USA: In Hawkish Jackson Hole Debut, Chairman Warsh Says the Fed's "Predominant Focus Right Now Should Be On Prices"

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BOTTOM LINE: In a hawkish first Jackson Hole speech as Chairman, Kevin Warsh said that with inflation "running above our 2 percent target," "the Fed's predominant focus right now should be on prices." Warsh characterized the inflation numbers as "concerning" and added 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 also acknowledged that "this summer's PCE and CPI readings were better than expected," but stressed that "they do not tell me that underlying trends have meaningfully improved." Warsh's speech suggests that a hike in September is possible if the August CPI and PPI come in firmer, but we continue to expect that core CPI and PCE inflation will print around 0.2% in August and that the FOMC will remain on hold.

MAIN POINTS:

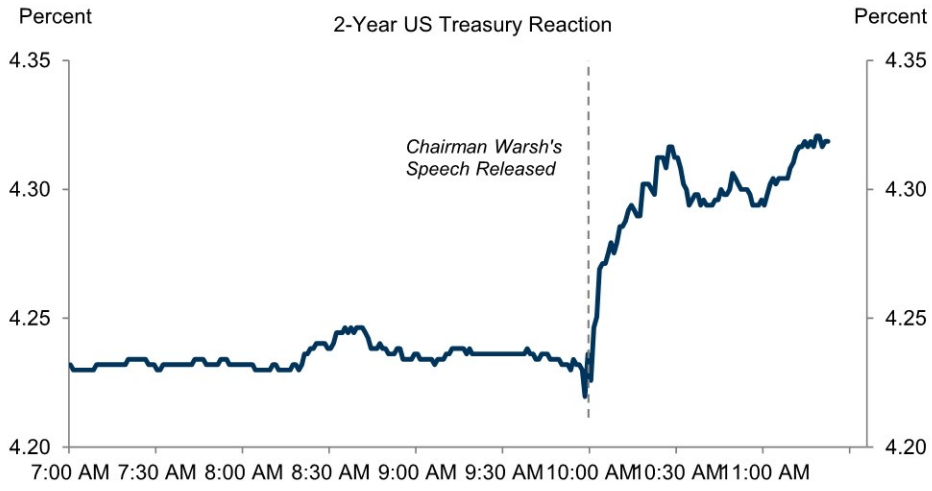
1. In a hawkish first Jackson Hole speech as Chairman, Kevin Warsh said that with inflation "running above our 2 percent target," "the Fed's predominant focus right now should be on prices." Warsh characterized the inflation numbers as "concerning" and added that "we must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed… otherwise, we have work to do." He also reaffirmed that "there should be no misunderstanding" that the "Fed's price-stability objective of 2 percent, as measured by the PCE index, is a firm, fixed target." Warsh acknowledged that "this summer's PCE and CPI readings were better than expected," but stressed that "they do not tell me that underlying trends have meaningfully improved." He took a hawkish angle on other price and wage data signals too. He noted that while wage growth remains "moderate," it "has not proven a reliable indicator of future inflation for a very long time." And he highlighted that the share of goods and services in the PCE basket showing price increases above 3 percent stands at 54% over the past 12 months, "well below the post-pandemic highs of about 77 percent" but "well above the level of 32 percent in the two decades that preceded the pandemic," a calculation that we recently showed partially reflects tariff effects.

2. On economic activity and the labor market, Warsh said that he is "impressed by the overall performance of the economy, which appears to have strengthened." He characterized real consumer spending as "healthy despite the shocks" and noted that "business capital expenditures are rising rapidly," highlighting that "more than half of the capex growth this year can likely be ascribed to the buildout related to AI." Warsh noted that private domestic final purchases—a measure that he described as "typically carrying more signal than GDP" but that we recently noted is currently distorted upwards by imports of technology goods for AI investment—has increased "at a pace of nearly 3 percent so far this calendar year." Warsh also struck

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an optimistic tone on the labor market, characterizing it as "quite stable" and "consistent with full employment," and noting that the unemployment rate "remains low by historical standards." On balance, he said, "I would be hard pressed to describe broad financial conditions as restrictive."

3. On the policy outlook, Warsh noted that at the July FOMC meeting "a good majority of my colleagues and I thought the wiser course was to await new information in the intermeeting period … before deciding whether a change in interest rate policy was advisable." Warsh's speech suggests that a hike in September is possible if the August CPI and PPI reports come in firmer than expected, but we continue to expect that core CPI and core PCE inflation will print at around 0.2% month-over-month in August and that the FOMC will remain on hold. The bond market also took today's speech as hawkish, with a roughly 7bp increase in the 2-year Treasury yield following its release, one of the largest moves around a Jackson Hole speech in recent years. Markets now price the probability of a September rate hike at slightly above 50%, up from roughly 30% before the speech.



Source: Goldman Sachs Global Investment Research

Disclosure Appendix

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