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Market Commentary **31 August 2026**

Warsh Reaffirmed Inflation as the Fed's Key Focus

Summary:

- Fed Chair Kevin Warsh explained how he reads the economy and how he intends to conduct monetary policy in his widely anticipated Jackson Hole speech.
- By acknowledging insufficient progress on inflation, Warsh's noticeably hawkish tone caused markets to increase the probability of a Fed rate hike in September.
- Warsh highlighted the importance of money as one of the Fed's key principles, stating that it plays an important role in monetary conditions and prices.

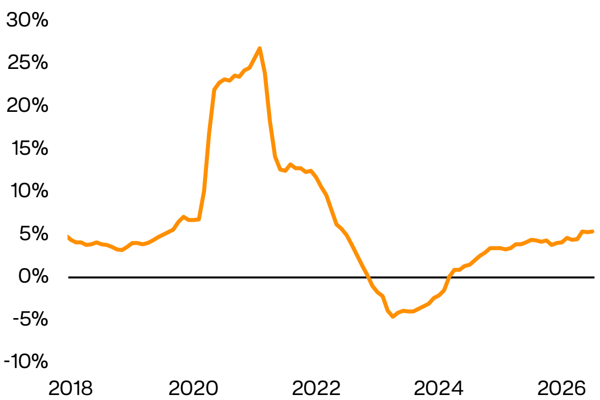
Fed Chair Warsh addressed market concerns by taking a firm stance on inflation. The spotlight of the annual Kansas City Fed Economic Policy Symposium remained firmly on Federal Reserve Chair Kevin Warsh, whose debut keynote outlined his read on the economy as well as his key policy principles. Warsh reiterated the Fed's 2% target as a key policy objective, with an explicit emphasis that recent moderating inflation figures do not yet confirm an improvement in underlying trends. He noted that 54% of goods and services in the PCE basket showed price increases above 3% year-on-year (YoY), well above the pre-pandemic norm of about 32%. Meaning, unless underlying inflation is moving clearly toward target at a sufficient pace, the central bank still has work to do. Furthermore, he argued that financial conditions could hardly be described as restrictive amid resilient economic growth, strong corporate profit margins, tight credit spreads and loosened lending standards.

Warsh outlined seven key policy principles. Warsh presented a list of principles that guide his thinking on the conduct of monetary policy: 1. interrogate reality, focusing on real-time trends over stale or inaccurate data; 2. acknowledge the inherent imprecision in balancing supply and demand; 3. treat the 2% PCE inflation target as a firm, fixed target; 4. not sacrifice maximum employment for price stability; 5. keep short-term interest rates as the predominant tool; 6. money matters; and

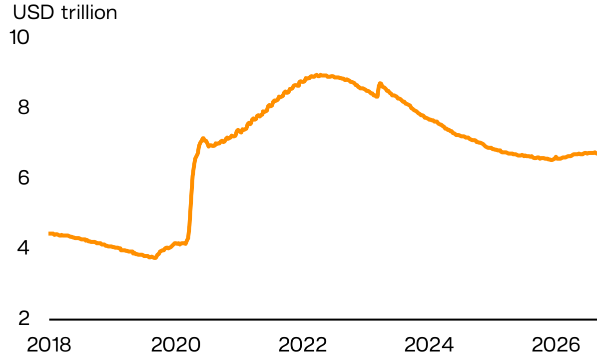
7. a quieter Fed that limits excessive forward guidance.

Markets priced in higher odds of a rate hike in 2026. While Warsh refrained from providing any indication of the future policy trajectory, global financial markets reacted swiftly to his hawkish economic assessment and predominant focus on inflation, driving up expectations of a rate hike at the September meeting, fully pricing in one hike in 2026 which may come as early as September.

Warsh highlighted money as another key pillar of the Fed's guiding principles. He stressed that the Fed needs to maintain focus on money, given its significance to monetary policy. In particular, money created by the central bank and money from the banking and financial systems interact closely with factors such as the monetary base, money velocity, and the broader economy, thereby exerting a meaningful influence on financial conditions and prices. This marks a notable shift for market observers, as money has received relatively little attention in recent Fed communications.



Source: Bloomberg



Source: Bloomberg

A closer look at recent monetary data underscores the scale of the prevailing liquidity conditions. M2 money supply growth recently hit 5.4% YoY in July, marking the fastest pace since June 2022 and signalling a renewed expansion in broad money. Such an acceleration could fuel inflationary pressures. This comes against the backdrop of an unprecedented balance sheet expansion during the pandemic, when the Fed's total assets ballooned from roughly USD 4.2 trillion at the end of 2019 to a peak near USD 9 trillion in 2022. Although a subsequent quantitative tightening program has reduced the Fed's balance sheet to approximately USD 6.7 trillion, total assets remain significantly above pre-pandemic levels, leaving ample liquidity within the financial system. Taken together, with Warsh's long-standing opposition to the Fed's large balance sheet and his renewed emphasis on money as a key principle in monetary policy, these metrics demonstrate that there remains considerable scope for further balance sheet normalisation, helping to bring money creation into closer alignment with the Fed's long-run price stability objective.

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