutional traders such as Susquehanna International Group.

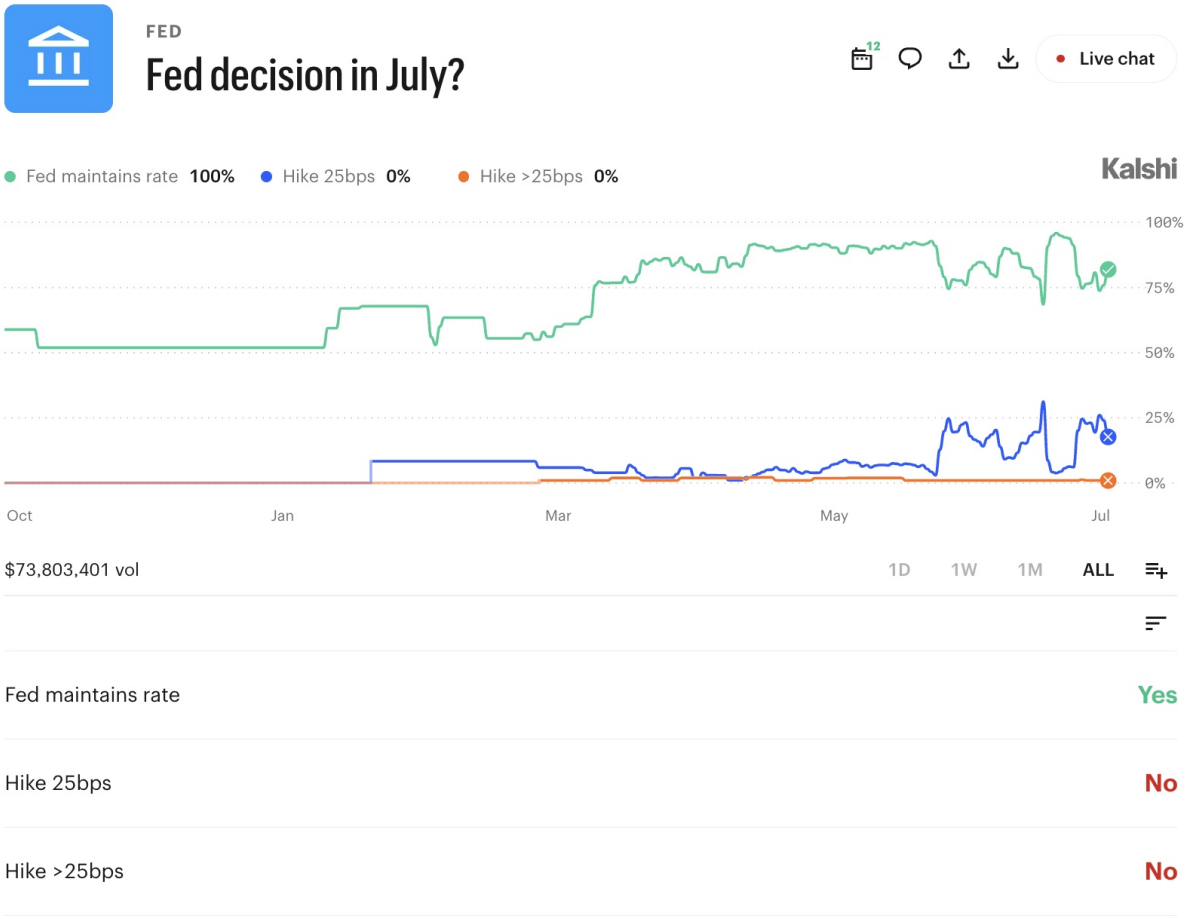

Figure 6: https://kalshi.com/markets/kxfeddecision/fed-meeting/kxfeddecision-26jul

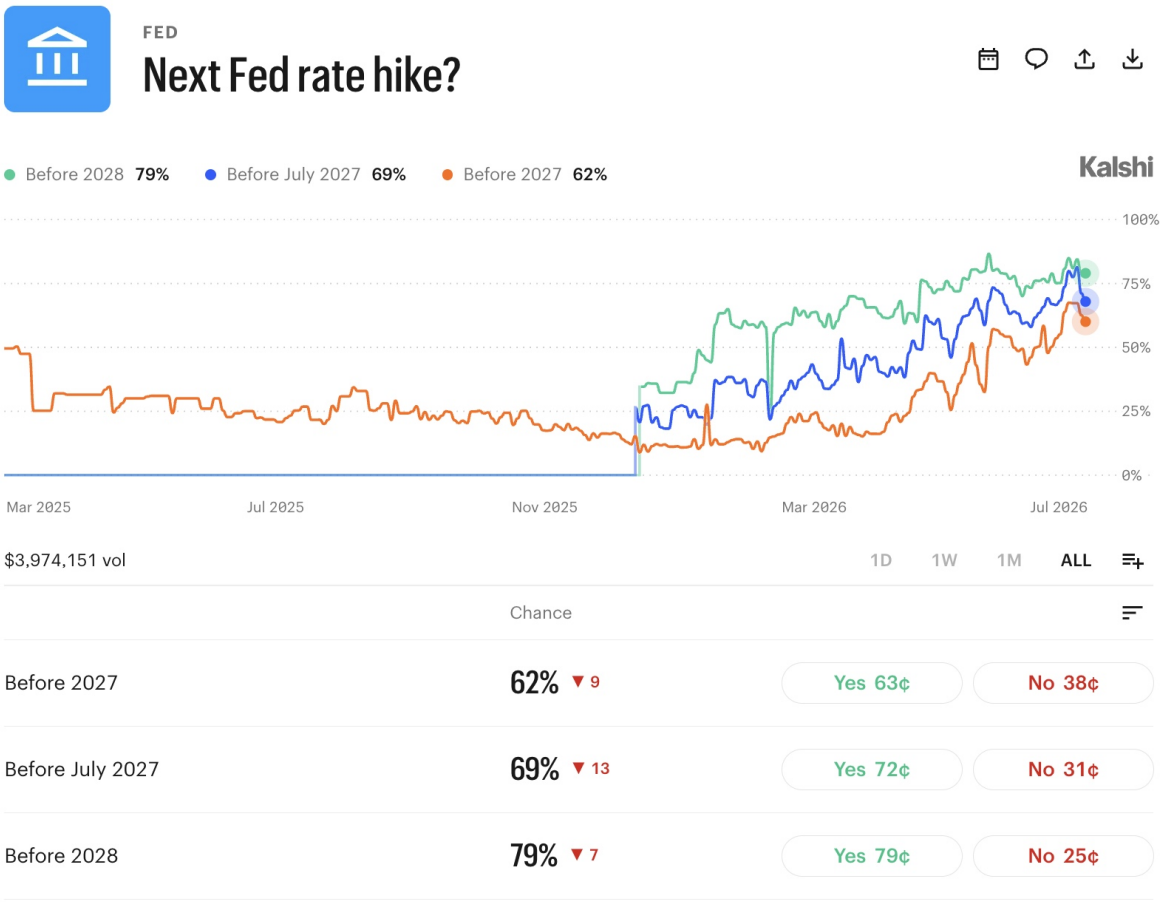

Figure 7: https://kalshi.com/markets/kxfedhike/next-fed-rate-hike/fedhike

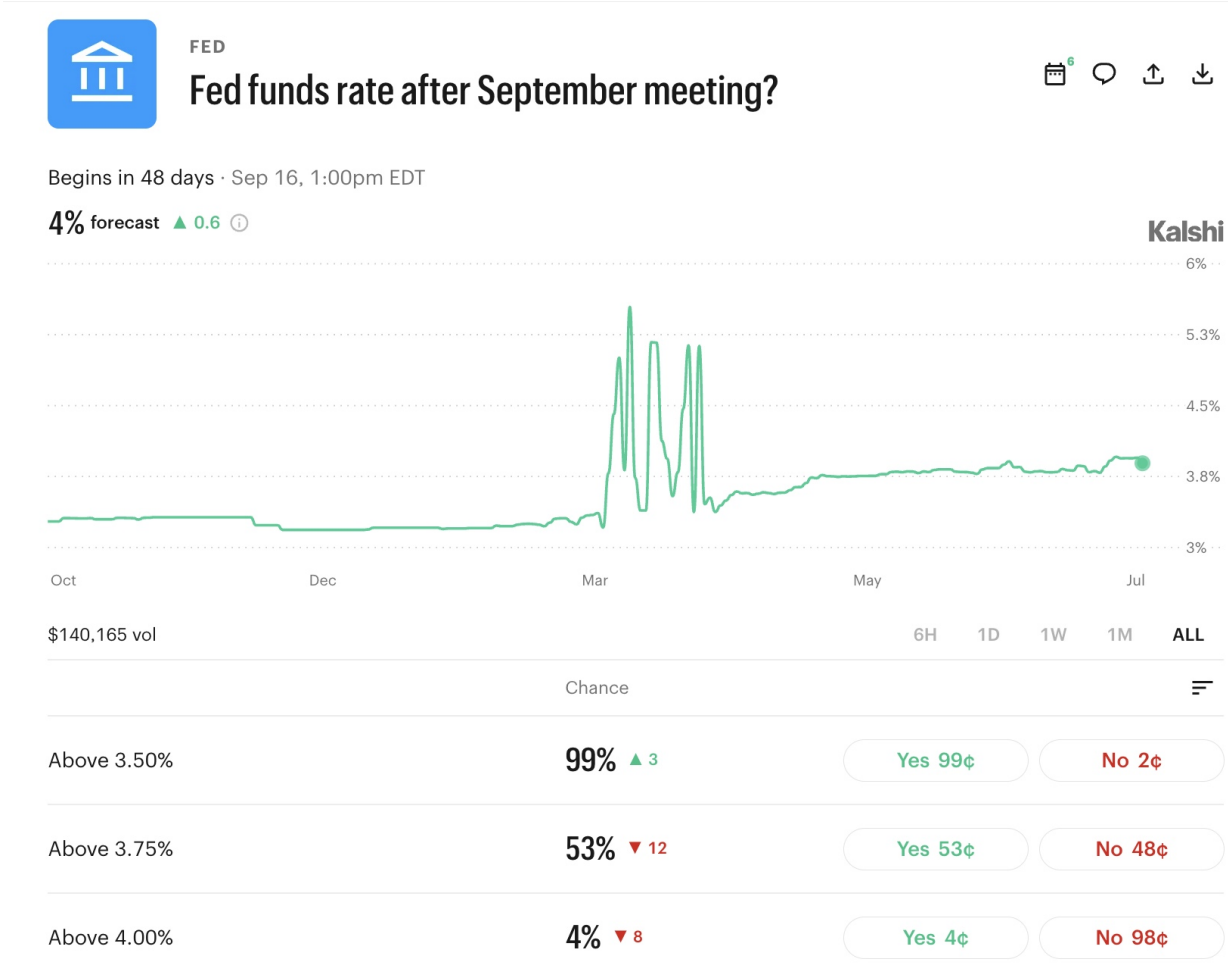

Figure 8: https://kalshi.com/markets/kxfed/fed-funds-rate/kxfed-26sep

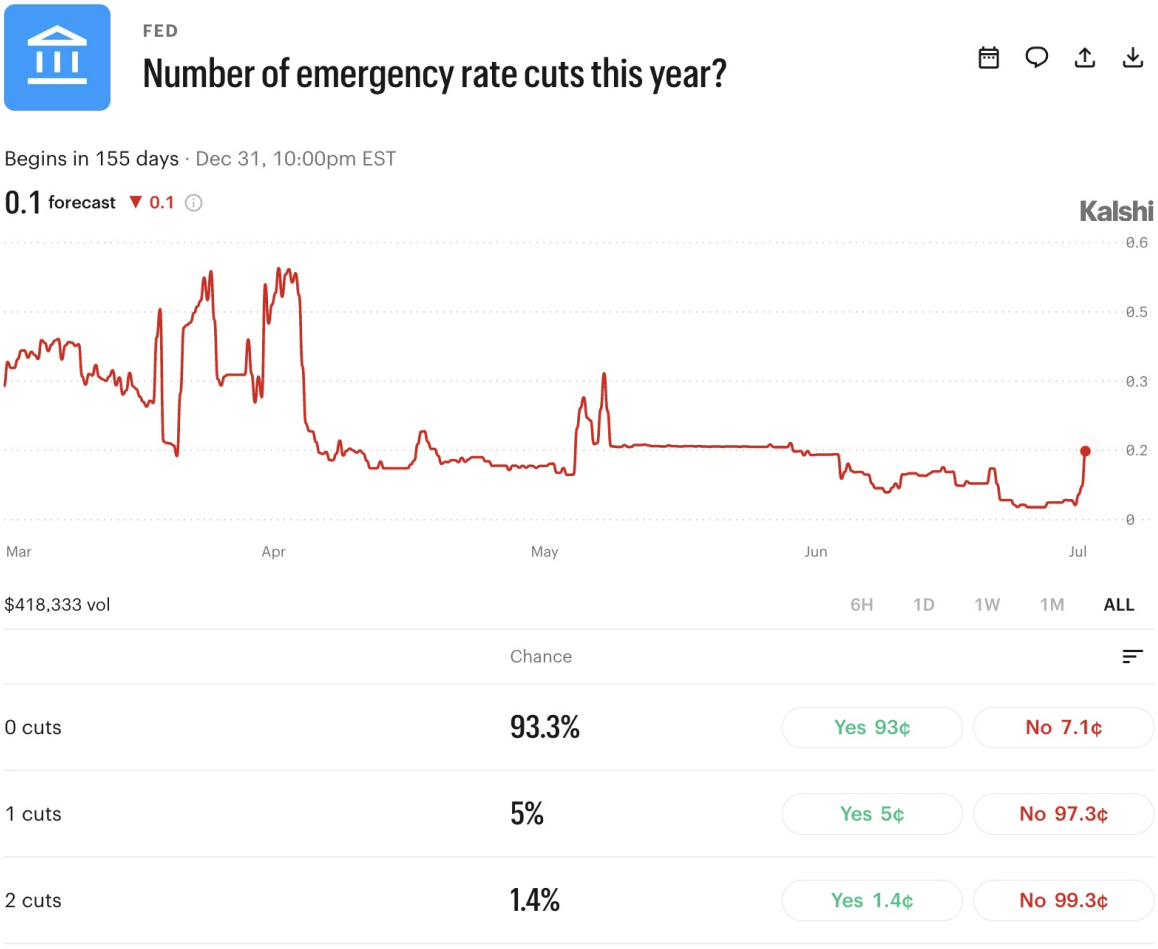

Figure 9: https://kalshi.com/markets/kxemercuts/emergency-rate-cuts/kxemercuts-26

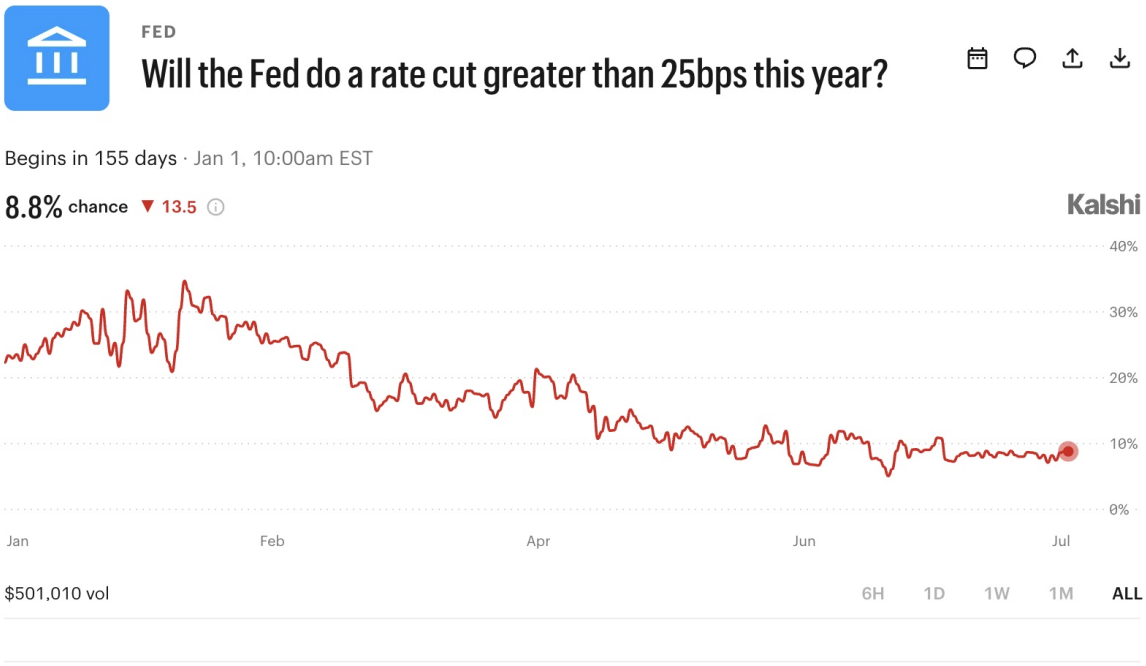

Figure 10: https://kalshi.com/markets/kxlargecut/large-cuts/kxlargecut-26?op_market_ticker=KXLARGECUT-26

Polymarket

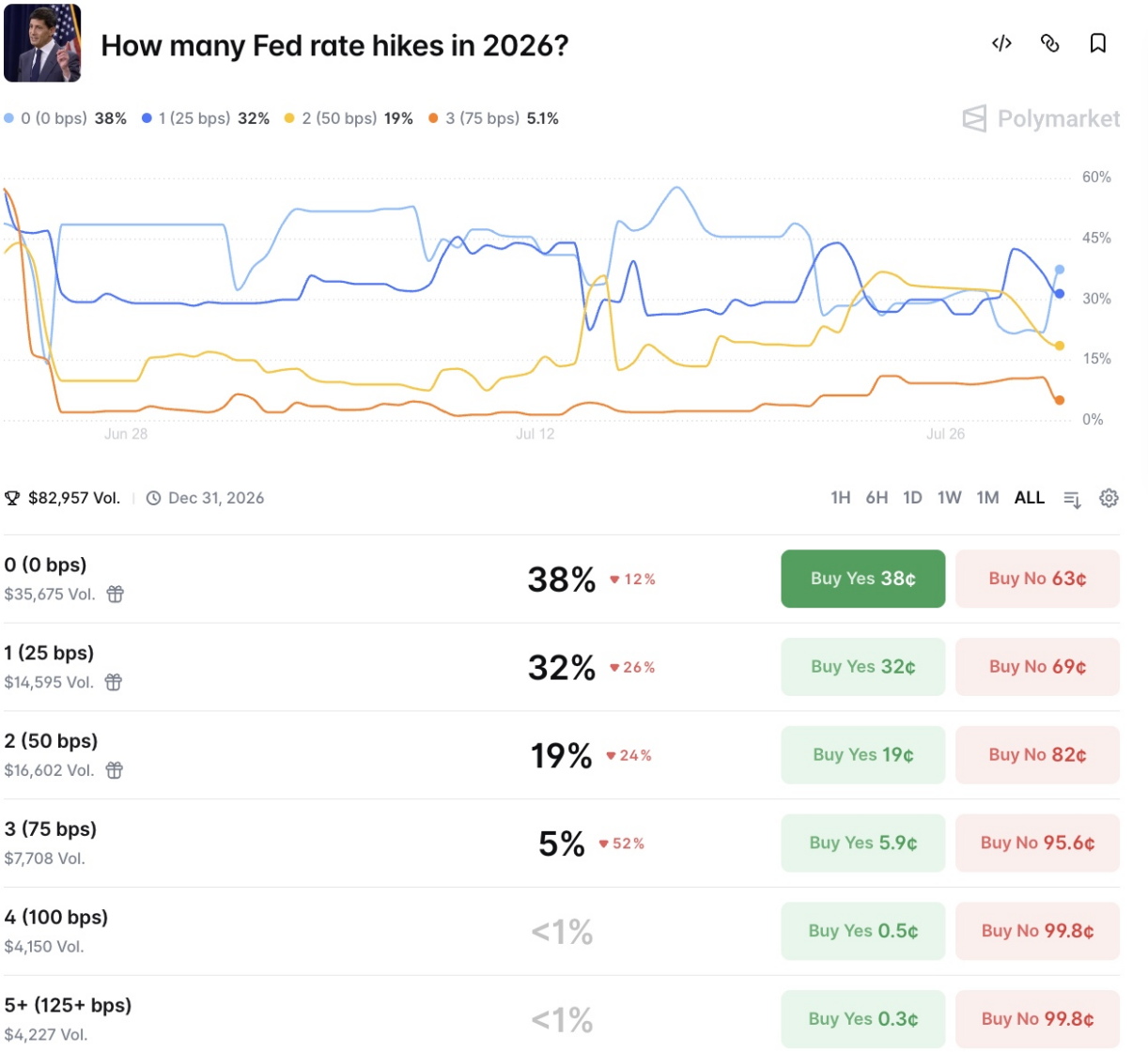

Figure 11: https://polymarket.com/event/how-many-fed-rate-hikes-in-2026-20260623190717369

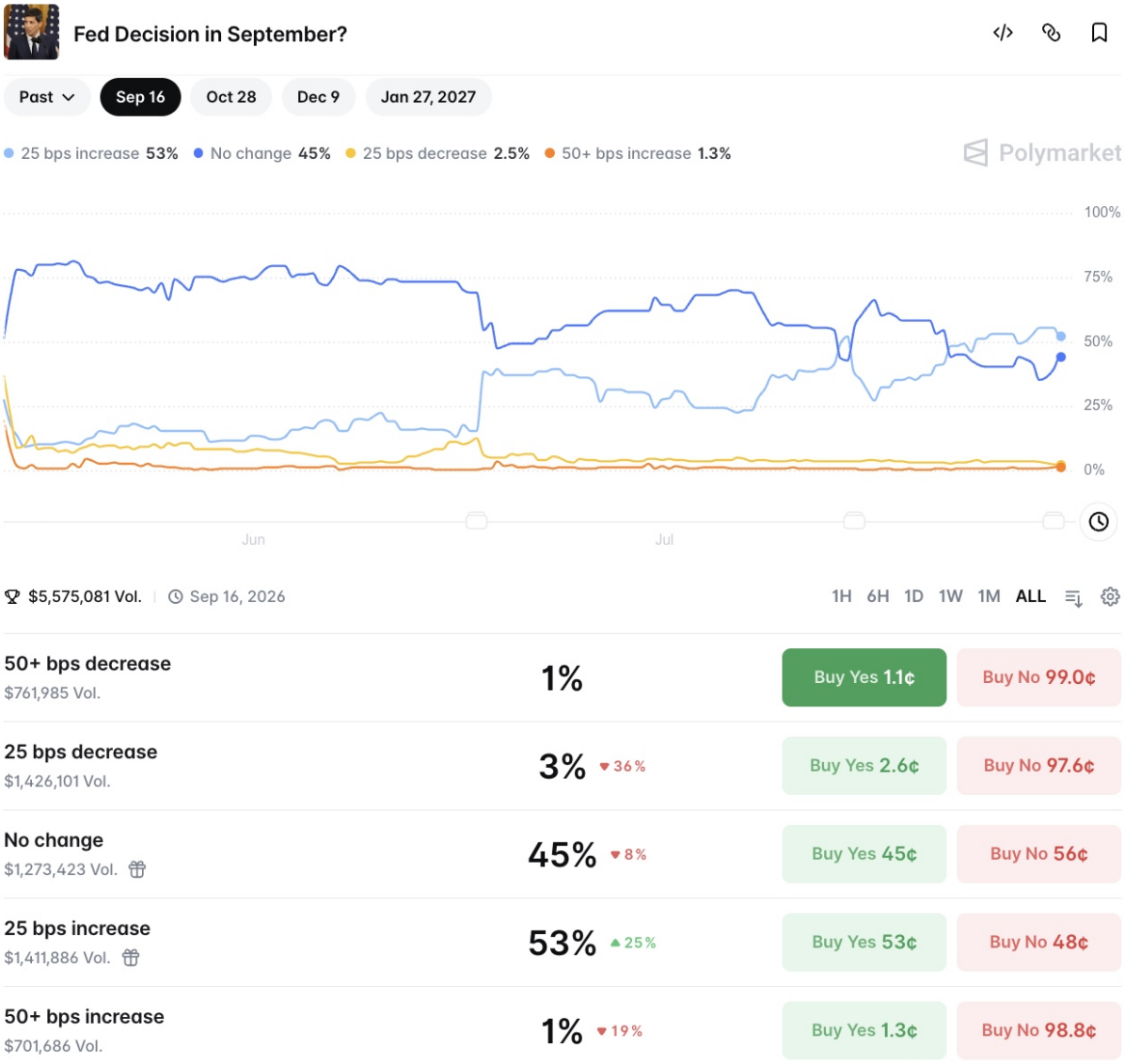

Figure 12: https://polymarket.com/event/fed-decision-in-september-762

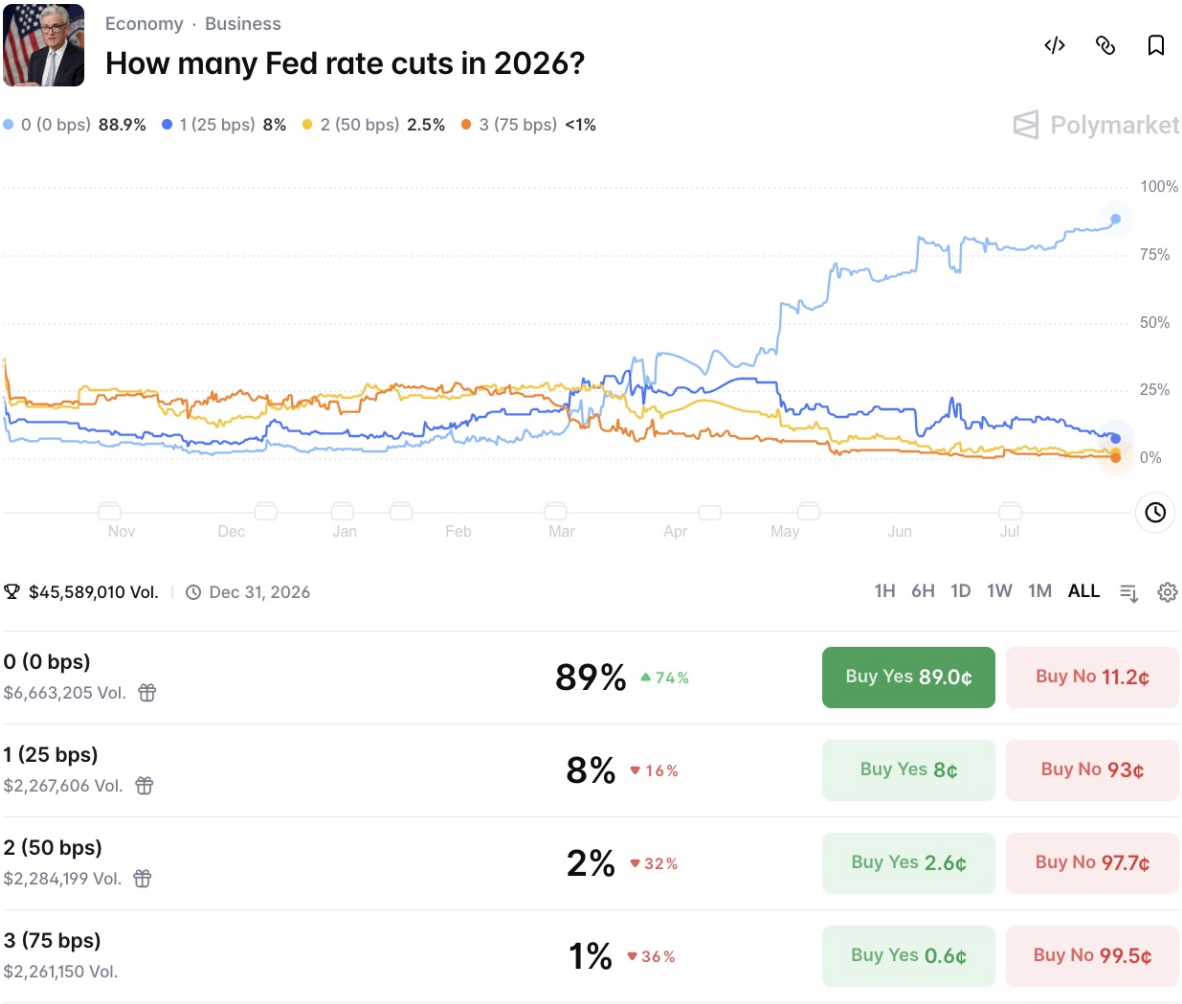

Figure 13: https://polymarket.com/event/how-many-fed-rate-cuts-in-2026

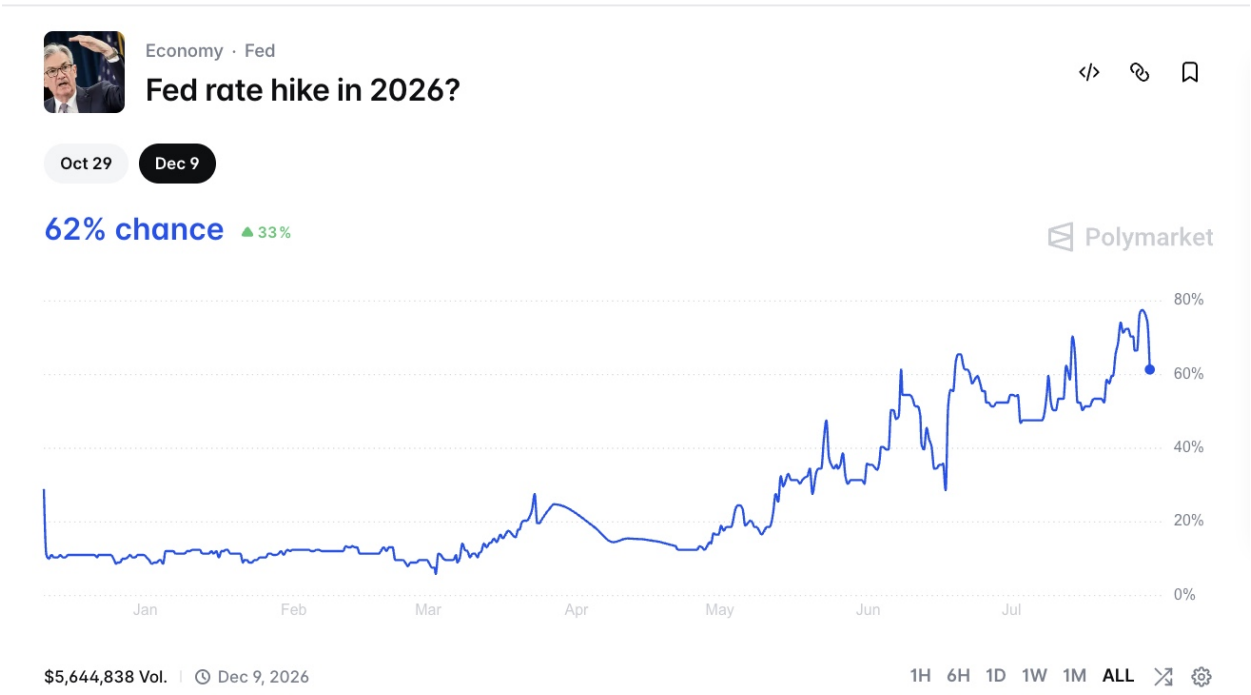

Figure 14: https://polymarket.com/event/fed-rate-hike-in-2026

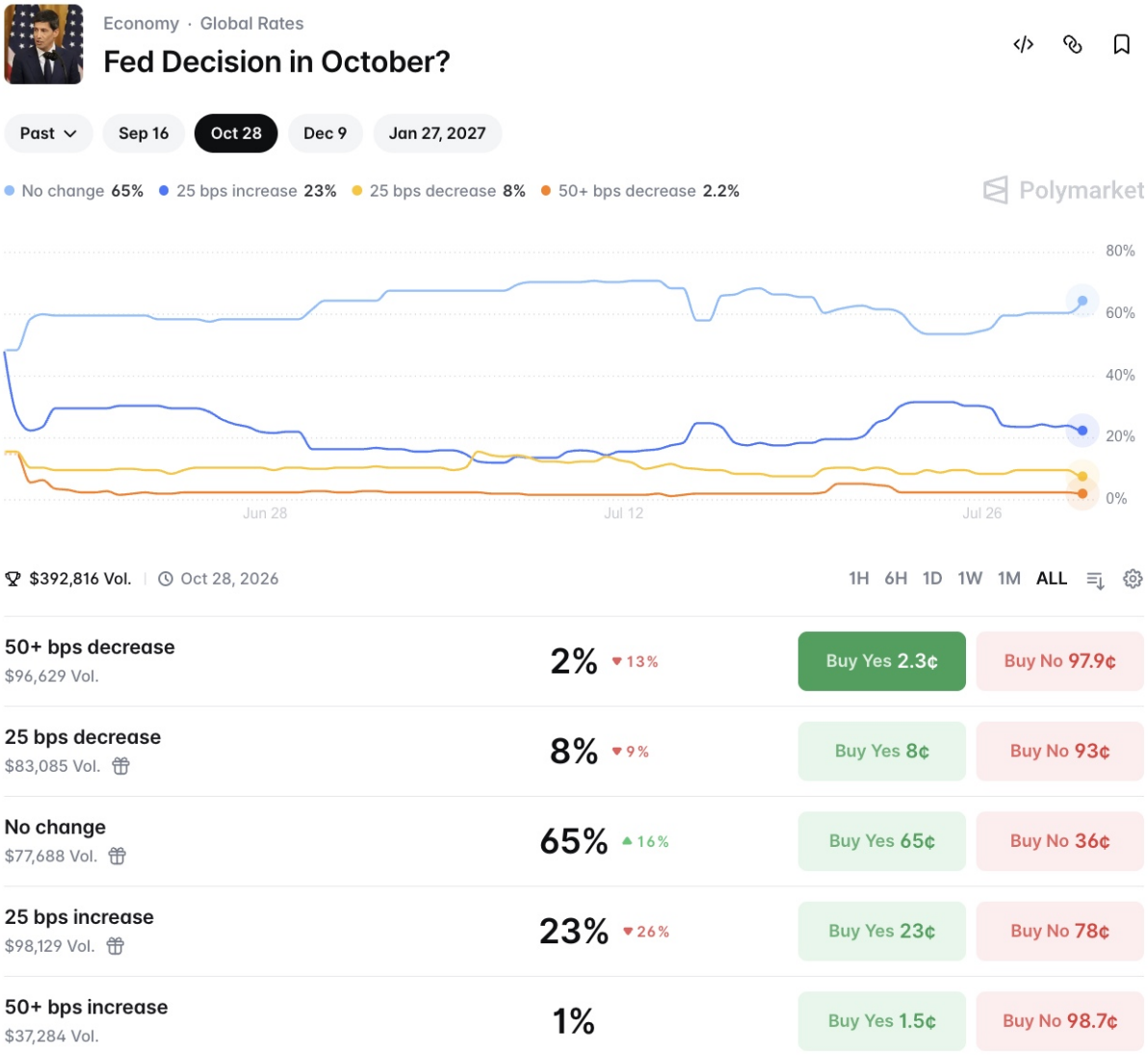

Figure 15: https://polymarket.com/event/fed-decision-in-october-20260617190323537

Between the two markets, there is roughly 136 million USD invested by retail and institutional investors. Figures 7, 8, 11, 12, and 14 all point to a rate hike and, at a bare minimum, a rate hold. Taken together, a rate hike in 2026 and early 2027 is very likely, and, at the bare minimum, the effective FFR will be held steady at the current 3.50–3.75. Based on all financial forecast market data as of right now—Fed Fund Futures, OIS, event-contract trading platforms—a 25- to 50-point rate hike is most likely, with the second-most-likely scenario being a rate hold through 2026 and early 2027.

Macroeconomic/Geopolitical variables

Financial markets certainly lean towards the hawkish side, and currently, I believe that the direction in which the macroeconomic/geopolitical variables are heading supports a rate hold with a possible hike towards the final months of 2026 and early 2027.

Although headline PCE is cooling from the initial energy supply shock brought on by the Iran war, there is not enough evidence to support the conclusion that this is an overall trend and not an outlier. Moreover, geopolitics, especially with the Iran War recently boiling over to the Houthis and Saudi Arabia, has remained especially volatile. Personally, I believe the current evidence indicates the war will drag on through endless ceasefires and intermittent periods—forecasting when the war will end is neither practical nor feasible. Core PCE is additionally rising by 0.1% month over month and is currently at 3.3%—higher than the Fed's 2% target rate. Throughout Warsh's several Senate testimonies and public appearances, he specifically highlighted the Fed's mandate to ensure price stability—publicly making him less likely to appear dovish.

Moreover, his hesitancy about the Fed being seen as forecasting, as seen with his abstention from the June Summary of Economic Projections (SEP) and public comments, may possibly be an attempt to appease the Trump Administration—which is openly pushing for rate cuts and has launched punitive DOJ investigations into current Governor Lisa Cook and former Chair Jerome Powell for their hawkish-leaning views. This is purely speculation, but it does lend some credence to the idea that Warsh himself leans hawkish; taken together with inflation, this makes him very unlikely to consider rate cuts.

The June headline and core CPI are falling too; however, energy price swings remain a large factor in this, and especially during a volatile war in the Middle East, it is far too soon to tell whether this will manifest as a larger trend. Moreover, energy impacts several other factors including manufacturing costs, airfares, food distribution through fertilizers, shipping, and consumer goods prices, and all of these prices remain volatile regardless of the June report. Fiscal policy, including tariffs, compounded by the increased demand for computer/semiconductor parts, has exerted higher demands on consumers.

GDP growth has slowed since Q1, from 2.1% down to 1.5%. While this headline is more cut-friendly, the overall GDP growth does understate the strength of domestic demand. Specifically, real final sales to private domestic purchasers—which combine consumer spending and private fixed investment—accelerated from 1.7% to 3.9%—and this reading is more hawkish.

Taken together, the current information is indicative of a rate hold with a likely hike. That is not to say that a rate cut is impossible or even improbable. The current Trump administration's stance on foreign and fiscal policy has seen rapid and widespread changes over short periods of time. At the moment, their actions—the Iran War/Middle Eastern actions, tariffs, stance on Russia/China, and broader foreign policy—lean hawkish, but the administration has been known to make swift fast reforms, and could implement policy that leans dovish. For rate cuts to be feasible, the current administration would need to implement changes that lead to several consecutive core PCE readings near 0.2% monthly or lower and a meaningful rise in unemployment above its present 4.2%—both of which are not impossible, but they are not probable given recent events.

In terms of creating a budget forecast, I would lean on the conservative side and expect the effective FFR to remain between 3.50% and 3.75%.