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Federal Reserve Chairman Kevin Warsh in Washington, D.C. ERIC LEE/ REUTERS

As Warsh's Fed Tries to Say Less, Investors Are Listening Harder

BY SAM GOLDFARB

Federal Reserve Chairman Kevin Warsh wants to talk less about monetary policy so markets can respond independently to economic data. Many investors, though, think he's already said plenty.

At his first Fed meeting as chairman last month, Warsh shortened the Fed's policy statement, declined to submit an interest-rate forecast and deflected questions on economic and policy matters to newly established task forces. But he still communicated a tougher line on inflation than previously assumed. Bond yields climbed. Stocks slid.

On Wednesday, Warsh again wouldn't say whether the central bank needed to consider a rate increase this month. He did say inflation risks have receded, evidence markets have grasped his hard line on prices. Stocks were up slightly and bond yields lowered.

Even if Warsh talks less than some of his predecessors, his words could still have just as much impact, said Alex Obaza, a fixed-income portfolio manager at T. Rowe Price.

"If he comes out in a press conference and he mentions price stability a lot more than economic growth, and he says that he doesn't see policy being restrictive anywhere besides housing, he probably has a pretty good idea how the market's going to react," he said.

Getting a read on the new Fed chairman is just one of the challenges confronting investors. Although indexes remain at or near records, weakness in tech stocks pulled the Nasdaq composite down 4.6% last week. Questions remain about the durability of a recent drop in oil prices, with tanker traffic through the Strait of Hormuz still below prewar levels.

But the Fed's approach to communications is no small matter for markets. Expectations for where the central bank will set short-term rates in the future influence the yields of U.S. government bonds—which determine mortgage rates and other borrowing costs.

Warsh has said the Fed should say less for more than a decade, and he reiterated that view at his recent postmeeting press conference. Markets, he said, “are probably the most important source of information to guide central bankers” but work best when they are reacting to incoming economic data rather than asking how the Fed will react to that data.

Like-minded analysts sometimes point to 2021, when then-Fed chair Jerome Powell described a surge in inflation as “transitory.” Some contend that numbed investors to the threat, keeping yields and borrowing costs lower than they should have been. Yields only jumped the following year when the Fed pivoted and started raising rates aggressively.

Still, markets have hardly treated Fed guidance as written in stone. Bond yields in recent years have often climbed or dropped sharply in response to jobs or inflation reports, reflecting bets on how that data would change future Fed guidance.

Looking past Warsh's first press conference, some investors remain nervous about the prospect of a quieter Fed, arguing that more uncertainty could lead to a more volatile market.

No matter what, they say, there will always be intense interest in what the Fed is thinking. Before the 2000s, when the Fed communicated much less about the potential path of rates, investors resorted to extreme measures such as assessing the size of Alan Greenspan's briefcase when he entered meetings. A bigger briefcase was seen as a sign that Greenspan was marshaling evidence for raising rates.

The result of “communicating less is not that the market is going to give you better information, it's that the market will be a lot more jumpy,” said Ed Al-Hussainy, a fixed-income portfolio manager at Columbia Threadneedle Investments.

Hanging over Warsh's early actions as Fed chairman are the unusual circumstances surrounding his appointment. Previously a Fed governor under Chairman Ben Bernanke, Warsh was nominated by President Trump in January while he was engaged in an unprecedented pressure campaign to get the Fed to lower rates.

Some analysts have posited that Warsh may be trying to highlight changes to the way the Fed does business in part as a way to deflect political pressure while elevated inflation keeps him from pushing for the rate cuts that Trump has demanded. Others have noted that carefully crafted comments that drive up Treasury yields could be a way to lift borrowing costs without taking the politically risky step of raising short-term rates in the near term.

Still, Treasury yields have fallen in recent days alongside the drop in oil prices. And analysts are still debating how to interpret Warsh, much as they did with previous Fed leaders. Some didn't see his comments on inflation at his first press conference as particularly meaningful, arguing that they need to hear or see more to judge his intentions.

Unless backed up by actions, the Fed's messages can become “just words,” said Blake Gwinn, head of U.S. rates strategy at RBC Capital Markets. “It's like a politician being like, ‘I will get this budget under control and reduce the deficit’ ” and then proposing “a \$3 trillion spending package that's not financed.”

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