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Monthly consumer price information will be released Wednesday. A grocery in North Carolina. ALLISON JOYCE/ BLOOMBERG NEWS



# Inflation Reports Pose Test For New Fed Chair

### Monthly readings take on outsize import after Warsh's tough talk on prices

BY NICK TIMIRAOS

Federal Reserve Chairman Kevin Warsh envisions a central bank whose interest-rate decisions don't hinge on the latest monthly data. That vision might have to wait.

Two inflation reports over the next month are set to shape whether his colleagues push to raise rates in September or extend their pause.

CPI

A cool number in Wednesday's release of the July consumer- price index would relieve pressure on both Warsh personally and a policy committee weighing whether it has misread the U.S. economy. A firm one could force him to demonstrate with action what he struggled last month to convey in words.

The consumer-price index feeds into the Fed's preferred inflation gauge, to be published later this month. Economists expect core consumer prices, which exclude food and energy, to have risen 0.2% in July. Monthly readings at or below that level would be consistent with inflation returning to the Fed's 2% goal. Anything higher would not. Core inflation in the preferred gauge was 3.3% in June, up from 2.8% a year earlier.

The monthly readings have taken on outsize importance for two reasons.

First, several officials, in forecasts released in June and speeches since, have said they expect inflation will return to their 2% goal without tighter policy. They thought tariffs would raise prices once and fade, and energy would follow crude oil lower as Middle East hostilities quieted.

Instead, the shocks have persisted and overlapped with a newer one, a surge in prices for technology equipment and software tied to the artificialintelligence build-out. The coming reports will show whether these officials can still defend their forecasts.

Second, Warsh has made getting inflation down his signature theme, and that has left him with expectations to meet. The Fed held rates steady last month as broadly expected, but investors reacted with doubts when Warsh didn't explain the decision.

Asked whether higher rates were the remedy if inflation didn't come down, Warsh said they could be part of, but maybe not primarily, the solution. He suggested rising bond yields had done some of the Fed's work and hinted at redefining the Fed's inflation objective. That left investors unsure whether Warsh was willing to fight inflation with more than talk.

Analysts said the Fed had good reasons to hold steady even if Warsh didn't state them. Labor costs have been growing slowly relative to productivity, making a broad price breakout less likely. Tariff-related contributions appear to be fading. And methodological changes should revise down core inflation in the Fed's preferred gauge in September.

The 30-year Treasury yield rose while Warsh spoke and hasn't come back down, which can reflect doubts about whether the central bank will act to bring inflation down if necessary. That kind of move is unusual around a policy meeting, said James Egelhof, chief U.S. economist at BNP Paribas, and suggested "something more fundamental is afoot related to the market's perception of" the Warsh Fed.

Speaking in gauzy principles rather than specifics could leave Warsh facing more pressure to prove he will act, said Paul McCulley, former chief economist at Pimco. "He's done it with such bombast that actually, practically speaking, he has limited his options," he said.

Ten of 19 officials who participated in July's policy meeting, including half of all 12 voters, spoke publicly in the days after the meeting, supplying reasoning that Warsh hadn't. At least six of the voters have signaled in recent weeks they could eventually support raising rates if inflation doesn't improve. Three of them dissented last month in favor of raising rates.

Warsh's comments raised doubts among some observers over his motives: whether he is playing down the need for rate increases because he believes tough talk can delay action, or because he wants to avoid a confrontation with President Trump, who appointed him and has demanded the Fed keep rates low. Those who know him have said he would reject both explanations.

People sympathetic to Warsh acknowledge the confusion created by the news conference might need to be addressed, perhaps when he speaks later this month at the Kansas City Fed's annual conference in Jackson Hole, Wyo. Some said the reaction has been overblown, noting that market-based measures of expected inflation are little changed.

Note

"The market reaction isn't telling as dire a story as the market commentators are," said Donald Kohn, a former Fed vice chairman. "But you don't want to go into that press conference and get the result you got: long-term rates up, short-term rates down."

The calm might also be misleading. July's setback is surmountable because it was the first. If investors expect a move in September and don't get one, there is nothing to stop the Treasury market from repeating what it did last month.

Warsh came to the Fed intending to change how it communicates. He believes telling markets what factors and conditions would prompt action can tie the central bank's hands and cloud a useful sig-nal: what investors think the economy requires. Less guidance, in his view, delivers a cleaner read.

Note

That approach has a cost, Kohn said. "If you don't articulate what you're thinking about and how you're thinking about it, then how will you know when your thoughts are not being validated?"

If the July and August inflation reports are firm, Warsh could face a choice between raising rates or staying on hold while absorbing a fourth or fifth dissent. If the Fed holds, the doubts that surfaced in July would be harder to dispel.

Mild readings would spare him all of that. The hawks would have less of a case to press. And Warsh could use Jackson Hole to lay out his thinking on his own terms rather than under pressure from recent data.

The importance placed on two monthly reports is an uncomfortable spot for a chairman who has argued against letting individual releases drive policy.

"The historic problem with data dependence is the data and the dependence," he said last month. Reports draw this much attention precisely when they could confirm the existing trend, or signal a new one.

The Fed has often put off a move without much consequence because timing matters less when investors understand what it is doing and why. But that protection might not be there when investors can't get a read on the new chair.

The Fed's next meeting after September falls days before the midterm elections, a moment when officials might be reluctant to make a first rate increase. That effectively pushes a deferred decision to December, meaning four more months resting on an inflation forecast Warsh's colleagues are already struggling to defend.