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Warsh sounds more hawkish in Jackson Hole, finding a middle ground on guidance

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- **Overall, we would characterise Chair Kevin Warsh's Jackson Hole keynote as an improvement from the July press conference. While Warsh was always highly unlikely to abandon his anti-forward guidance stance, he was able to find more of a middle ground between the overly explicit and precise forward guidance that has prevailed at times in the past and his attempt to seemingly say as little as possible about monetary policy at the most recent press conference.**

- **Most notably, though Warsh was careful to avoid offering any guidance and even downplayed the idea of providing an explicit reaction function, he did outline a list of "key principles" informing his approach to monetary policy. Importantly after some of his comments in July, these included a re-affirmation of interest rates as the Fed's primary tool to address inflation and of PCE inflation as the metric though which the 2% target is defined.**

- **Turning to a discussion of the economy, Warsh clearly emphasised inflation as the Fed's main concern, noting that the underlying trend may not have "meaningfully improved" despite better numbers in the past couple of months. With the Chair also conceding that broader financial conditions may not be restrictive, Warsh noted that the Fed could still have "work to do", suggesting that rate hikes are a clear possibility.**

- **In this vein, the market is now pricing odds of a September hike of just above 50%, compared to roughly 35% prior to the speech. For now, we stick with our call of another hold, though we are not overly confident in this view, and the onus may be on the August inflation data to show another month of relatively benign core for the Fed to stay on the sidelines.**

Overall, we would characterise Chair Kevin Warsh's Jackson Hole keynote as an improvement from the July press conference, with parts of the speech offering some antidote to prior criticisms. The Chair did touch on some of the so-called "big picture" questions in his Jackson Hole speech, though these were less of a focus than we had been anticipating. While Warsh still avoided any explicit forward guidance, even devoting a section of his speech to defending this stance, he did offer some comfort after his widely-criticised press conference by outlining some "key principles" in terms of how he thinks about monetary policy, and more clearly emphasising that the Fed may still have "work to do" on the inflation front, sounding more hawkish in the process.

The criticisms of Warsh's previous press conference were less about a lack of explicit guidance than they were about a lack of clarity on the reaction function and how the Fed approaches monetary policy decisions, along with comments that some had interpreted as raising the possibility of using other tools than interest rates to address inflation and/or opening the door to a shift away from PCE in defining the 2% target.

At Jackson Hole, though Warsh did downplay the idea of providing an explicit reaction function, his comments today address some of the criticism by at least outlining "key principles" which "guide [his] thinking on the appropriate conduct of monetary policy". These include:

- Making sure to be forward-looking rather than focusing on stale data, relying on trends rather than isolated data points
- Evaluating both the supply and demand sides of the economy
- Explicitly re-affirming that the 2% target is defined in terms of PCE inflation

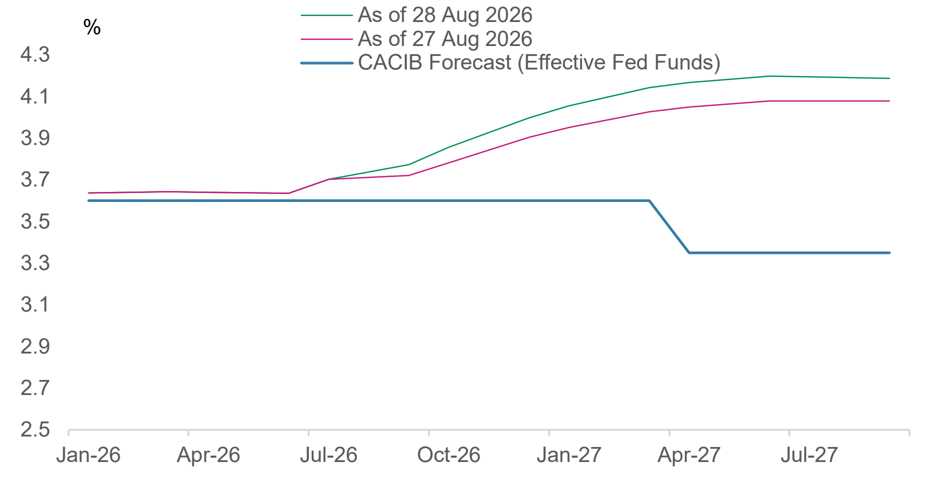
- Stressing that he does not see the two sides of the dual mandate to work at cross-purposes, with price stability an important condition to allow for full employment
- Outlining interest rates as the primary monetary policy tool, with unconventional policies to be used sparingly, during times of crisis
- Suggesting that he takes into account monetary aggregates in his analysis: “money matters”
- Reiterating that he prefers a quieter Fed

Overall, these principles at least provide some framework for how Warsh thinks about monetary policy and re-affirm that the Fed still sees interest rates as the primary tool to address inflation, with no intention of defining the 2% target as anything other than PCE inflation. This should provide some comfort following a couple of the main criticisms of Warsh’s July press conference.

Warsh then turned to a discussion of the economy, where he sounded generally upbeat, particularly about the strength of investment, while also offering little concern about the employment side of the mandate. **On inflation, in contrast, Warsh described the numbers as “more concerning”,** while noting that, despite better numbers over the past couple of months, “they do not tell me that underlying trends have meaningfully improved”.

When this inflation focus is combined with comments that Warsh would be “hard pressed to describe broad financial conditions as restrictive” and the admission that there could be “work to do”, rate hikes clearly remain a possibility. In this vein, the market is now pricing odds of a September hike of just above 50%, compared to roughly 35% prior to the speech. For now, we stick with our call of another hold, though we are not overly confident in this view, and the onus may be on the August inflation data to show another month of relatively benign core for the Fed to stay on the sidelines.

Fig 1. Market adds to hike expectations post-Jackson Hole



Source: Bloomberg, Crédit Agricole CIB

Elsewhere in the speech, Warsh did touch on some big picture issues, though we will not spend a lot of time on these portions of the speech as parts were filled with more questions than answers (eg, on the potential impacts of AI on the economy) or repeated ideas Warsh has shared multiple times in the past (eg, arguing that forward guidance reduces flexibility and that the Fed needs clear market signals). Regarding the task forces, Warsh indicated that early check-ins have been “encouraging”, though offered no further detail, so we will likely have to wait until closer to the end of the year for the results of these.

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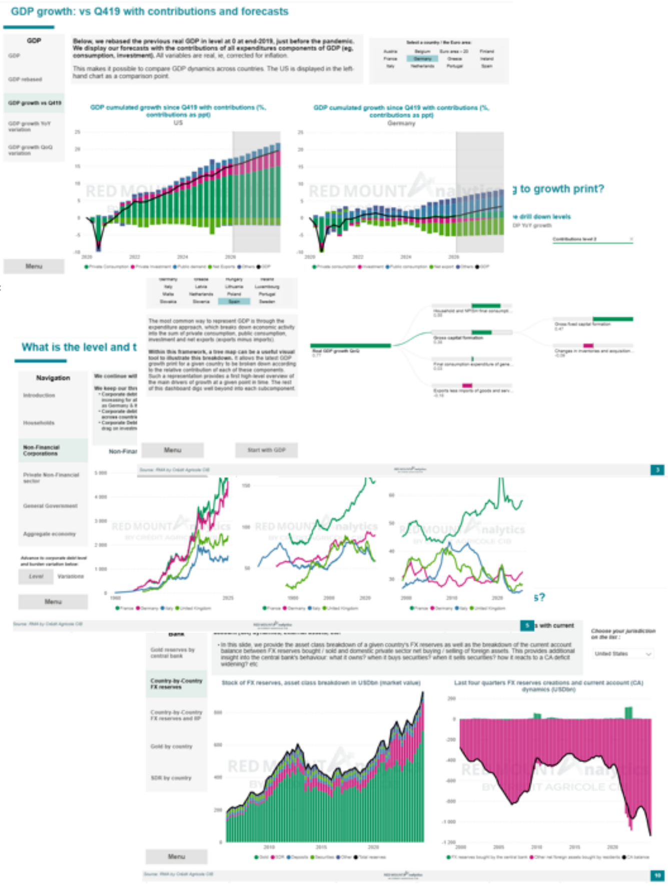

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