27 October 2026

Reading the Markets USD

The return of money, credit and debt to Fed's inflation analysis

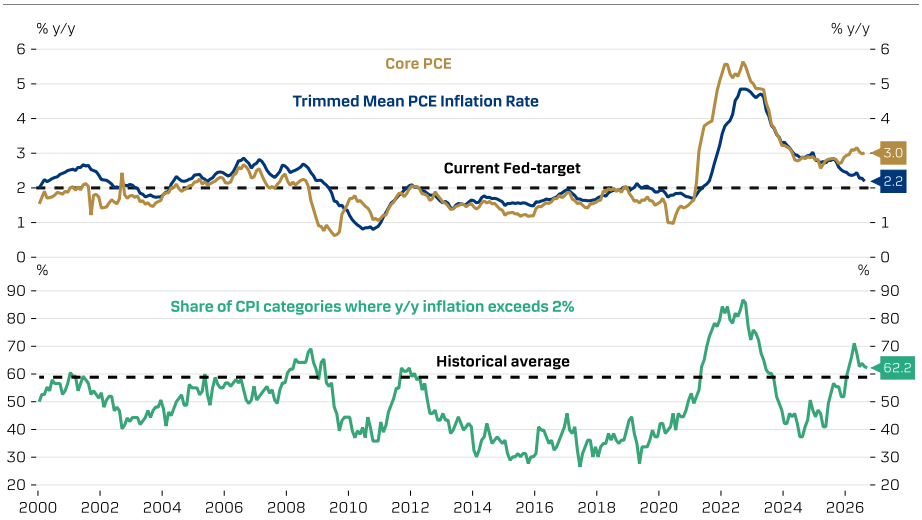
At his first post-FOMC press conference in June, Fed Chair Warsh announced **the creation of five task forces** to evaluate the Fed's communications, balance sheet policies, data sources, productivity and inflation framework. Warsh said he expected the task force conclusions by the end of 2026.

This week we focus on the inflation task force. The objective of that is to: "Examine the drivers of inflation, first principles, and weigh the full range of ideas for delivering price stability in a changing economy." Warsh wants it to investigate three questions: 1) what are the drivers of inflation? 2) What is the Fed's responsibility for inflation? 3) How does the Fed best measure inflation?

Regarding 3), Warsh said there would be some overlap between the inflation and data task forces. The task force members' views on how best to measure inflation itself remain to be seen, so we will focus on the members later.

After his appointment, **Warsh confirmed his support for the 2% PCE inflation target.** However, during his confirmation hearing, he said that **"the data used to judge inflation is quite imperfect"**. He argued that trimmed mean measures could offer a better way to assess inflation. While core inflation excludes the same volatile components, food and energy, each month, trimmed mean inflation removes a fixed share of the items with the largest price changes. **Trimmed mean inflation has continued to trend towards 2% through 2026**, in contrast to core PCE inflation (see chart 1). After the September meeting hike, Warsh argued that one of his concerns was that too many categories were still posting increases above 3%.

Chart 1: Alternative inflation measures still points to decreasing price pressures



Source: US Bureau of Labor Statistics, Dallas Fed, Macrobond, Danske Bank.

Key views

- **Macro:** Cyclical outlook remains healthy, even if stagnant labour supply growth weighs on real growth. GDP +2.1% in 2026 below consensus at +2.3%.
- **The Fed:** 25bp hikes in December and March. Rates held at 4.25-4.50% for the rest of 2027 (below market pricing).
- **EUR/USD:** Relative macro and monetary policy outlook maintain downward pressure on EUR/USD 12M forecast at 1.10. Below consensus (1.16) and forward (1.14).
- **10Y UST:** 5.30% in 12M (above forward at 5.11%).

Read our Fed Preview and FX Forecast Update

- *Fed Preview: On hold in October, hiking resumes later*, 22 October
- *FX Forecast Update - EUR/USD headed towards 1.10*, 21 October

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In the lower panel of chart 1, we show the share of CPI categories running above the Fed's 2% target year-on-year. **This has fallen to 62.2% from 70% at the start of the year** but remains above its historical average of 60%. It is hard to say what an explicit target of these measures should be, **but given that they are still trending down, it should offer the Fed some relief** if such measures were considered instead of the current core inflation measure.

Task force members' inflation views

While the members appointed to the task force have not said much about how to measure inflation, **they are quite outspoken in their views on how to tackle inflation.** The members are all highly regarded economists: Harvard Professor Greg Mankiw, Nobel Prize winner Thomas Sargent and former OECD Chair William White. Their views on what drives inflation and central banks' responsibility for inflation could influence the Fed's future monetary policy.

Mankiw is considered a leading New Keynesian thinker, the school of thought on which modern monetary policy has been built. He was a member of the Republican Party until 2019, but then he left because he believed it had become too centred around Trump. In a 2024 *speech*, Mankiw set out his current views on inflation. Mankiw stated that **monetary aggregates deserve more attention, as they proved useful in predicting the 2022 inflation surge** (see chart 2).

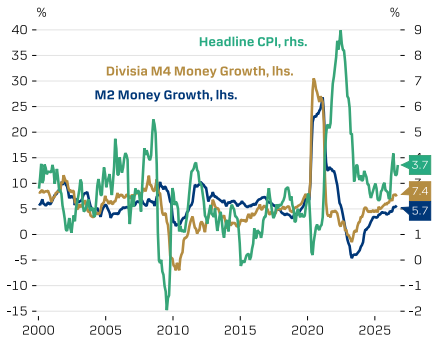
This aligns with Fed Chair Warsh, who has been open to using monetary aggregates as part of the broader mosaic of information the Fed should consider when conducting monetary policy. This does not mean that either Warsh or Mankiw seems to think that monetary aggregates can stand alone.

Mankiw said he thinks **a 2% inflation target is superior to a 2.0% target.** This aligns with Warsh's view that he would rather focus on the numbers to the left of the decimal point and put less emphasis on the decimal places to the right. **That sounds more like an inflation target between 2-3%** than a strict 2% target. Though Warsh said that it makes no sense to lift the target, before the Fed can deliver on its recent target. Mankiw sees reasonable arguments for increasing the 2% target, though is ambivalent about final conclusions.

Moving on to Sargent. He co-authored a *paper* last year in which the authors argue that the current government's overall budget constraint points to permanently higher inflation and higher nominal Treasury yields. Growth in US public spending has outpaced growth in tax revenues since COVID (see chart 2). So far, Warsh has refrained from commenting on fiscal policy. Sargent's work suggests that the Fed may need to take rising debt into account in the fight against inflation. **In the current fiscal environment tighter monetary policy.**

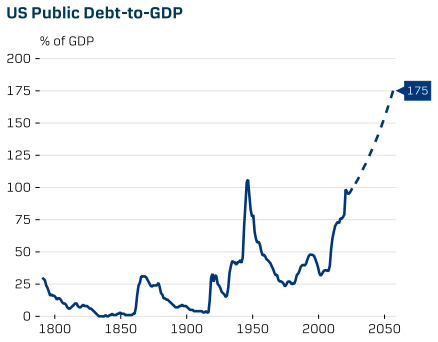
Last member, White, wrote an *article* this year on rethinking inflation targeting. He describes himself as "a dissenter from orthodox monetary policy". He argues that inflation-targeting regimes reinforce the procyclical nature of the financial sector in advanced economies. He also believes they have contributed to record-high debt levels in many advanced economies. In his view, central banks should place greater weight on fighting financial instability, rather than focusing only on inflation. **They should therefore track money and credit growth, not just inflation and unemployment.** For example, they should react to credit booms (see chart 4), even if inflation temporarily falls below target. **This would imply tighter monetary policy on average than the Fed has conducted in recent decades.** White warned against easing monetary policy on the assumption that AI will lead to lower inflation through productivity gains. He called Greenspan's widely praised decision to lower interest rates in the 1990s in response to a productivity surge a policy error.

Chart 2: Elevated money growth in 2021 was a warning sign of elevated inflation



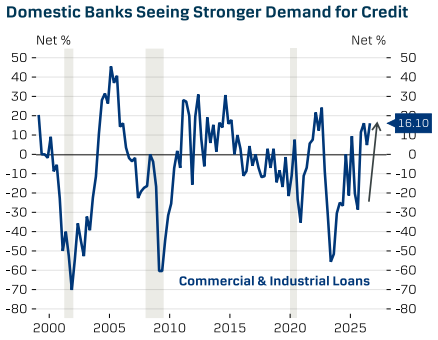
Sources: US Bureau of Labor Statistics, Federal Reserve, Center for Financial Stability, Macrobond

Chart 3: US budget deficit expected to continue its increase towards new highs



Sources: US Treasury, CBO, Macrobond

Chart 4: Credit demand has increased



Sources: Federal Reserve, Macrobond

Tracking money growth, a more flexible inflation target and tighter policy

Overall, our reading is that the task force is likely to recommend a more flexible approach to inflation targeting in both directions, rather than a strict focus on 2.0%. We also expect it to place greater emphasis on tracking monetary aggregates and credit growth as part of the Fed's assessment of inflation risks and financial stability. We could also see a recommendation for tighter measuring of government budget deficit. Taken together, such recommendations would point to a broader inflation framework and imply a tighter monetary policy stance on average than the Fed has maintained in recent decades.

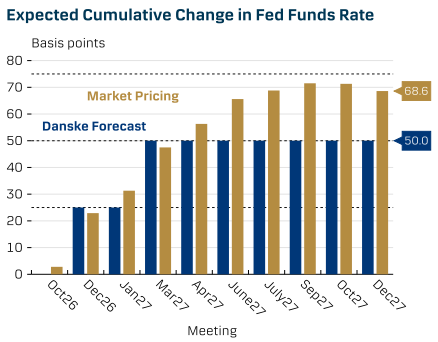
Key topics this week

The main event of the week is Wednesday's announcement of the FOMC rate decision and following press conference. We expect the Fed to keep policy rates unchanged at the October meeting, in line with consensus. Markets price in a 15-25% probability of a hike. Most central FOMC members have signalled they can wait until December before hiking again, though a few see more urgency. We expect 2-3 votes for a hike. We still think further tightening will be needed and stick to our call for two more hikes, in December and March. (For details see *Fed Preview: On hold in October, hiking resumes later*, 22 October.)

If the Fed keeps rates unchanged, and Warsh sticks with his limited guidance approach, UST yields could come marginally lower, and the curve could re-steepen. Holding rates steady now would strengthen the case for only quarterly hikes going forward. This is already largely reflected in current pricing (chart 5) but would reduce the perceived likelihood of a hike also in January. EUR/USD could shift modestly higher, but if Warsh underscores the commitment to price stability, we would view any uptick as temporary. We forecast EUR/USD heading towards 1.10 in 6-12M horizon.

On Thursday, Q3 flash GDP data and September PCE are due for release. We expect GDP to have increased by 3.4% q/q SAAR. If correct, this would suggest that our latest Nordic Outlook forecasts of 2.1% GDP growth in 2026 and 1.8% in 2027 are too low, mainly due to upward revisions to consumption growth in H1 26. As with CPI, headline PCE likely rose in September, driven by a further increase in energy prices from August. We will focus mainly on signs of inflation broadening beyond energy components.

Chart 5: Quarterly hikes are the base case for us and the markets



Sources: Bloomberg, Danske Bank

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