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More (Johnny) Cash?

I'm Going to Jackson, I'm (Not) Gonna Mess Around...

Hotta than a pepper sprout it was not. Kevin Warsh's low-key Jackson Hole speech offered little fresh guidance on the Fed's intentions, which makes the sell-off in gold look overdone. Still, Chair Warsh did reinforce several points:

> - Fed funds remain the key policy lever
> - Money matters as a gauge of monetary policy
> - The Fed's balance sheet is best used in crisis situations, not outside
> - Inflation on most measures lies consistently above its 2% target

The central issue is not whether Jackson Hole changed the policy outlook, but whether Fed and Treasury actions continue to blur the line between monetary policy and fiscal financing. That distinction matters for both bond-market stability and monetary inflation hedges, like gold and Bitcoin.

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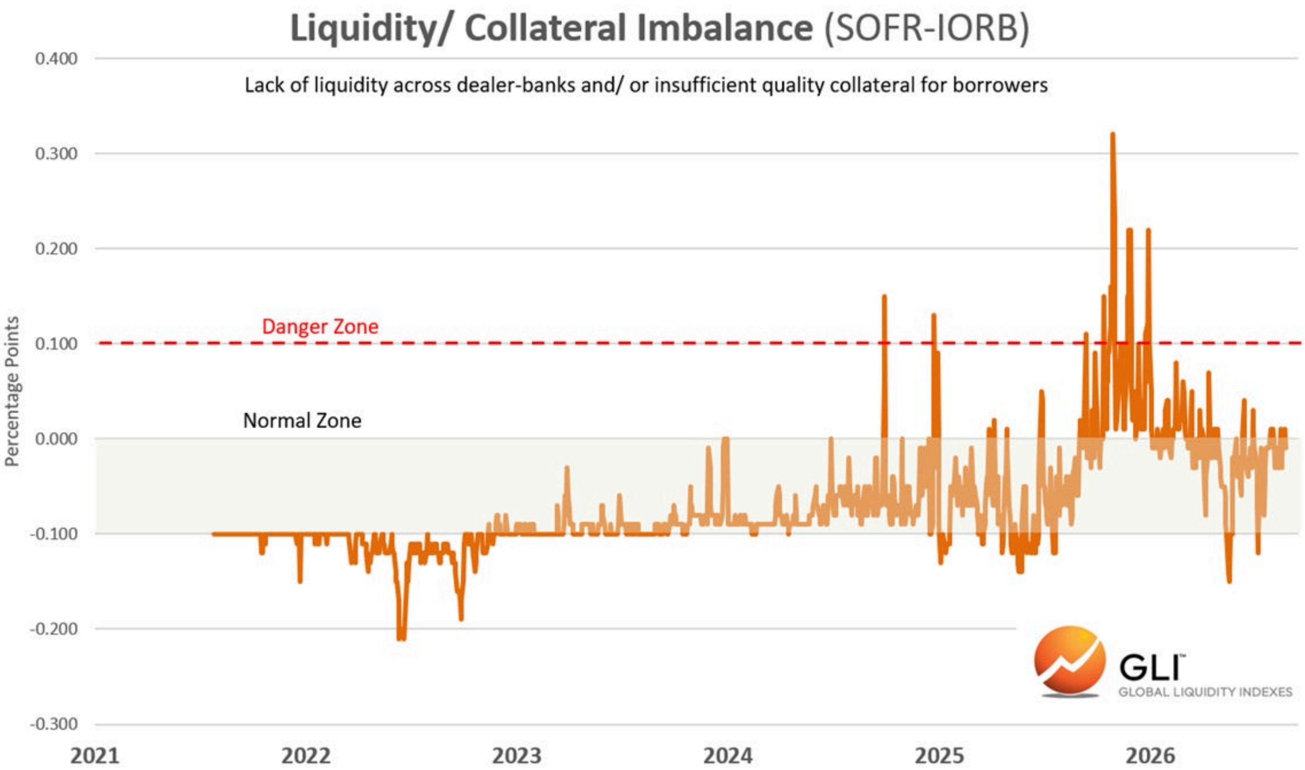
The more important policy message is not what Chair Warsh said at Jackson Hole, but what was left unsaid, namely that current Fed and Treasury behaviour is still being shaped around liquidity management, deficit funding and the avoidance of a disorderly bond-market adjustment. The Fed Chair did not address the concern voiced by many, but recently articulated by veteran investor Stanley Druckenmiller in a WSJ opinion piece:

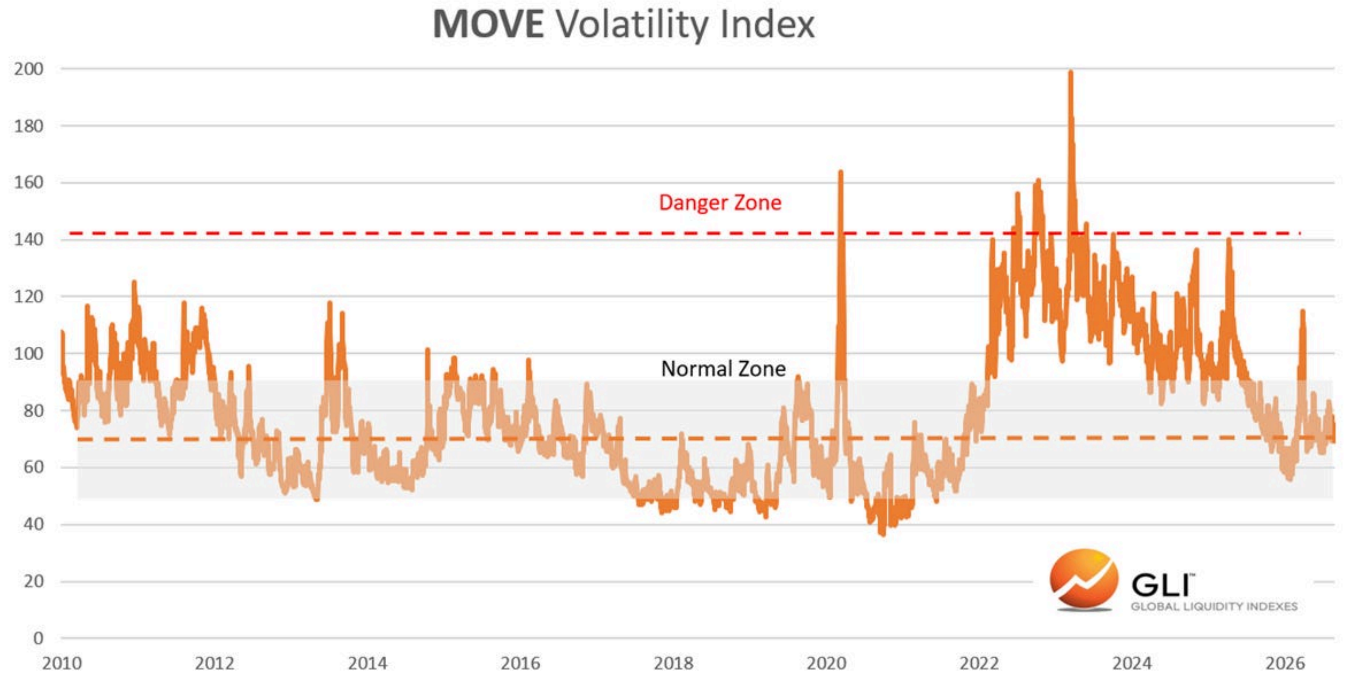
"If markets are demanding higher yields because US fiscal fundamentals are deteriorating, policymakers should fix the fundamentals rather than manipulate the price that is revealing the problem."

Put bluntly, the Fed must avoid becoming fiscally dominated by the Treasury, while politicians must reduce the swelling deficit.

However, neither outcome looks likely, and both are probably outside the Fed's direct control. We have long characterised US policy as a progressive shift from 'Fed QE' to 'Treasury QE'. In practice, this means financing directed fiscal spending in the real economy through Treasury bills and short-dated notes sold to the private sector and banks, rather than through another expansion of the Fed's balance sheet. This is not 'financial repression': it is 'monetary accommodation'.

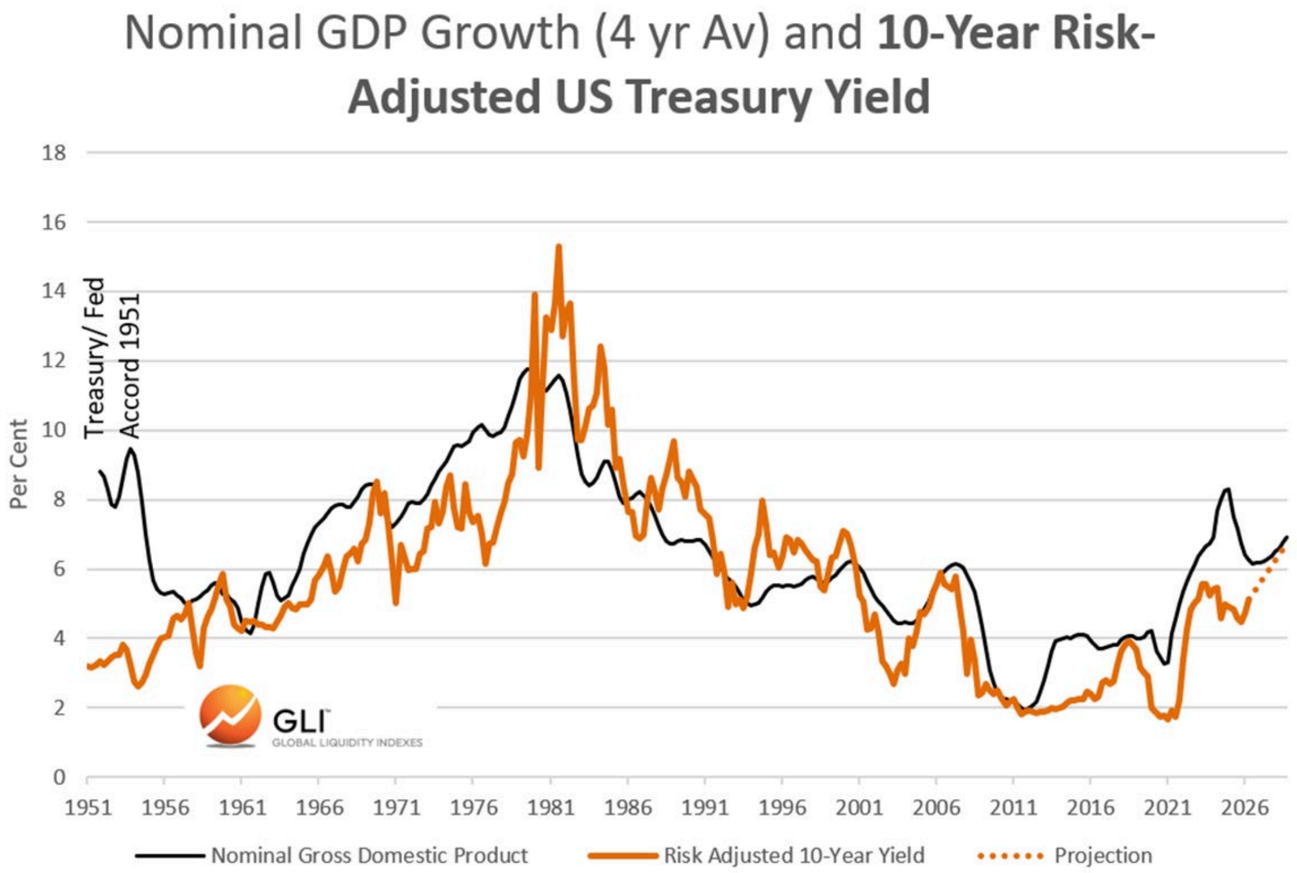
The Fed's practical job is to maintain an orderly bond market and ensure that banks and money markets have sufficient liquidity. We monitor that task through two indicators: **SOFR spreads**, which show stress in short-term funding markets and bank liquidity levels; and the **MOVE index**, which captures Treasury volatility and the prospective elasticity of the financial system. Both are currently within their 'normal' ranges and look benign.





In fact, recent Fed and Treasury actions appear focused on avoiding exactly these pressures. Chair Warsh's last post-FOMC speech emphasised the need for adequate bank liquidity, while Treasury Secretary Bessent has increased the buyback programme to improve bond-market functioning and lower volatility. Markets largely ignored the first signal and badly misread the second, helped along by lazy press commentary.

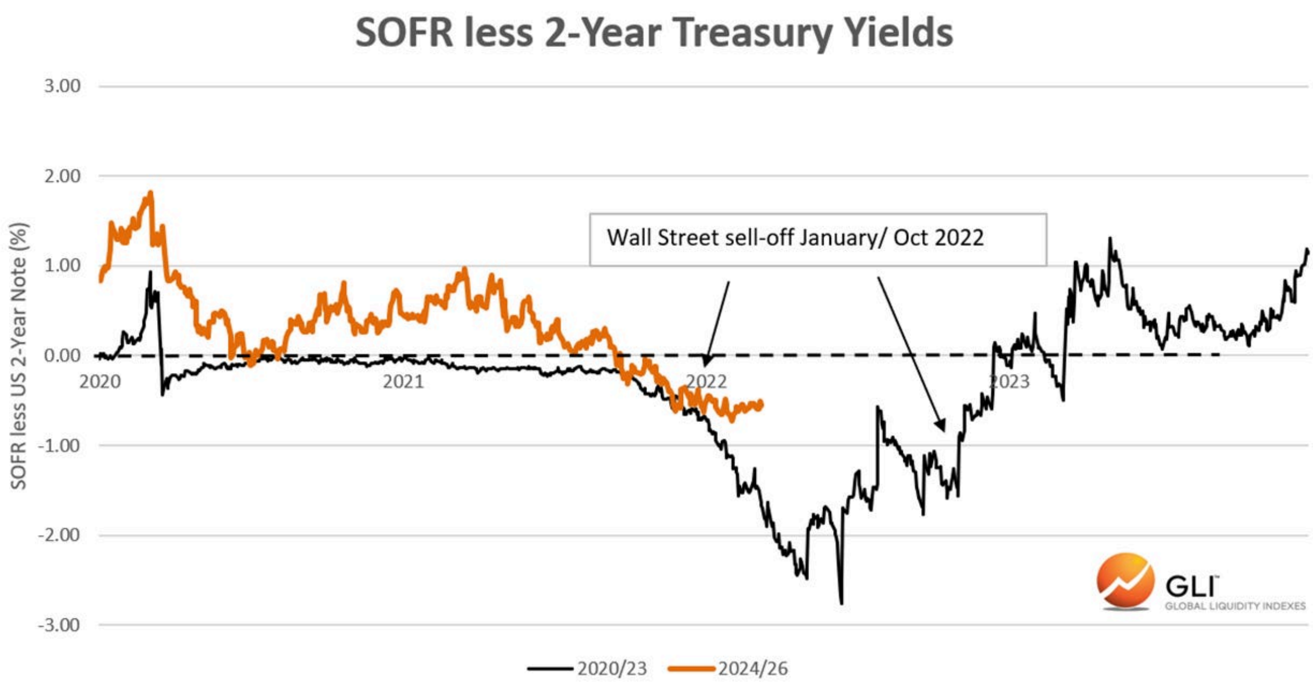
Refreshingly, Chair Warsh accepts that the Fed is neither an oracle nor all-powerful. Yet, the plain fact is that the policy environment is lagging the bond markets in adjusting to the reality of faster nominal growth. Whether or not the long-term goal is nominal growth of 4-5% per annum, the reality is that US NGDP growth is currently running at a 6-8% annual clip. It looks more than a blip: the latest odds from *nowcast* studies is that NGDP growth remains around this pace. This represents the fastest nominal growth rate since the mid-1980s, when 10-year Treasuries yielded around 8%. Consider the chart below.



Looking ahead, we expect a continuation of the 'Treasury QE' policy. This means that NGDP growth will be underpinned and there will be greater bill issuance. Bills make up just over 22% of outstanding US public debt, but investors should expect this proportion to test 30%, similar to its share two decades ago. The attraction of bills as a funding mechanism is that banks are natural and keen buyers because the low duration of bills closely matches their liabilities. However, this comes at the cost of potentially bigger increases in bank balance sheets and hence faster monetary growth. This 'monetization' should help propel gold higher. Hence, it could be worthwhile buying any dips.

This fact may ultimately justify Chair Warsh's comments that money matters in monetary policy. In other words, we suspect US policy makers will continue 'Treasury QE' until rapid monetary growth poses a problem.

The bottom line is that Jackson Hole really told us little that we did not know before. That is the reality of no 'forward guidance'. Yet, it does underscore the view we presented after the last FOMC that **the Fed is following a softer tightening path than the 2021-22 squeeze.** This is demonstrated by the following chart of the sensitive SOFR (repo) less 2-year Treasury note yield. Note the track of the current tightening cycle in orange. It does not rule out a token interest rate increase at the upcoming September FOMC (markets largely already acknowledge this), but with the Treasury market looking fragile and the mid-terms approaching fast, the message is that Chair Warsh is trying hard not to rock the boat.



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