Warsh at JH – Hawkish, but still room to hold

Steve Englander
+1 212 667 0564
Steve.Englander@sc.com
Head, Global G10 FX Research and North America Macro Strategy
Standard Chartered Bank NY Branch

Dan Pan
+1 212 667 0647
Dan.Pan@sc.com
Economist, Americas
Standard Chartered Bank NY Branch

Event

Fed Chair Warsh's Jackson Hole (JH) speech gave the market more hope that he would raise rates if inflation did not decline at a sufficient speed, but stopped short of making a hike the baseline. However, his comments on easy financial conditions largely ruled out a cut. Overall, there is still a case for waiting and seeing, but his comments imply hikes by end-2026 if inflation does not decline meaningfully.

Implications

Warsh came across as somewhat hawkish. He largely shut down any possibility of a rate cut before the midterm elections with his comments on financial conditions not being restrictive. He moved closer to the centre of the FOMC with his view that inflation would have to trend down meaningfully to remove the case for tightening. He dismissed low compensation and unit labour cost growth (incorrectly, in our view) as factors relevant to inflation. He did not mention the restraint from higher bond yields – UST yields and the balance sheet were mentioned only incidentally. Interestingly, while he still focused on disaggregated prices, his interpretation of them seems to have flipped 180 degrees. His emphasis now seems to be on the unusual upside skew that remains.

The USD was up about 0.2% at 11:00 local time versus just prior to the speech. The biggest move was in short-term policy rate expectations, with December 2026 fed funds futures up 7bps. He (and Treasury Secretary Bessent) likely saw the early 2bps drop in 10Y UST yields as a sign that Warsh calibrated the speech correctly, but bond yields subsequently retraced higher. The S&P initially softened a bit but was 0.4% higher at 11:00 local time than just prior to the speech. Higher-beta currencies are underperforming despite the S&P rally. However, the CHF is among the weaker performers. Gold prices also edged lower.

While not giving explicit forward guidance, he said enough to convince markets that he will hike if inflation does not decline soon. We do not yet think that means a September hike, and unless the August CPI and PPI come in on the high side, we think he can get a hold from the FOMC, giving inflation a bit more time to decline. The biggest dovish lean was the reassurance he drew from low inflation expectations. We think there is enough risk of benign inflation prints that we are not shifting to a hike, but it is a close call. His comments may help the USD a bit by removing some of the risk premium markets added after the July FOMC and Bessent's intervention, but we are talking small beer here.

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Document approved by
Razia Khan
Head of Research, Africa and Middle East

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