Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

By: TA | AP Insight

Fed Chair signals rate hikes to bring inflation down

Federal Reserve Chair Kevin Warsh said Friday that inflation is still too high and suggested the central bank may have to raise interest rates in the coming months to bring it down, a clearer signal than he had sent previously about his economic outlook.

In his first high-profile speech at the Fed's annual conference in Jackson Hole, Wyoming, Warsh acknowledged that recent U.S. reports show that inflation has cooled a bit, but "they do not tell me that underlying trends have meaningfully improved."

"We must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed," Warsh said. "Otherwise, we have work to do."

Comments from the new Fed chair appeared to reassure Wall Street that fighting inflation remains the priority for the central bank.

Warsh did not imply in his speech that a rate hike is imminent, but at the same time, he seemed to dismiss perceptions that inflation is not a threat.

He pointed to data showing that inflation remains stubbornly above the central bank's 2% target. Warsh replaced Jerome Powell in late May after his predecessor's term ended.

The U.S. stock market held steady

The U.S. stock market held steady after the speech, but expectations are building in the bond market for the Fed to hike interest rates.

The yield on the two-year Treasury, which closely tracks expectations for what the Fed will do with its federal funds rate, moved from 4.22% to 4.30%, a sign that investors expect short-term yields to move higher.

Longer-term yields on 10-year and 30-year Treasuries were mostly flat, suggesting investors aren't worried that higher rates will be needed for a long stretch of time to fight inflation.

> Warsh succeeded in conveying a tougher approach on inflation - Jon Faust

Jon Faust, an economist at Johns Hopkins and a former adviser to Powell, said Warsh succeeded in conveying a tougher approach on inflation while, at the same time, avoiding the detailed guidance customary among his predecessors that he has disparaged.

"He found a way to convey that if necessary he would support raising rates, which is one thing people were concerned about," Faust said.

Yet Michael Strain, director of economic policy studies at the American Enterprise Institute, said the Fed chair has talked tough on inflation before without hiking the Fed's key rate.

His Friday remarks don't provide any clearer guidance on the timing of any Fed moves, he added.

Rising bond yields

The Fed chair, who replaced his predecessor, Jerome Powell, on May 22, faces high stakes with his speech as questions swirl around Wall Street about his focus on fighting inflation.

Those concerns may have contributed to rising bond yields, which can increase the cost of borrowing for the government and everyone else.

Yet Warsh has said he doesn't want to provide what analysts call "forward guidance" about whether the Fed will hike or cut rates or stay on hold at upcoming meetings. He argues that it limits the Fed's flexibility by committing it to a specific policy.

> Warsh did suggest that interest rates currently aren't restricting economic activity

Yet some economists have argued that he could say more about his views on Fed policy without tipping his hand about future actions.

Warsh on Friday reiterated his skepticism about providing such guidance or even outlining his broad approach to interest-rate policy.

But he did suggest that interest rates currently aren't restricting economic activity, pointing to robust business investment in AI equipment and infrastructure and strong consumer spending.

As a rule of thumb, interest rates often need to be high enough to limit borrowing and spending to cool inflation.

Rates may not be high enough to bring inflation down

The Fed next meets Sept. 15-16, and Warsh's remarks don't necessarily signal that the central bank will raise rates then.

But his speech indicated that rates may not be high enough to bring inflation down to the Fed's 2% target.

Warsh said inflation data "are more concerning" than trends in the job market, where the unemployment rate is low. He also argued that inflation is unlikely to move back to the target on its own.

Warsh noted that in the past year, 54% of goods and services tracked by the government have seen price increases of 3% or higher.

While that is down from the pandemic peak, it is "well above" the 32% that saw such increases in the two decades before the pandemic.

> Inflation cooled in June and July after spiking in May from soaring gas prices, yet it remains above the central bank's target

Inflation cooled in June and July after spiking in May from soaring gas prices, yet it remains above the central bank's target. According to the Fed's preferred measure, it was 3.7% in July.

Warsh also sought to clear up some areas of confusion that arose after his remarks at a July 29 news conference.

He specified that short-term interest rates are the "predominant tool" the Fed can use to lower inflation.

Previous Fed chairs have often used speeches at Jackson Hole to address broad questions about interest-rate policy and the economy, or to signal upcoming changes in their approach.

In 2022, with pandemic-era inflation having soared to 9.1%, Powell signaled the Fed would continue to sharply raise interest rates in a fight against runaway prices, and he acknowledged that such maneuvers would bring "pain" to consumers and businesses.

Wall Street investors now see the potential for a rate hike at the Fed's next meeting Sept. 15-16 as basically a coin flip, according to futures pricing tracked by CME FedWatch, up from previous odds that put the chance of a hike at just one-third.

Trump has continued to defend Warsh

Questions about Warsh's approach have intensified amid President Donald Trump's continued calls for lower interest rates.

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Trump has also renewed his efforts to remove Fed Governor Lisa Cook, who was appointed by former President Joe Biden.

Replacing Cook would enable Trump to appoint a majority of the seven-member board.

Trump tried to fire her last year but was temporarily blocked by the Supreme Court.

Longer-term rates have steadily risen in recent weeks because of a range of factors, including burgeoning U.S. government deficits and outsize borrowing by tech firms building AI infrastructure.

The rate on the 30-year Treasury bond reached the highest level in 19 years last week, prompting an unusual effort by Treasury Secretary Scott Bessent to buy back bonds and push yields lower.