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Warsh guides forward without forward guidance

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We got far more here from Chair Warsh then we were getting from his two FOMC meetings to date. He was keen not to provide forward guidance, but his words smacked of forward guidance; he was net hawkish. That does not guarantee anything, but front end rates are higher and back end rates lower as a reaction. Seems fair. Nothing on the Treasury buybacks, as expected

Warsh's hawkish words pivots the curve flatter

At the Jackson Hole Symposium, Chair Warsh struck a more hawkish tone than the bland price stability ambition that he had opined on from FOMC meetings. Key Comment:

Price stability is not self-executing, nor is inflation necessarily mean-reverting. It is the Fed’s job to deliver stable prices.

That, with the acknowledgement that inflation is well above 2%, struck a clear tone of hawkishness from the Chair.

To boot, Warsh noted that the inflation trend has not meaningfully improved, while the Fed's 2% PCE inflation objective is firm. He also made reference to strong capex growth related to AI, noted low credit spreads and strong issuance, and that commercial and loans markets were buoyant; emphasising that monetary conditions are not restrictive. He also noted a stable labour market and low jobless claims. Chair Warsh concluded by noting that market expectations are relaxed on inflation, and asserted a belief that such expectations can be achieved, with the Fed's job to ensure that inflation does not become un-anchored. He was more balanced here, but net hawkish overall.

The yield curve has come out of this flatter from both ends. The front end has been hurt (2yr yield), while the back end has been comforted (30yr yield a tad down). The 10yr yield is mixed, but the inflation breakeven a tad lower. The 5yr part of the curve is de-richening (cheapening) also, which points to an increased worry on the rate hike risk. The 2yr yield is up to 4.3%, pushing the carry spread to the funds rate out to above 66bp. Typically, when that gets to 75bp there is an imminent hike priced. The September FOMC meeting has been re-priced as a toss of a coin. Before the speech, it was priced at a 34% probability for a hike. It's now at 54%.

He also made some humbling remarks on the ability of the Fed to forecast the future, and noted that the markets watching the Fed for forward guidance, and the Fed in turn watching market reflective expectations, is not an optimal outcome. Hence, the rationale for less forward guidance.

That said, he has done enough today to validate the market discount that had been biased in the direction of a rate hike risk to begin with. That discount has hardened. We are far more constructive on inflation, and its path lower through 2027, and without the need for hikes. But there may well be a sense here that the wider FOMC might not have the same patience that we have on the timing of inflation falls. As it is, the September meeting is now a market toss-up.

Nothing from Chair Warsh on the fiscal deficit, or on Treasury Secretary Bessent's market buybacks or on the US dollar. Absolutely no surprises there. That's for the US Treasury to opine on. He stuck to his lane.

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