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AIP

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Deciphering Kevin Warsh

In his first briefing, Warsh came across as an inflation buster. The drop in oil prices should help.

Summary

Fed Chair Warsh's inflation focus on his debut briefing has tightened financial conditions. The oil price drop to pre-conflict levels should ease inflation, allowing him to hold rates this year. A rate pause and solid earnings should support risk assets.

Sounding hawkish, delivering less

In his first media briefing since becoming Fed Chair, Kevin Warsh managed to tighten financial conditions by focussing singularly on bringing down inflation. This has fuelled rate hike expectations, bolstered the dollar and dragged gold lower. The plan – to sound hawkish and tighten financial condition so that the Fed has to eventually deliver less in terms of rate hikes.

Oil price pullback to help Fed hold rates, cap USD upside, support gold

The sharp pullback in oil prices to pre-Middle East conflict levels should help cool inflation in the coming months, enabling the Fed to hold rates this year. Thus, limited USD upside and limited gold downside from here. The main risk to this core scenario is an acceleration in US growth beyond the temporary summertime, World Cup-fuelled demand boost. Any signs of growth and job creation accelerating - despite the negative impact of AI already seen on finance and IT sector jobs - would set the stage for a rate hike. Such a rate hike alongside solid corporate earnings growth, would continue to support risk assets.

Broadening risk exposure

Near-term challenges from a hawkish Fed, still-elevated investor positioning and flood of IPOs remain. Corporate earnings continue to be upgraded in US and Asia ex-Japan. Meanwhile, the supply of IPOs relative to US market cap remains historically low despite the large dollar amounts being raised.

Remain constructive on AUD bonds

Although the AUD has pulled back on the back of a broad-based rise in the USD, the AUD to recover on the back of a stabilisation in the USD, resilient domestic growth, firmer core inflation and stabilising China demand for commodities. Bullish view on AUD bonds (FX unhedged), despite the fall in yields over the last few weeks. While there is little room for AUD yields to fall further, the absolute yield remains attractive vs. peers.

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