

Dutta's Economic Daily

The mask has come off

Friday, September 18, 2026

Warsh returns to his true form

The mask may have come off this week. Kevin Warsh is more hawkish than most of his colleagues at the FOMC. A few things stood out to me.

Immediately following the release of the press statement and Summary of Economic Projections (SEP), US equity and fixed income markets did not do much. Stocks largely held onto their gains from earlier in the session. As I explained earlier this week, if anything, the movement in the policy rate was somewhat less than one would expect based on a Taylor Rule type framework. During the press conference however, equities were sliding. Warsh was hawkish.

Importantly, while Warsh did a reasonably good job outlining why the Fed hiked, he did not do much to provide an off-ramp. We know this is part of a series of hikes, but we have no insight yet as to what stops it. Normally, I would say the data will tell us when the Fed should stop. However, Warsh made it a point to say that he does not like sort of data-point dependence embodied by Governor Waller. If it takes a series of data points to shift his views, it might take a little longer for a change in tone once he's already hiked.

Earlier this year, Warsh noted that monetary policy was having uneven results: conditions were tight for housing, as an example, but loose for financial markets. Yesterday, no such distinction was really made. The focus was left on financial markets being accommodative. One conclusion to draw from this is that ensuring a return to price stability will require tighter financial conditions. It's an important point considering Warsh's point that the Fed is removing a "dose of accommodation" and that the Fed's "action starts to show we're serious about [price stability]." We're closer to the beginning than the end. For someone against forward guidance, he was giving quite a bit of it.

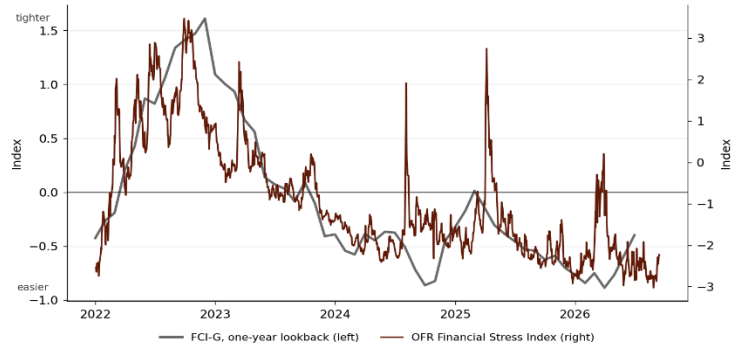
Markets price nearly three more hikes by July 2027

(Jul-2027 fed funds future implied rate less the current target midpoint, in 25bp moves)

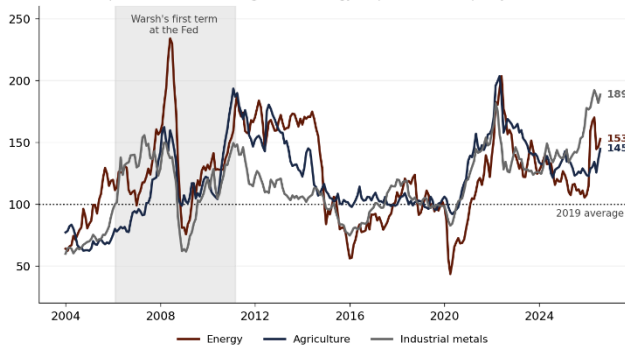


Financial conditions are still a tailwind, not a headwind

(FCI-G one-year lookahead to Jul-2026 (negative = easier); OFR stress index to 15-Sep-2026)

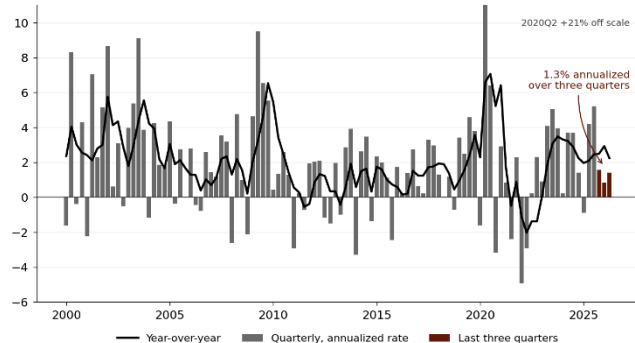


Commodity prices run well above their pre-pandemic average
(S&P GSCI spot indexes, 2019 average = 100; energy is up 38% over the past year)



Next, while some argue that the Fed should not hike in the face of negative supply shocks, Warsh made it a point to highlight commodity prices, noting that they “bear watching.” **Rising commodity prices were one reason why Warsh was hawkish in 2008. He is reverting to his old form.** At any rate, prices for commodities remain lofty, especially for agricultural commodities and energy.

Productivity has run at just 1.3% annualized for three quarters
(Nonfarm business sector, output per hour, SA, percent)

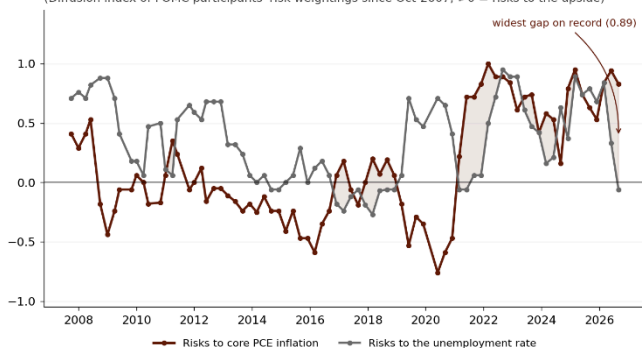


Lastly, I think the statement has been the most obvious example of Warsh leaving his mark on the Fed. The statement is short and often says things that are somewhat misleading. For example, productivity is described as “strong” even though it has been up just one percent SAAR over the last three quarters. This is probably a nod to Warsh’s view on an AI driven productivity boom. But, **one thing the statement notes is a “timelier” return to the Fed’s 2% price stability goal. Interestingly, the SEP, of which Warsh is not a part, doesn’t show that – it’s still another three years away in the SEP.**

In short, I think there are two conclusions to draw from this discussion.

- **Warsh seems more hawkish than his colleagues.** The man allegedly hired by President Trump to cut rates has now done the opposite. More importantly, the sequencing should not be lost on anyone: Warsh was hawkish at Jackson Hole. Waller, the swing voter, was dovish. The Fed hiked in September. Hard to blame a hostile committee with this set-up!
- **Warsh failed to lay out a framework for what would get him to stop hiking.** Near-term data won’t necessarily do it. Focus on the trends instead. Financial market conditions? Too easy by his telling. Warsh has provided very blunt guidance: return to price stability. **Taking all of this together, there is a reasonable chance that Warsh keeps going until something in the economy goes awry.**

Fed's risk tilt from jobs to inflation is the widest on record
(Diffusion index of FOMC participants' risk weightings since Oct-2007; >0 = risks to the upside)

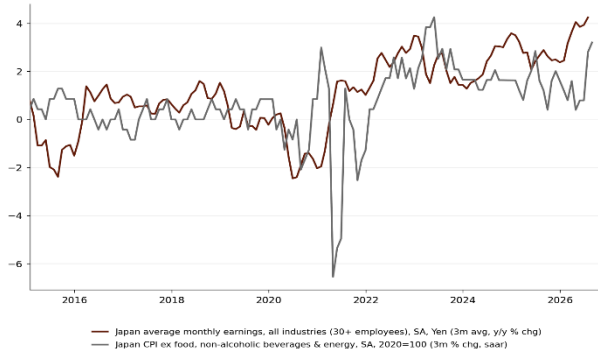


Warsh has been willing to let the labor market slide to achieve the inflation side of the mandate. His actions to date tell me he is willing to do it again.

BoJ has more work to do

- The Bank of Japan raised its benchmark interest rate by 0.25ppt to 1.25 percent. While the BoJ signaled that it is open to further tightening, traders were unimpressed. Despite the hike, the yen has weakened by just over one percentage point to 157.78 against the USD. Indeed, the BoJ risks falling behind its peers in the tightening campaign. Markets have the Fed and ECB priced over 50 percent for a hike next month but see the odds of a hike out of the BoJ at less than one-in-five. This seems odd considering the recent acceleration in core inflation and continued rapid increase in wage growth. The BoJ has more work to do.

Wage growth and core inflation argue for more tightening



Source: Renaissance Macro Research, Haver Analytics

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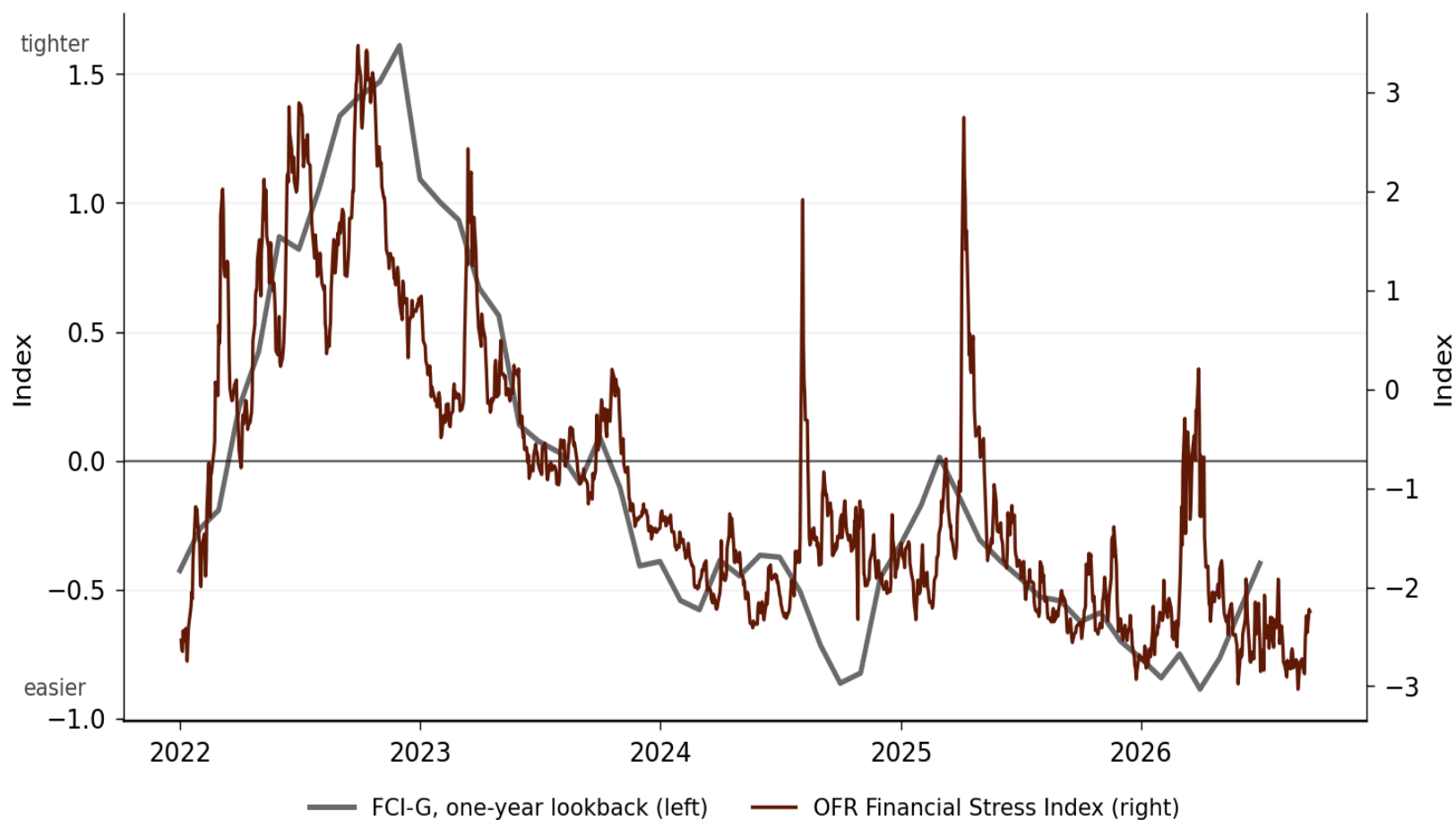
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Source: Renaissance Macro Research, Bloomberg

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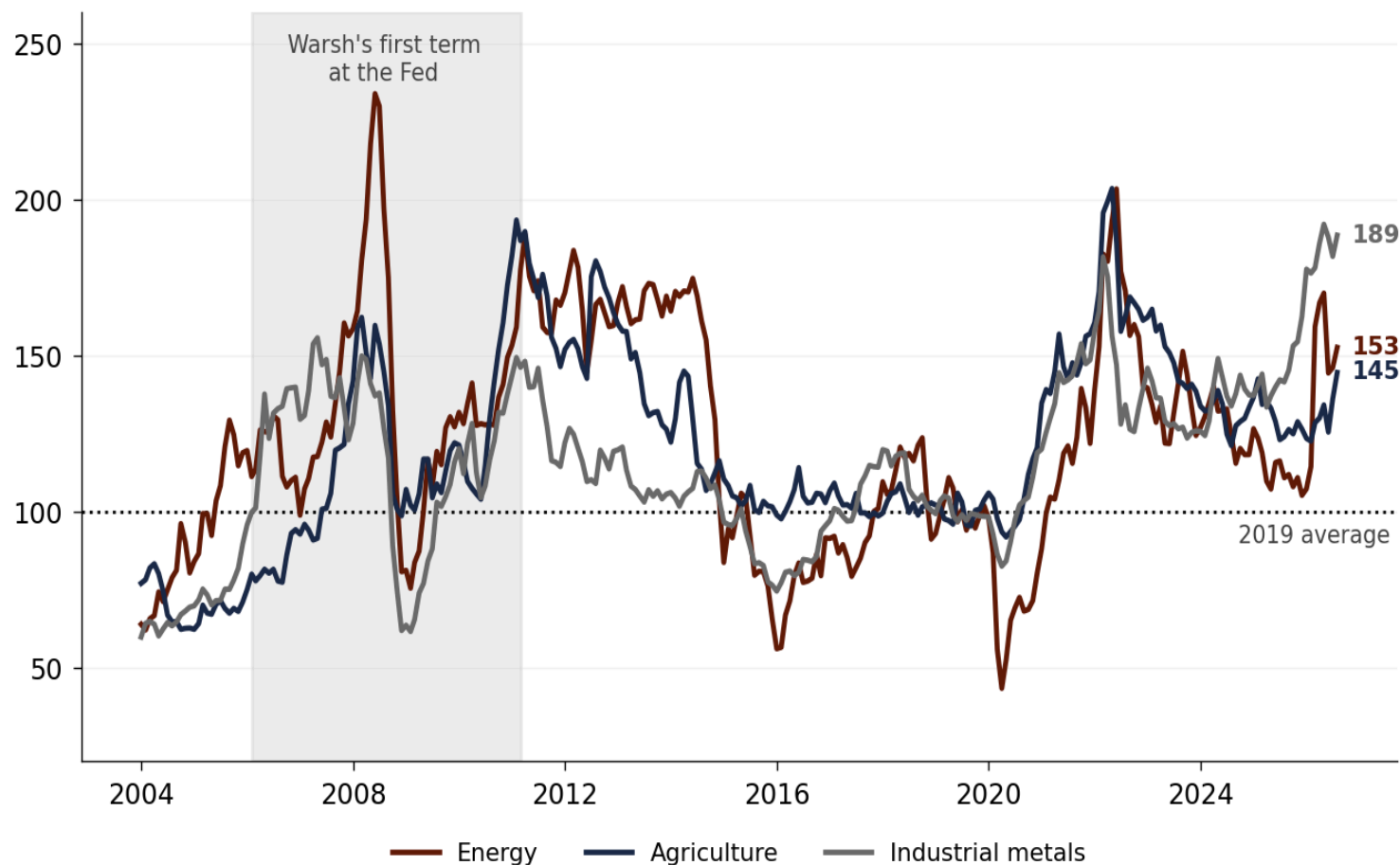
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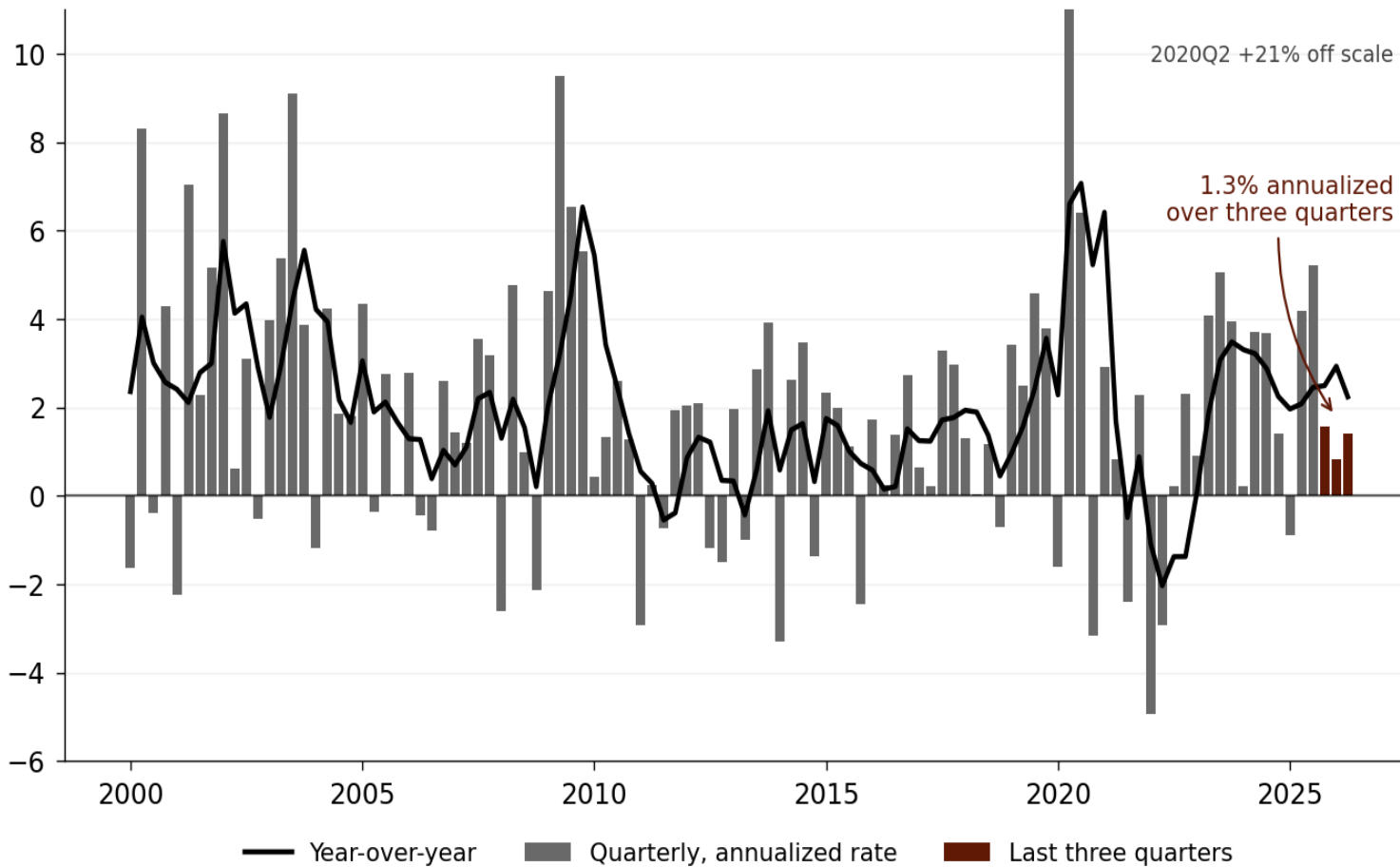
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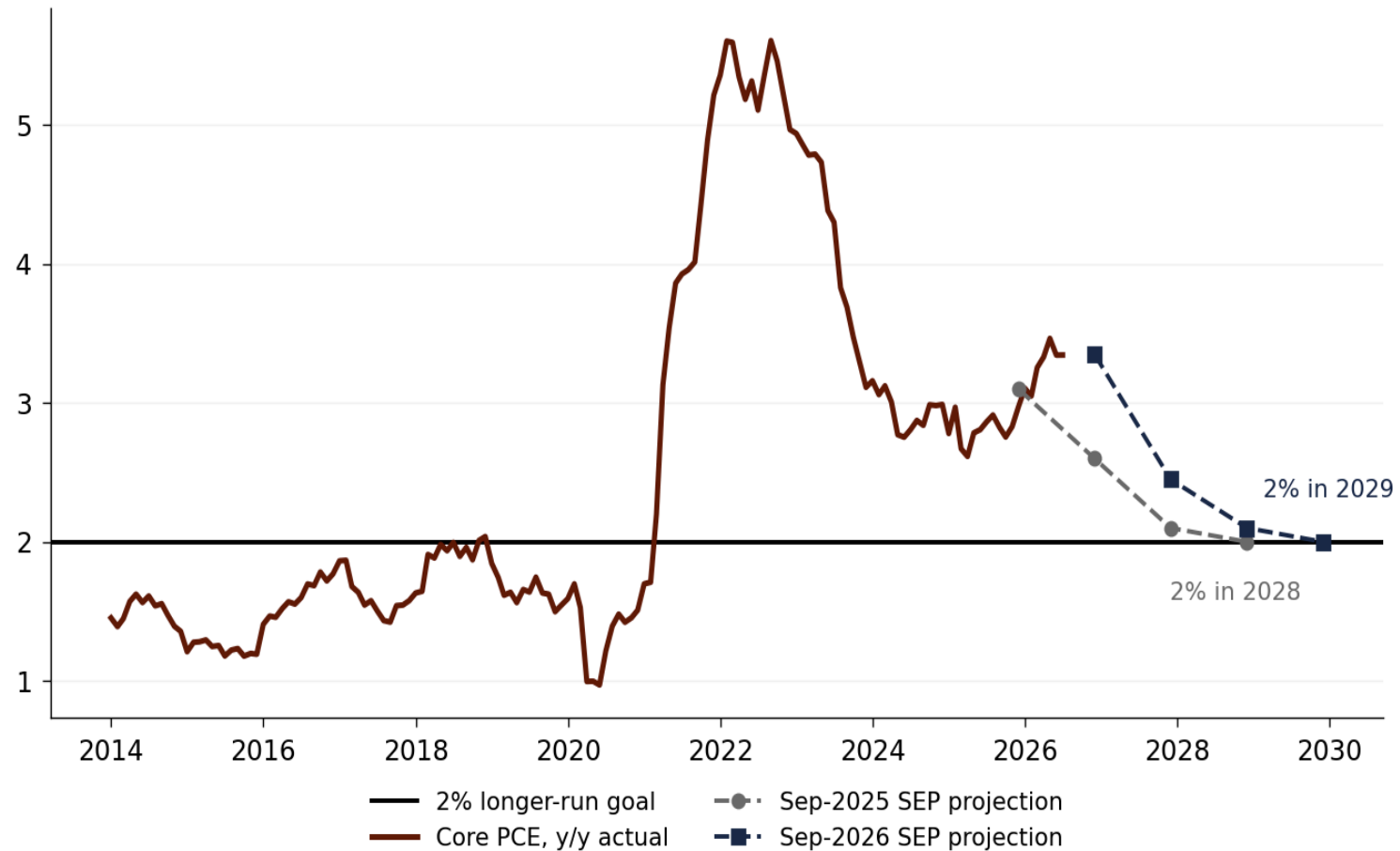
(Nonfarm business sector, output per hour, SA, percent)



Source: Renaissance Macro Research, Haver Analytics

The SEP reaches 2% in 2029, a year later than it did last September

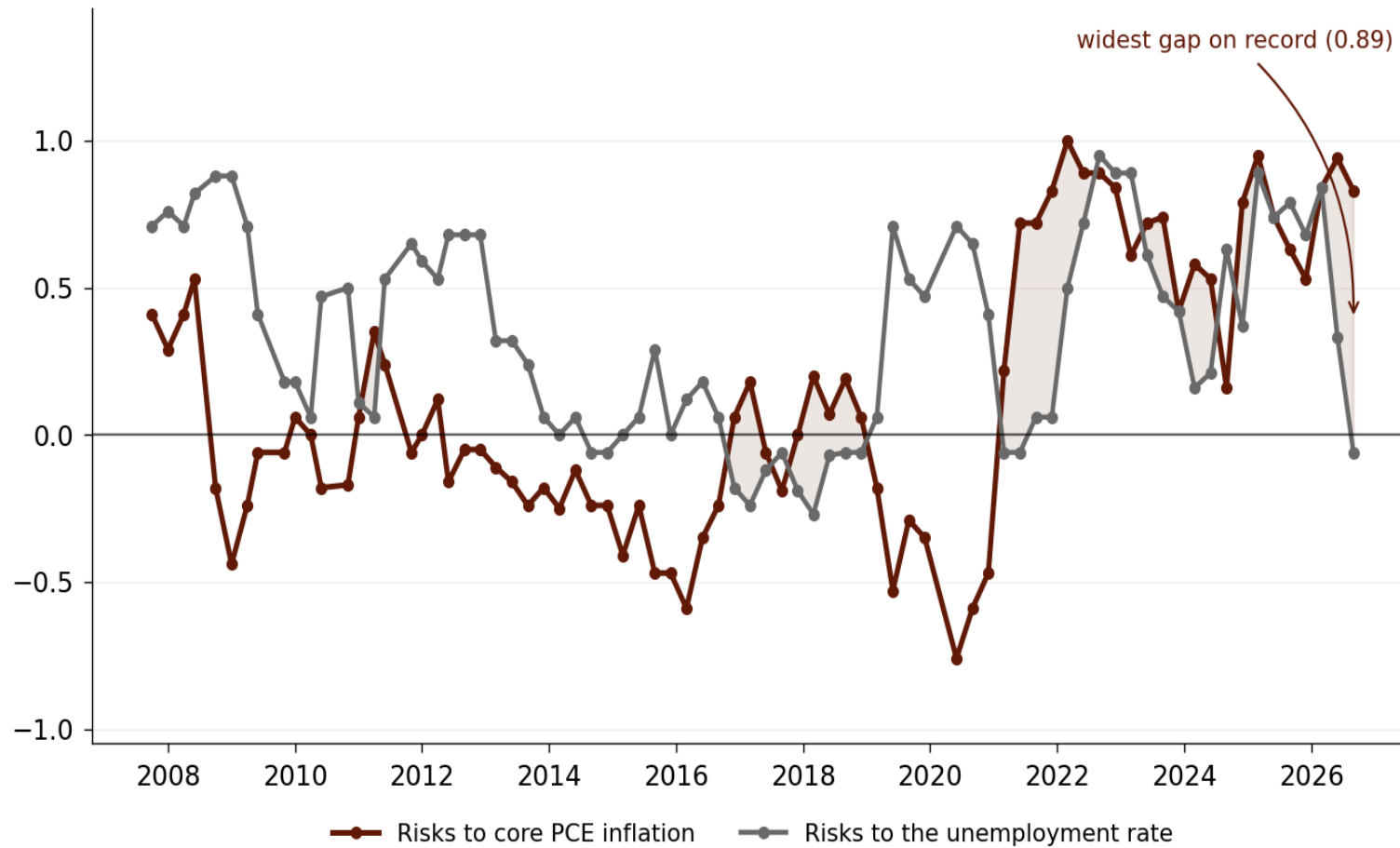
(Core PCE inflation, percent — monthly y/y actual and SEP central-tendency mean (Q4/Q4))



Source: Renaissance Macro Research, Haver Analytics

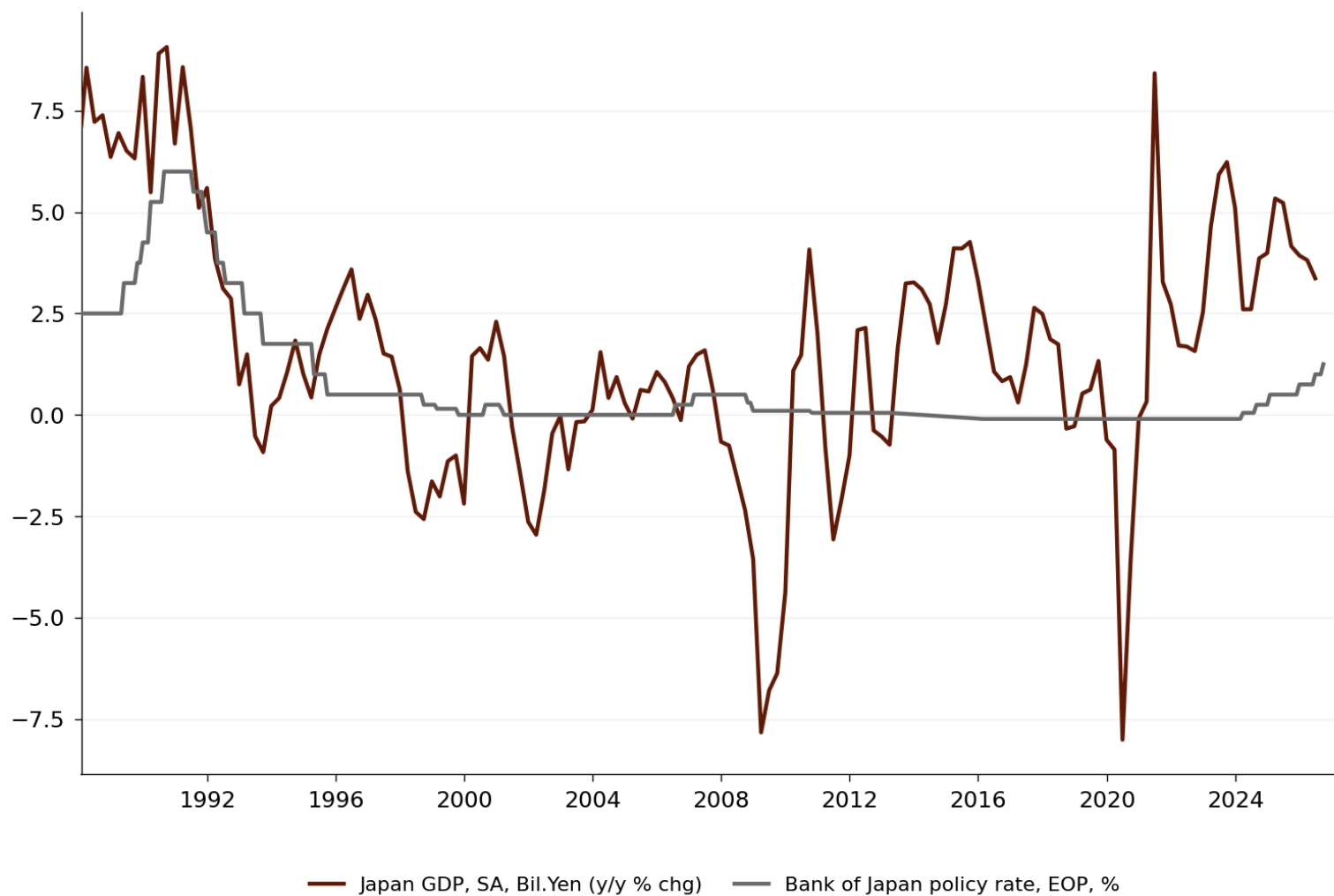
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