

MARKET COMMENTARY

Jackson Hole: Warsh turns hawkish. "But don't call it forward guidance"

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- **Warsh delivered a moderately hawkish message: bringing inflation back to 2% remains the overarching priority and, if the data do not show sufficient progress, the Fed will act forcefully. It was enough to push the odds of a September hike back to 60%.**
- **He would be "hard pressed to describe broad financial conditions as restrictive", implying that, contrary to what he had suggested in recent weeks, financial markets are not doing the Fed's job and that further action on rates may be needed.**
- **Warsh again criticised forward guidance. It has "overstayed its welcome" and can contribute to policy errors.**
- **Finally, he confirmed his optimism on the economic impact of AI. It could mark a significant shift in potential growth and productivity.**

In his Jackson Hole debut as Fed Chair, Kevin Warsh avoided, as expected, providing any signal on September policy and remained faithful to his pledge to abandon forward guidance. Yet the overall message was unmistakably hawkish. Inflation remains the Fed's primary concern and policy cannot be judged restrictive while inflation remains materially above target (in July, core PCE inflation was 3.4% year on year). He made this clear by stating that "We must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed. Otherwise, we have work to do."

He Fed's 2% inflation objective remains a "firm, fixed target", and he stressed that, despite the encouraging recent prints, inflation remains well above target across all major measures. He argued that recent improvements in CPI and PCE data do not yet provide sufficient evidence of an improvement in the inflation trend. To reinforce the message, he acknowledged that responsibility for the prolonged period of elevated inflation "sits squarely with the central bank."

Warsh's view of the economy is constructive. Business investment is accelerating, profits remain strong, credit conditions appear accommodative, and the labour market continues to be consistent with full employment. While recognising that high yields are hurting construction, he pointed out that financial conditions are hardly restrictive; they are not yet contributing enough to ensure a timely return of inflation to target. This somewhat contradicts his previous statements that markets were doing the Fed's job.

A second important theme was Fed communication. Warsh again delivered a forceful critique of forward guidance, arguing that it has "overstayed its welcome". In line with his previous speeches, he warned that excessive guidance can distort market pricing, create a "hall-of-mirrors" problem between markets and policymakers, and potentially contribute to policy mistakes.

Finally, Warsh devoted substantial attention to AI and productivity. He suggested that the US economy may be approaching a historic inflection point in which advances in artificial intelligence raise productivity, investment, and potential growth.

Markets quickly repriced the odds of a September hike, from 35% yesterday to around 60% after the speech was published. Two-year Treasury yields rose by 10 bps to 4.3%, while greater reassurance on inflation pushed the 10-year yield marginally lower.

A December hike remains our baseline, given the mildly reassuring inflation data. Moreover, we do not think that the FOMC will completely ignore the mixed signals from July payrolls and personal consumption expenditure data. However, this has clearly become a closer call after this speech.