

## IS KEVIN WARSH'S NOMINATION AS FED CHAIRMAN A GAME CHANGER?



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The Trump administration has nominated Kevin Warsh, a former Federal Reserve Board Governor (2006-2011), as the next Fed Chairman for a 4-year term. He must still face Senate confirmation hearings, a complex process with potential delays. Born in 1970, Warsh graduated from Stanford and Harvard, worked at Morgan Stanley, and advised George W. Bush on financial regulation. He is married to the daughter of Estée Lauder's son, a longtime friend and financial supporter of Trump. Warsh was appointed Fed Governor in 2006 and warned about liquidity risks before the 2008 global financial crisis. He led post-crisis reforms focused on systemic risks, including efforts to modernise the Fed's real-time market-surveillance systems and played a role in designing emergency liquidity facilities during the crisis itself. In a notable contradiction, he supported the Fed's 2020 quantitative easing despite his stated scepticism on the need for an easy monetary policy. Warsh, who left the Fed in 2011, has since criticised the institution for keeping rates low for too long after the pandemic, blaming those policies for the 2021–2022 inflation surge.

### A FRAGILE ECONOMIC BACKDROP

Powell's chairmanship expires on May 15th, and the next FOMC meeting will take place in June. Fed funds were last pricing in not even one full rate cut by the end of 2026, with a likelihood that the central bank may remain on hold until Q4/2027.

Indeed, more clarity is needed around the outcome of the war with Iran (the current federal deficit is being dug by roughly another \$ 1 billion per day) and which of the Fed's mandates, i.e. low and stable inflation or full employment, is most in jeopardy. Based on the latest data, core Personal Consumption Expenditures YoY rose to 3.1%, a re-acceleration of inflation (excluding food and energy) while the labor market is showing unexpected signs of weakness, with a negative print of non-farm payrolls in February as well as unemployment rising to 4.4%, close to its highest level since 2021.

### A "DOVISH HAWK" UNDER POLITICAL PRESSURE

Warsh is regarded as a "dovish hawk", neither too hawkish nor too dovish and has publicly supported Trump's call for significant interest rate cuts. Seen as a conservative Republican economist, some view Warsh as a Trump ally aiming to boost the economy before midterms. But if Warsh is serious about his pledge to preserve the Fed's political independence, he will avoid becoming a proxy for Trump, especially given the president's repeated efforts to influence monetary policy by pressing for lower interest rates, in opposition to current Chair Powell's roadmap.

An independent central bank can more easily take unpopular steps to fight inflation, such as raising interest rates, which makes borrowing costs more expensive. A loss of Fed independence would weaken the US dollar, import inflation, and reduce global confidence in US assets. Such a situation, often sought to boost growth or reduce debt, could trigger more foreign exchange volatility.

### WARSH'S POTENTIAL ROADMAP

In this context, what could be Warsh's roadmap? Given that he has been a long-time critic of a large, expanded balance sheet, he will likely diminish its size, i.e. reduce the Fed's holdings of bonds, and aim for a smaller, shorter duration, US Treasuries-only balance sheet.

**"An independent central bank can more easily take unpopular steps to fight inflation."**

He may by the same token also advocate for a shift in policy, i.e. reducing the Fed's reliance on quantitative easing and simultaneously making room for lower interest rates by using the monetary lever as a compensative stimulus tool. He has also suggested a "new Treasury-Fed accord" to coordinate a smaller balance sheet with Treasury's debt management, which could allow for this lower interest rate policy, while simultaneously reversing previous emergency liquidity injections. Still, such an initiative might be complicated by structural constraints, such as the banking system's reliance on high levels of liquidity, making a quick, large-scale reduction difficult without causing market volatility.

Finally, while Warsh is inclined to shrink the Fed's balance sheet (a shift back towards quantitative tightening) he would still have to work within the Fed's collegial, consensus-driven decision-making process. Market conditions and the need to secure majority support within the FOMC could ultimately lead to a more gradual approach than his personal preferences might suggest.



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