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Hawkish Warsh in Jackson Hole

Last Friday, Fed Chair Kevin Warsh delivered his first Jackson Hole speech. His statements carry weight as these provide indications of how he will manage the Fed under his term.

Importance of Jackson Hole

The Fed hosts an annual symposium in Jackson Hole that is attended by prominent central bankers and policy makers. Investors play close attention to this event as central bankers typically give a roadmap of where monetary policy is headed. They also explain new programs or changes that they will implement. In his speech in August 2010, former Fed chair Ben Bernanke signaled additional monetary stimulus to support the economic recovery. This eventually led to the launch of the second phase of quantitative easing in November 2010. In 2016, Janet Yellen's speech ushered 200 basis points of rate hikes which were meant to tame inflation. And in August 2024, Jerome Powell's statement was followed by a cumulative rate reduction of 100 basis points.

Price stability is the main priority

The hawkish policy tilt and renewed focus on price stability were confirmed in Warsh's latest statements in Jackson Hole. He said that "while this summer's inflation readings were better than expected, they do not tell me that underlying trends have meaningfully improved." He 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. That's our job, our mandate and our charge to keep." Moreover, he stressed that the Fed's two percent inflation goal is a "firm, fixed target." These statements raise the odds for a policy rate hike next month.

Quieter Fed

Warsh confirmed his preference for brevity while veering away from detailed forward guidance. This harkens back to the practice of Fed chairs before the financial crisis when they avoided providing overt verbal cues about their intentions. Warsh called for a "quieter Fed, more purposeful in its communications." He explained, "the Fed plays an essential role in the economy and the markets. And our tools are powerful. We determine the path of short-term interest rates. And market participants will always try to anticipate what we will do next." He stressed that "we should not indulge a regime in which market participants are looking primarily to the Fed for their next trade."

Resilience of Main Street and Wall Street

Warsh touted the strength of the overall economy. He said, "One indicator of strength is how well an economy holds up to shocks. On that score, both Main Street and Wall Street have been remarkably resilient." He also cited strong corporate earnings and high capex growth due to the AI buildout. Moreover, he added that he does not view broad financial conditions as restrictive.

What this means for the economy and stock market

Warsh's Jackson Hole speech gives us some insights on how the Fed will behave under his term. He appears quite satisfied with the performance of the economy and the stock market. This means that he will maintain his hawkish bias and pursue the Fed's primary objective of bringing down inflation back to the two percent target. His statements signal that the path of interest rates is higher. After his speech, the US dollar strengthened. The Japanese yen weakened and went past 160. The peso reached a new record low as it breached the 62 level despite the BSP's latest policy rate hike. A hawkish Fed would be detrimental to sectors that are sensitive to higher interest rates such as small caps in the Russell 2000. Meanwhile, a stronger dollar would mean costlier imports for countries such as the Philippines. Moreover, US dollar strength would weigh on the performance of emerging market stocks, bonds and currencies.

Learning from Jackson Hole

We can learn much from the latest statements of Kevin Warsh, just like the speeches of past Fed chairs in Jackson Hole. In this light, investors should take their cues and use these to guide their investment decisions. Overall, Warsh's Jackson Hole speech served as a confidence booster for the US stock market and cleared some uncertainty regarding the direction of Fed policy.