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Steno Signals

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Steno Research

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Warsh versus Bessent

Warsh was not the productivity dove I had hoped for, and the market now treats a September hike as the base case (everyone suddenly thinks the man who refuses to do forward guidance just forward-guided a hike… lol). But run the language through a quant lens, and he did NOT set a new hawkish peak. The repricing was the LACK of dovishness after soft CPIs, not added hawkishness. Herein: why the PCE-CPI spread has only one historical parallel (1983) and only one direction from here, the disinflation pipeline running into Q1, why any hiking cycle will be SHORT-lived… and why Warsh just forced Bessent to press the buyback button harder. I think 10bn per operation is coming.

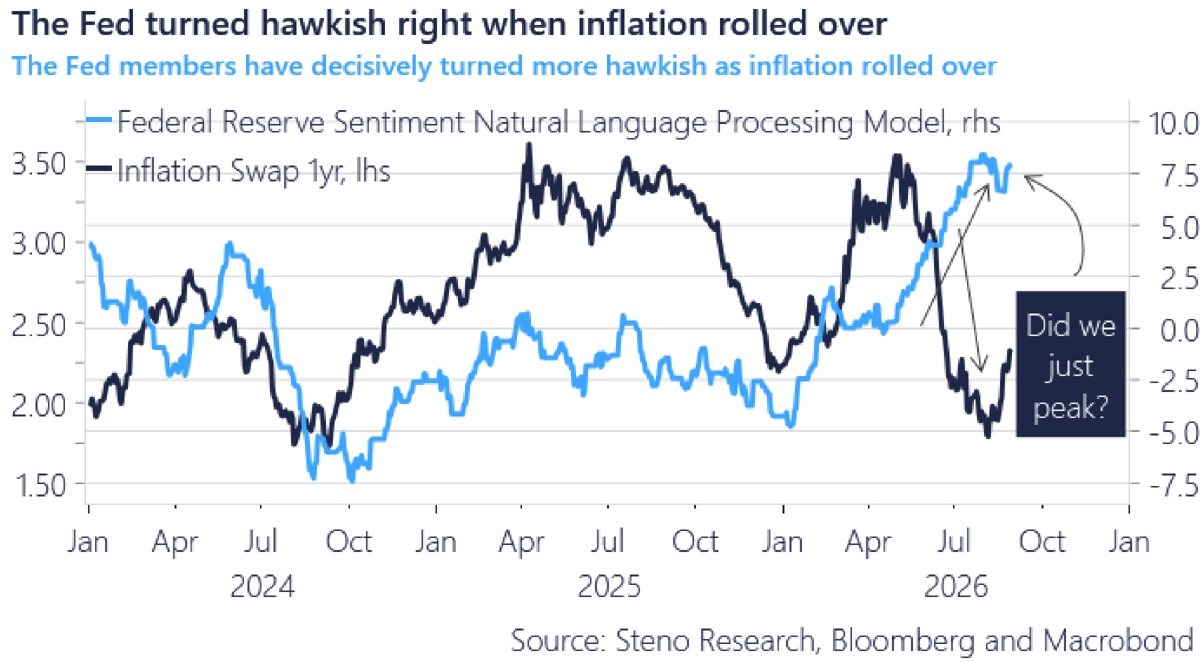
Happy Monday, and welcome back to my editorial on everything macroeconomic!

The verdict from Wyoming is in: Warsh was NOT a productivity dove. That much is for sure. My friend Dario Perkins at TS Lombard put it better than I could: in July, Warsh kind of hinted that we were waiting for a new inflation measure. He took that off the table (for now) by being strict about the PCE… probably to satisfy the committee, and THAT is what the market takes as hawkish. Warsh famously does not give forward guidance, but if he did, he would have just signaled a September hike. I have to agree with Dario, even if I think we may be overreading it. My best guess remains that Warsh is simply trying to buy himself time until the committees and task forces are done… and being strict on the old yardstick is the cheapest way to keep the hawks quiet while the new yardstick gets built.

Because here is what the headlines missed: after having run the numbers (assessing the language of the speech in a quant setting), he did NOT set a new hawkish peak. Our NLP model on Fed communication puts the speech BELOW the July highs in hawkishness. So, the repricing on Friday looks a little off to me... even if there is admittedly a bit of "cry wolf" risk building around his continued firmness on inflation (firmer on the PCE this time) if the committee does not eventually follow suit with a hike. What really struck me was the LACK of a slight dovish re-adjustment given the softness in the CPI over the summer... and maybe that is where the true repricing came from.

Not Warsh becoming more hawkish, but Warsh refusing to become less hawkish after a couple of soft CPI reports. The answer to that riddle rests with the PCE-CPI spread, which sits at (almost) ALL TIME wide levels in core terms... and which obviously will not last. More on that below.

Chart 1: Warsh did NOT set a new hawkish peak... the quant read of the speech sits below the July highs



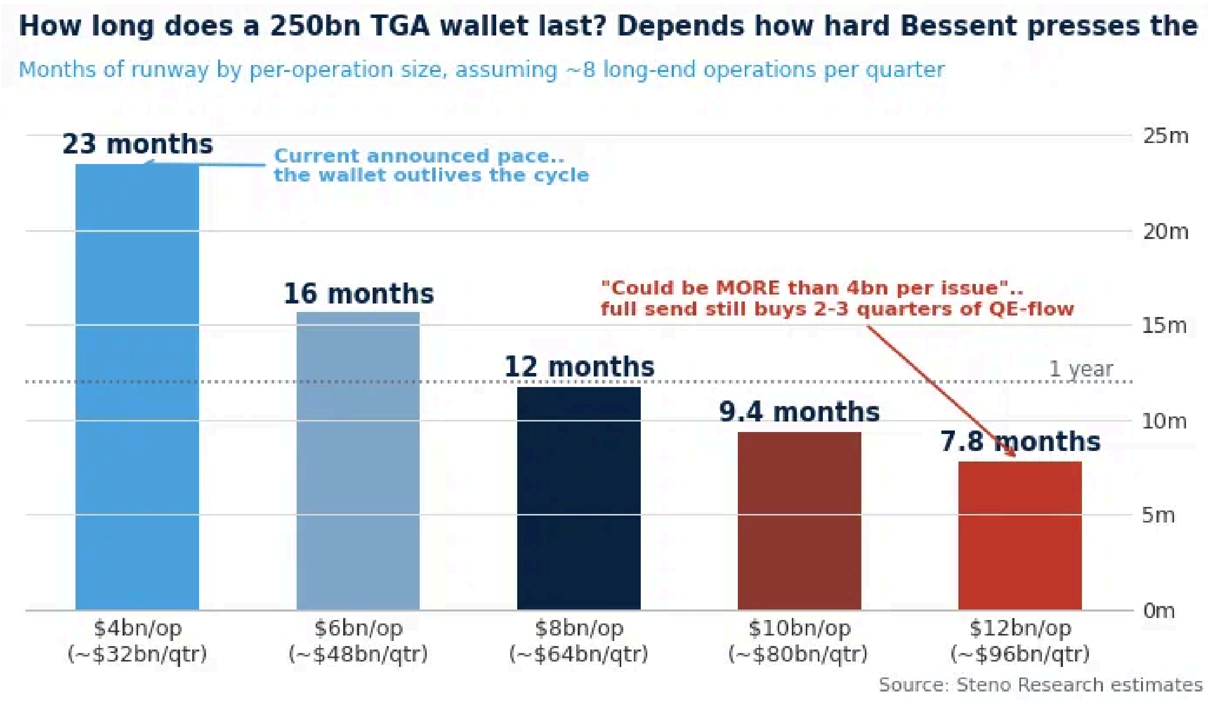
The fun thing is that Warsh versus Bessent is now a REAL issue.

One could argue that being hawkish brings long bond yields down, so it is not crystal clear that Warsh makes Bessent's life worse... but from a LIQUIDITY standpoint, he absolutely does, and it means Bessent needs to buy back MORE at the first opportunity next week.

Bessent has stated "at least 4bn" per operation; the officials hinted last week that the TGA is potentially in play as the funding source, and there is PLENTY of firepower to go well above the stated minimum.

Would it not be fun if Bessent showed up and bought, say, 10bn worth of long bonds in a single operation? I actually think he will do it. Run the wallet math below, and you will see why he can afford to: even at 10bn per op, a 250bn TGA drawdown funds the program for the better part of a year, and at the announced pace it outlives the cycle entirely. And do not forget the one part of the Trump mandate that Warsh IS very explicitly delivering on: communicating that the market should trade everything BUT the Fed.

Chart 2: The TGA wallet math... even a 10bn-per-operation Bessent runs for the better part of a year



Not sure it will be an easy task, but he tries every single time, and Trump has been vocal about the same thing: Good data should be good news for equities, rather than “good data = rate hikes = sell everything”. If they pull that off, the Bessent liquidity machine becomes the market’s central bank in practice. Maybe we should all just trade Bessent’s buybacks instead.

Now to the riddle from above, because this is the analytical heart of the whole Warsh-versus-reality debate.

It is INCREDIBLY rare that the PCE runs this hot versus the CPI... we actually only have a couple of observations in history, and typically the PCE has been the LOW one of the two on average.

Outside of the landslide disinflation of 1983 (where the CPI simply dropped faster than the PCE on the way down), there are NO similar observations to the current setup. And notice what the 1983 parallel tells you: the spread blew out because inflation was COLLAPSING, not because it was re-accelerating. It solidifies the point I have been making for weeks now: the CPI is the directional guide. End of discussion.

The PCE will come down. So sure, hiking here looks decent from a backward-looking perspective. The Fed’s preferred gauge says 3.7% and Warsh recited it dutifully, but I doubt the cleverness of it given the observations above — and given that our own nowcasts are trending MUCH closer to the CPI than the PCE (actually a touch BELOW the CPI currently).

Warsh is anchoring policy to the one index that history says is about to fold.

And the disinflation pipeline into the PCE-folding is loaded. Start with energy: there is plenty of oil and energy disinflation to come in YoY terms on current prices alone, running all the way into 2027 mechanically. The base effects do the work even if spot goes nowhere.

Chart 3: The PCE-CPI spread has (almost) never been this wide... and the only parallel is the 1983 DISINFLATION landslide

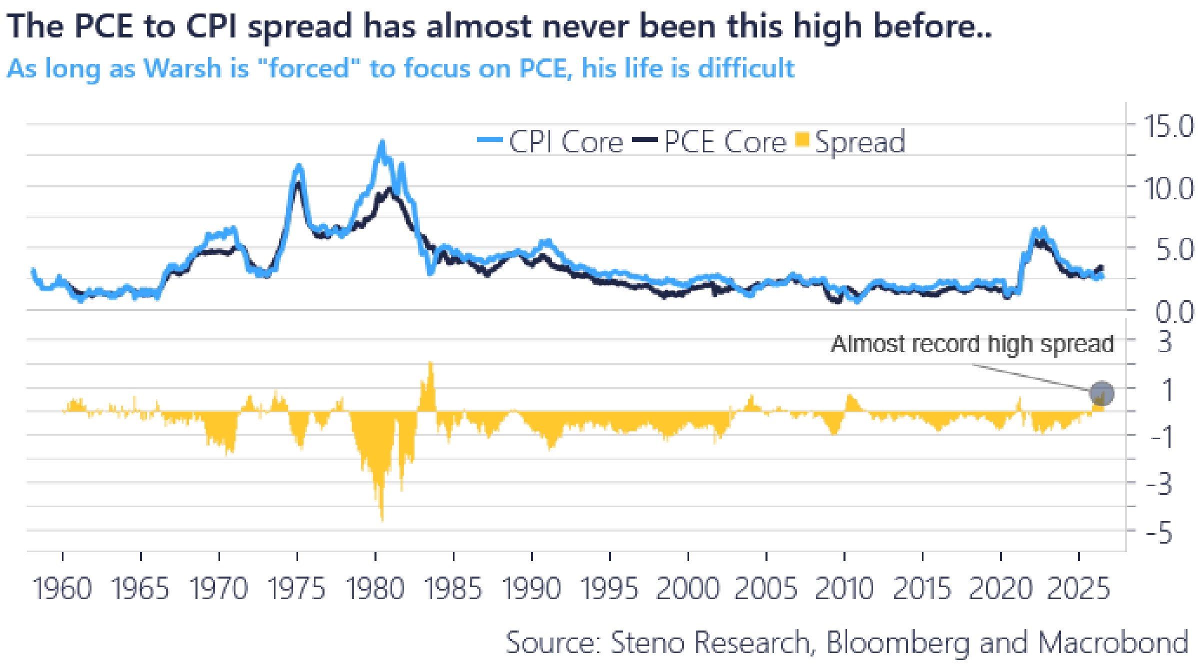
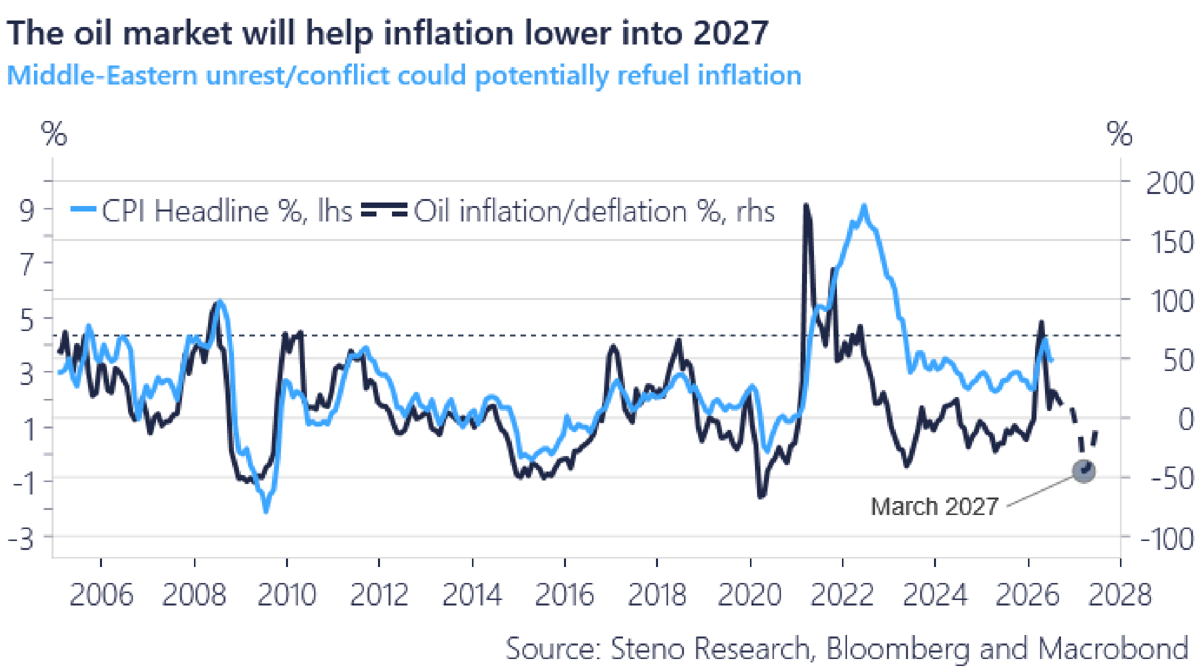


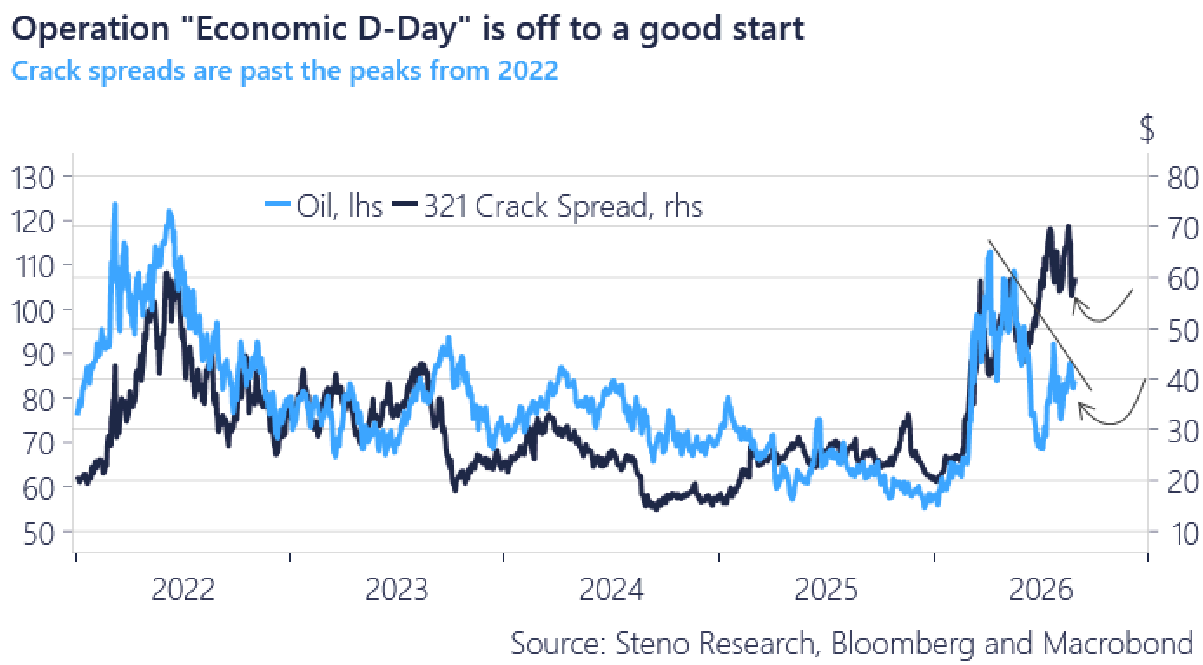
Chart 4: The oil market helps inflation lower into 2027... on CURRENT prices, no heroics required



And even MORE energy disinflation can be unlocked from a products deal in the strait — and, for that matter, from a potential ramp-up of refining in Russia, which is running low due to the continued Ukrainian strikes on those facilities.

That combination is what makes diesel the “scarce” product globally right now: the cracks are elevated not because crude is scarce, but because REFINING is. Two diplomatic outcomes: A Hormuz products deal, or a Ukraine arrangement that lets Russian refining recover. Each would release a wave of product disinflation, and the administration is actively working on both. We remain short the crack spreads.

Chart 5: Operation “Economic D-Day” is off to a good start… and the crack spreads are where the unlockable disinflation lives

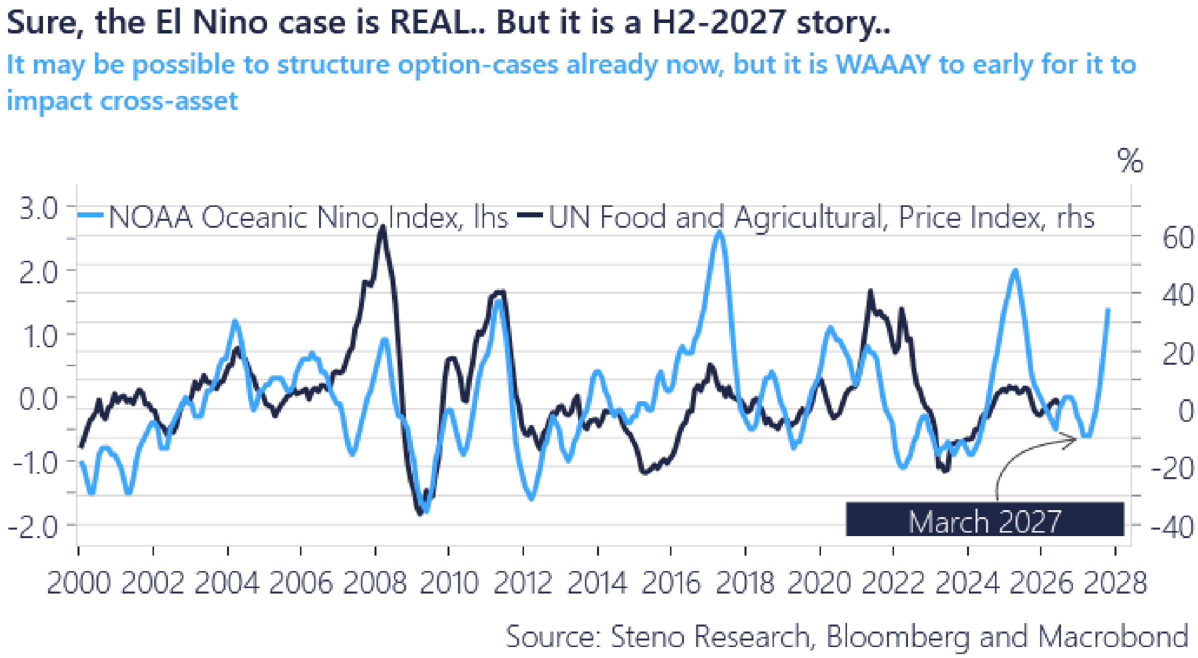


Then food: there is food disinflation on the cards all the way until March next year, before the El Niño phenomenon likely starts to impact prices UPWARDS into H2-2027… a story we will trade when it becomes tradeable, and not a day before.

Add the melting shelter glacier and the World Cup hangover in services, and my best guess is that inflation will look very soft come late Q4 and early Q1. Very, VERY soft... and WAAAAAAAY below the recent Fed projections.

Let us see how much the staff input guides the FOMC members in their September assessment in a few weeks... because the staff will be looking at exactly these charts.

Chart 6: Food disinflation runs until ~March 2027... THEN the El Nino story begins (H2-2027, not now)

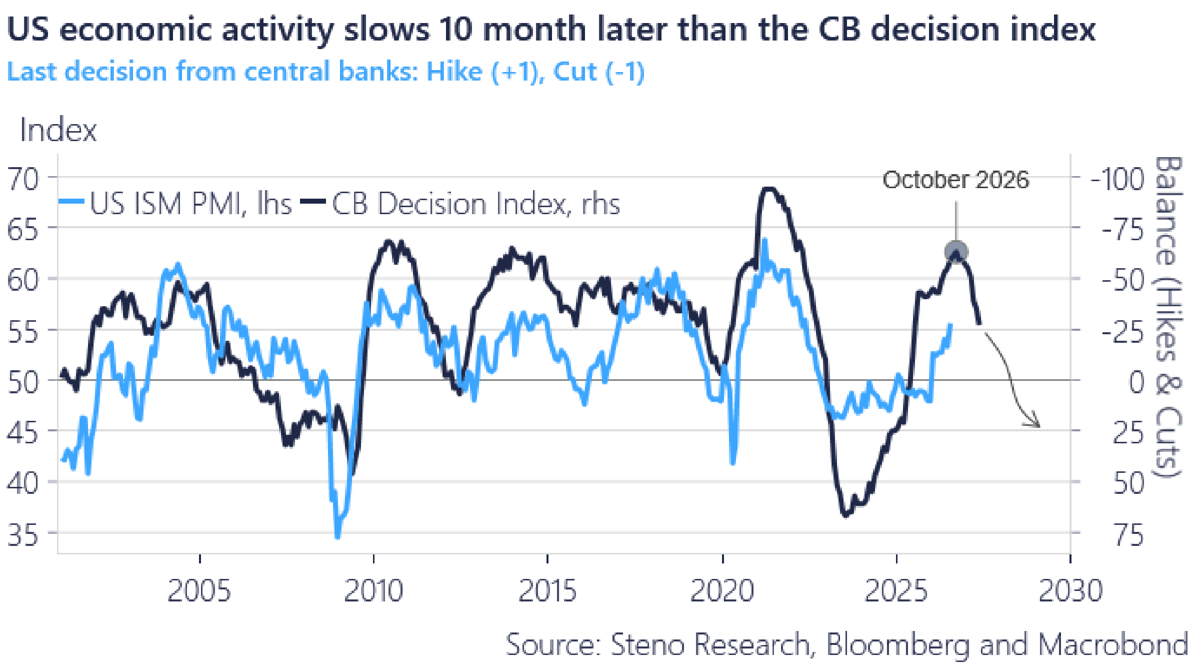


So let us entertain the thought that we get a hike in September, which is now the market base case. I love the fact that everyone thinks Warsh has forward-guided a rate hike in September now lol... the man spent twenty minutes in Wyoming explaining that he does not DO forward guidance, and the market's conclusion was "got it, hike confirmed". That is kind of entertaining in itself.

If it comes, the Fed will simply join ranks with the club that has already been leaning against the re-acceleration… the BoJ is mid-hiking-cycle with more to come, the BoE is staring at an economy running hot on BOTH engines, and the global decision balance in our CB index has already swung towards hikes.

And that is precisely the point of the chart below: the decision index is rolling over, but NOT in an aggressive way. So far, it looks far more like a mid-cycle adjustment feeding into the ISM in 2027 than the start of something dramatic. Think 1995 or 2019, not 2007 or 2022.

Chart 7: The CB decision index is rolling over… but as a MID-CYCLE adjustment, not a cycle killer

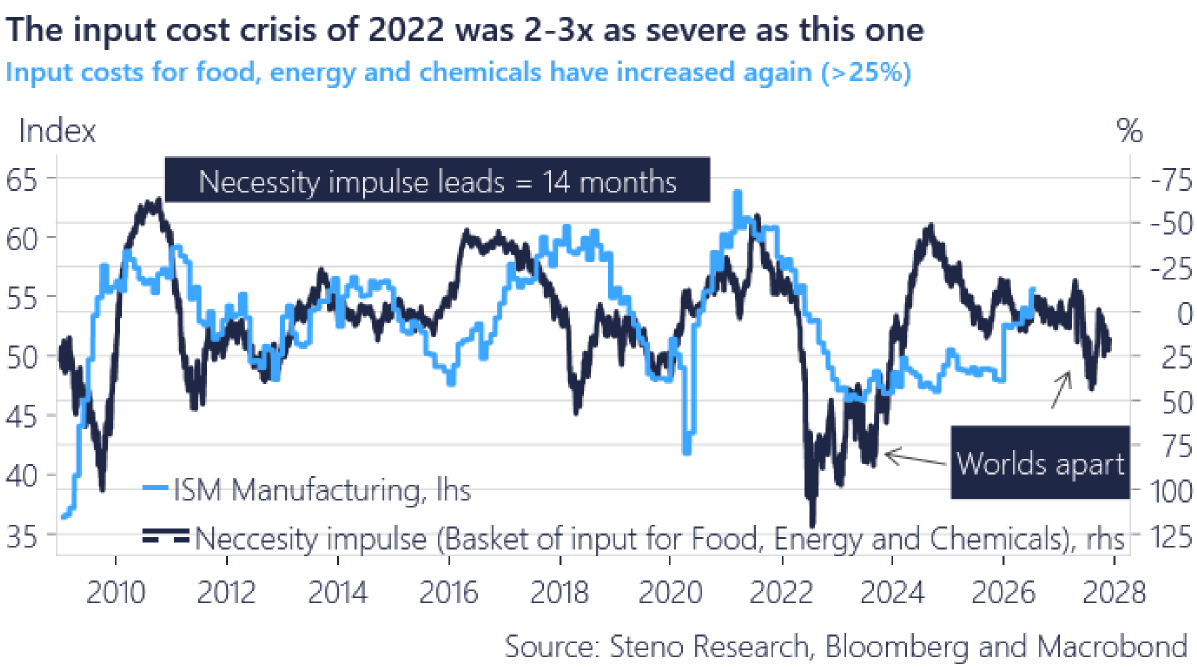


That mid-cycle read is backed up by one of my absolute best indicators: the necessity index… our basket of input costs for food, energy and chemicals, which has called out basically every major crisis in advance with a lead of roughly 14 months (note the INVERTED right-hand axis: rising necessity costs squeeze the discretionary economy with a lag, which is why the impulse leads the ISM downwards).

Yes, input costs have risen again, north of 25%... that is real, and it is a headwind for 2027 growth at the margin. But keep the proportions: the input-cost crisis of 2022 was 2-3 TIMES as severe as the current one, and the run-up to the GFC does not resemble this either.

The current "price crisis" is a drag, not a doom loop, entirely consistent with a mid-cycle ISM adjustment in 2027 rather than a bust. When my best crisis-caller is only whispering, I do not scream.

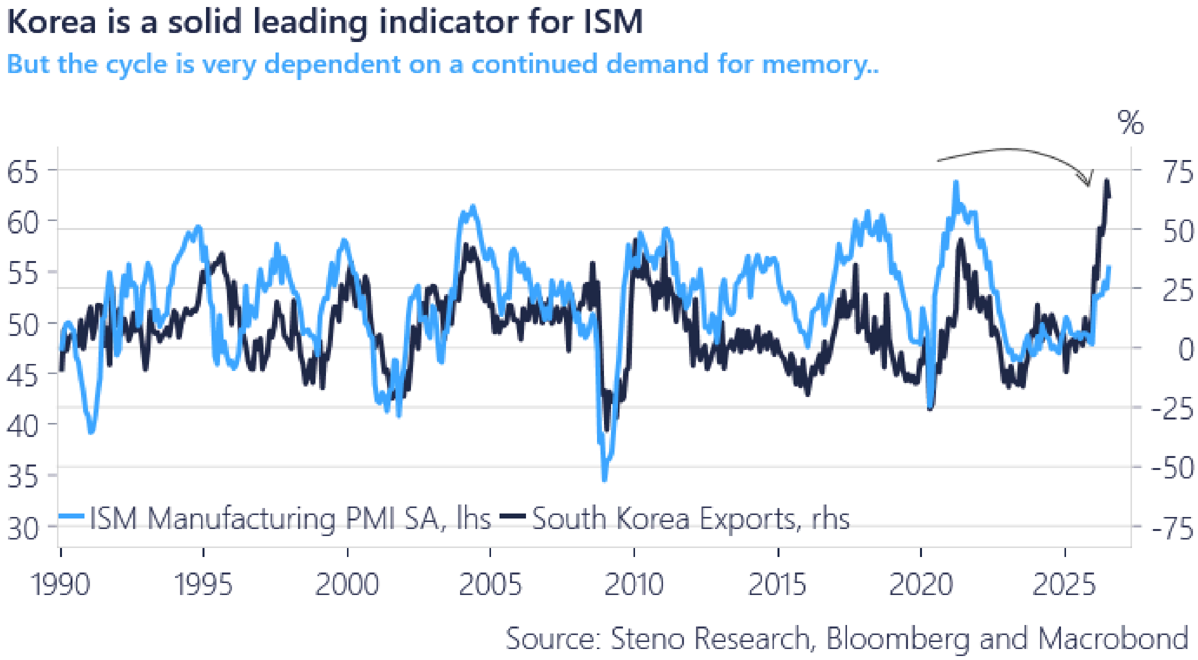
Chart 8: The necessity index (inverted)... a 2027 headwind, but 2022 was 2-3x as severe. A drag, NOT a doom loop



Short-term, there is meanwhile still very solid scope for a business cycle SURPRISE to the upside in Q4, on the lagged effects of the softness in financial conditions earlier this year... and Korea, the best coincident-to-leading indicator complex in the world for this cycle, agrees.

The export machine points to an ISM well above where the consensus has it, with the usual caveat that this cycle is unusually dependent on a continued demand for memory... which, after last week's Nvidia print and the 279bn of supply commitments, is not exactly the thing keeping me up at night.

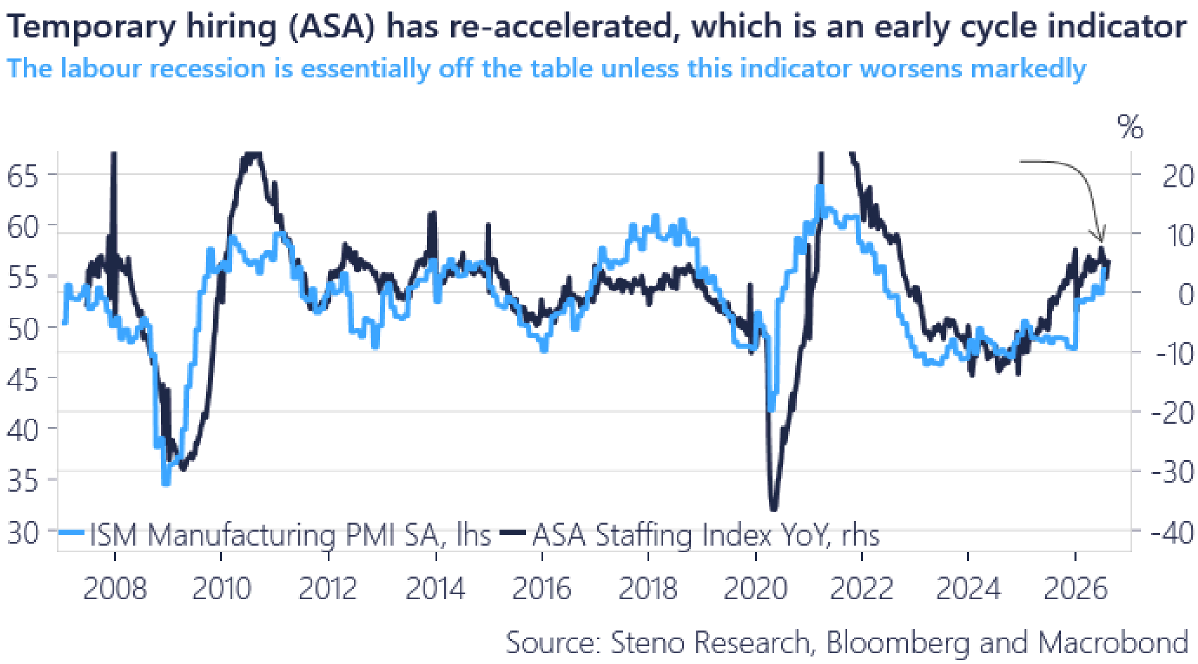
Chart 9: Korea points to upside cycle surprises in Q4... as long as the memory demand holds (it does)



And the labor market indicator number one... the ASA temp hiring index, which tells you what executives DO before they announce it (temps are hired first in an upswing and fired first in a downswing, which is why it leads)... is also still OK-ish. Re-accelerated from the lows, no longer accelerating, but nowhere near the levels that would put a labor recession on the table.

Executives are hedging, not cutting. Combine it with the record profit margins we covered on Friday, and you get the same conclusion: the productivity is being banked, the layoffs wait for the profit cycle to roll over... and that is not now.

Chart 10: Temp hiring is OK-ish… no longer accelerating, but a labor recession requires this to WORSEN markedly first



The bottom line: sure, we may get a hike, but it will be a very SHORT-LIVED hiking cycle in that case. The inflation evidence is pointing south rapidly across energy, food, shelter, and the pipeline into the PCE itself — though there is of course always the risk of a market hiccup when a central bank hikes into falling inflation (real rates up… remember what happened in July).

My honest read: this is a little adjustment, and potentially a SMART one by Warsh… a cheap way to signal that he is NOT Trump's puppet, bank some institutional credibility with the committee and the market, and then revert to the ranks in 2027 and talk productivity again once his task forces hand him the McKinsey-style external conclusion he pre-ordered (that is what every blue-chip CEO does, after all: pay the consultants to deliver the pre-decided answer, then present it as the reason for the new strategy). Inflation will hand him that opportunity into Q1… it will look very soft, and the cycle survives this without much doubt in my mind.

And the scorecard, because we keep one: I did not get my preview of this speech particularly right, and I will own that… though in my defense, we are talking about forecasting a human being with a very mixed incentive scheme. Not easy. I am NOT giving up on the short USD trade that I otherwise timed very well from early July until now, but let me be honest about Friday: Warsh did not make that trade’s life easier, and he handed the spec USD longs a lifeboat here. The medium-term case is fully intact… the transatlantic inflation gap, the Bessent liquidity machine, the PCE folding into Q1… but the path just got bumpier, and we trade it accordingly: core position on, powder dry for the buyback operations next week. If Bessent shows up with 10bn per op, the lifeboat sinks fast.

Have a great week ahead, and good luck out there!

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Andreas is the founder of Steno Research and the author of ‘Steno Signals’, the weekly editorial on everything macroeconomic. He covers central banks, inflation, liquidity and the global business cycle, and translates that macro read into positioning across rates, FX and commodities.

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