



Economics
Fed Notes

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What Warsh could mean for the Fed

Introduction

This morning President Trump announced Kevin Warsh as his nominee to replace Jay Powell as Chair of the Federal Reserve. We build on a prior note to discuss what this nomination could mean for the Fed.

Warsh's background

Warsh has a strong pedigree to be chair of the Federal Reserve, with a background somewhat similar to Chair Powell. Warsh is a lawyer by training, not a PhD economist, who has had an impressive mix of experience in the public and private sectors. On the public side, Warsh was a governor at the Federal Reserve from 2006 through 2011, a period that spanned the Fed's response to the GFC. During that period, he served as an important liaison between the Fed and markets.

On the private side, Warsh has held various roles, including currently as a partner at Stan Druckenmiller's family office, Duquesne. In addition to this role, Warsh has served as the Shepard Family Distinguished Visiting Fellow in Economics at the Hoover Institution and lecturer at the Stanford Graduate School of Business.

Warsh's Fed critiques

During recent years he has been particularly critical of the Federal Reserve. His criticisms span short-term policy decisions – for example, continuing QT and rate hikes in late 2018 despite shaky markets and the 50bp reduction last September – as well as longer-term considerations for the central bank, which he outlined in a speech this year at an IMF lecture hosted by the G30 (see [here](#)).

Warsh has been consistently critical of the Fed's active use of its balance sheet over the past ~15 years. This has earned him the label of a "hawk", at least with respect to the Fed's balance sheet. Although he supported the Fed's initial foray into QE in response to the GFC, he cautioned that later programs were not appropriate, possibly raising inflation and financial stability risks, as well as moving the Fed away from its core duties and into credit allocation policies that could distort market signals. As he noted recently, "I worried mightily in the summer and fall of 2010-- a time of strong growth and financial stability –that the decision to buy more treasury bonds—would involve the Fed in the messy political business of fiscal policy. QE2 was announced. I disagreed with the decision, and resigned from the Fed soon after."

While Warsh spoke out against QE2 at the November 2010 meeting (see transcript [here](#)), he ultimately did not dissent. At the time, he argued that he

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preferred to show consensus and support for Chair Bernanke's decision to undertake another QE program – Warsh did not want to undermine the effectiveness of that program by publicly showing disagreement on the Committee.

Warsh has further argued that the Fed's active use of its balance sheet may have brought about a period of "monetary dominance". By artificially depressing rates for extended periods, Warsh argues the Fed has played an important role in enabling US government debt accumulation. This contrasts with the usual concerns around "fiscal dominance", in which elevated debt levels make it difficult for the central bank to raise rates by increasing the debt service burden of the federal government.

Beyond the balance sheet, Warsh has levied a variety of criticisms on the Fed. For example, he argues that the Fed has been consistently too data dependent and not forward looking enough. **At the same time, Warsh has been critical of the Fed's regular use of forward guidance. He recently noted, "forward-guidance – a tool rolled out to great fanfare in the financial crisis—has little role to play in normal times."**

He also questioned various other aspects of how the Fed has set and/or justified monetary policy. Warsh has argued the Fed incorrectly believes: "monetary policy had nothing to do with money", "black-box DSGE models were anchored in reality", and "the surge of Putin and the pandemic were blameworthy for inflation rather than the surge of government spending and printing." **These criticisms imply that Warsh wants to put more focus on the Fed's balance sheet size and money supply in the conduct of monetary policy and could also be open to overhauling the Fed research staff.**

Finally, while he has described Fed independence as a "worthy" cause, he has also argued that the Fed has brought upon itself questions about independence. Warsh noted, "the Fed's outsized role and underperformance have weakened the important and worthy case for monetary policy independence." Further, Warsh denounced mission creep at the Fed, including considering issues related to climate and inclusion.

What Warsh could mean for near-term policy

Warsh is nominated by a president who has pushed heavily for steep rate cuts. The President recently renewed his arguments for interest rates to be several percentage points lower, given the US's premier credit standing.

Although Warsh has argued for lower rates recently, we do not view him as structurally dovish. Instead, as noted earlier, his views have tended to skew hawkish relative to others. The most notable example was his concerns about inflationary risks from QE around the GFC. A more recent example is that he did not support the Fed's 50bp reduction in September 2024.

In recent commentary, he has noted that the Fed could bring down inflation by reducing the size of its balance sheet, which in turn could allow for lower policy rates. However, with reserves already at ample and the Fed recently restarting Reserve Management Purchases (RMPs), this trade-off would only be feasible if regulatory changes are made that lower banks' demand for reserves (or if the Fed were to decide to move back to a corridor system, which is highly unlikely). While

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several Fed officials have made this argument recently, including Vice Chair of Supervision Bowman and Governor Miran, it is not obvious these changes are realistic in the near term.

Ultimately, however, Warsh will be one vote on a Committee that recently set up the potential for a pause at the January FOMC meeting. **Warsh will have to convince his colleagues that rate cuts are appropriate this year, an argument that is unlikely to win unless the labor market shows renewed signs of weakening or inflationary pressures ease materially later this year.** One path towards rate cuts that Warsh could argue is that policy changes (e.g., deregulation) and an AI-driven productivity boom could lift potential growth and allow for inflation-less growth and renewed disinflationary pressures, such as Greenspan laid out in the 1990s. We recently documented the similarities and important differences between this period and that earlier episode (see "[Reaping the productivity gains from prior labor market tightness](#)").

As with any Fed chair, Warsh will have to earn market trust and credibility around his commitment to achieving the inflation target. These bona fides always need to be earned by an incoming chair. The requirement could be more acute in the current context, with inflation well above target for five years and the President's calls for steep Fed rate cuts. For this reason, we remain skeptical that policy will change in a discrete way in June once the leadership handoff takes place, especially since the chair has just one vote on a particularly divided committee.

Warsh's path to the Chair seat

From the Trump administration's perspective, the clearest path to a more dovish Committee that can deliver lower rates would be to place Warsh in Chair Powell's vacated seat, which would allow for another nomination to Governor Miran's seat.

However, recent legal developments have complicated that path, at least in the near term. Following the DoJ's subpoena of Chair Powell, Republican Senator Tillis pledged that the Senate Banking Committee will not move any Federal Reserve nominees forward for vote until the legal issues are resolved. Tillis reiterated that vow this morning, even as he supported Warsh's nomination. Other GOP senators have expressed concern about Fed independence more broadly as well. Moreover, while not our base case, these legal developments have increased the potential for Powell to stay on as a governor after his chair seat expires in May (see "[Implications of the Fed's latest legal developments](#)"). Resolution of these legal actions could therefore be a pre-condition for clarity on Warsh's specific path to becoming the next chair of the Federal Reserve.

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Appendix 1

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