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Macro & Markets: How could Kevin Warsh influence the Fed?

Marketing communication

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This week, Kevin Warsh appeared before the Senate; while his tone was at times somewhat hawkish, it is far from certain that he would remain so as the Fed's new Chair.

How could Kevin Warsh influence the Fed?

Kevin Warsh appeared before the Senate this week ahead of potentially taking over as Chair of the Federal Reserve, succeeding Jerome Powell. While, in principle, Warsh would be just one of twelve voting members determining the policy rate, his remarks suggest he could meaningfully influence how the Fed operates. Warsh emphasised on several occasions that he would not be a "puppet" of Donald Trump and stressed the importance of central bank independence. He stated:

"The president never asked me to predetermine, commit, fix or decide on any interest rate decision... Nor would I ever agree to do so."

A more hawkish tilt?

Overall, Warsh's comments carried a distinctly hawkish tone. He argued that the Fed itself is partly responsible for the persistent inflation, noting that inflation has remained above the 2% target for several years. In his view, this cannot be explained solely by supply-side shocks – but reflects policy choices made by the central bank. He was also critical of the Fed's balance sheet policy. Warsh argued that a smaller balance sheet would make monetary policy more effective, and that the post-pandemic balance sheet remained too large for too long. He suggested that this kept financial conditions overly accommodative even as policy rates were rising.

A pragmatic – not fixed – policy stance

That said, it is too early to conclude that Warsh would consistently pursue a hawkish policy stance.

His historical track record indicates some flexibility. During Barack Obama's presidency (2009-2017), Warsh's views were predominantly hawkish, particularly in his criticism of quantitative easing and warnings about underestimated inflation risks. During Trump's first term (2017-2021), his tone became somewhat more dovish, emphasising caution around tightening and broader policy coordination. Under Joe Biden (2021-2025), his rhetoric became more hawkish again. He criticised the Fed for acting too slowly to raise rates and strongly rejected the notion that inflation would prove transitory.

Warsh has previously argued that AI could lead to a significant increase in productivity, which in turn may dampen inflation and give the Fed scope to cut rates. The idea is that, by materially raising output per worker, firms can expand without hiring proportionately more labour, allowing the economy to grow without generating excessive inflationary pressure. In this framework, Warsh also sees scope for the natural rate of interest in the US to drift lower over time. That said, this line of reasoning is not without challenges. The impact of AI on investment and, by extension, aggregate demand could prove stronger than its disinflationary effects, particularly in the near term. Moreover, there is uncertainty around how large the productivity gains will be in certain sectors – most notably services – where inflation remains elevated and where the scope for AI-driven efficiency improvements may be more limited.

Taken together, this suggests Warsh's policy stance may be adaptive rather than ideologically fixed.

Potential changes to the Fed framework

Warsh also highlighted several areas where he could alter how the Fed operates:

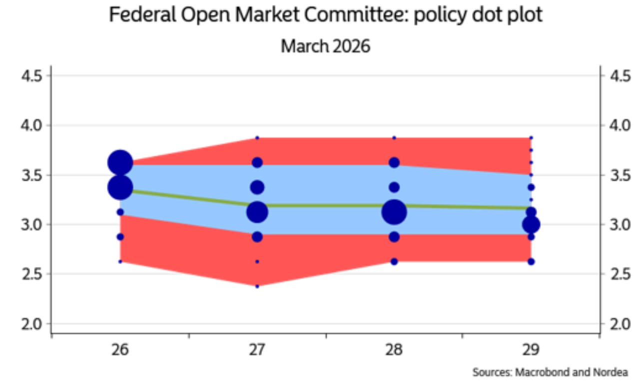
• A reconsideration of the inflation framework, including greater use of trimmed mean and weighted median measures, rather than relying predominantly on core PCE.

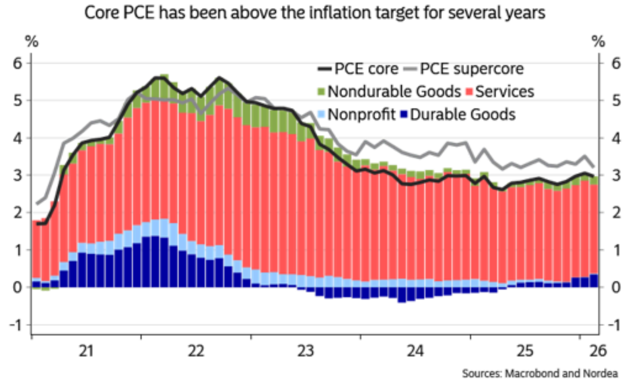
• A push for simpler and clearer communication.

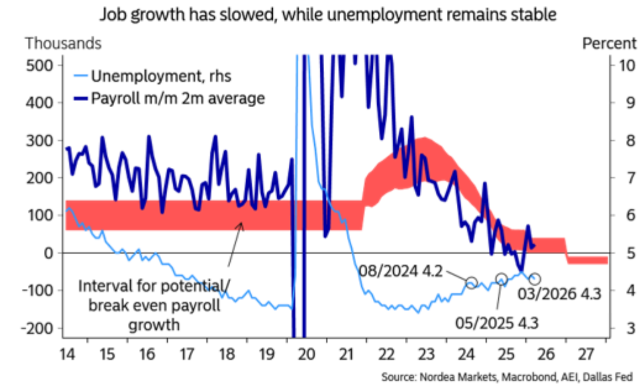
• Scepticism towards forward guidance tools such as the "dot plot", which he views as unnecessary and potentially misleading.

• A preference for fewer public speeches and interviews from Fed officials.

Kevin Warsh's remarks this week do not change our view on the Fed. **We still expect the Fed to keep rates on hold over the next two years. We assess the risks around the Fed's policy rate as broadly balanced.** On the one hand, inflation remains above target, and the conflict in the Middle East could push it higher in the coming months through increased commodity prices. At the same time, job growth in the US has slowed quite markedly in recent years, while unemployment has remained relatively stable. This suggests that the pace of "optimal" job growth has declined and is now close to zero. In practice, this means that monthly job gains can be near zero without pushing the unemployment rate higher. Should this dynamic reverse – either due to an increase in labour supply or a weakening in demand, leading to higher unemployment – it would, in isolation, point towards rate cuts.







Markets: Pricing in a peace scenario

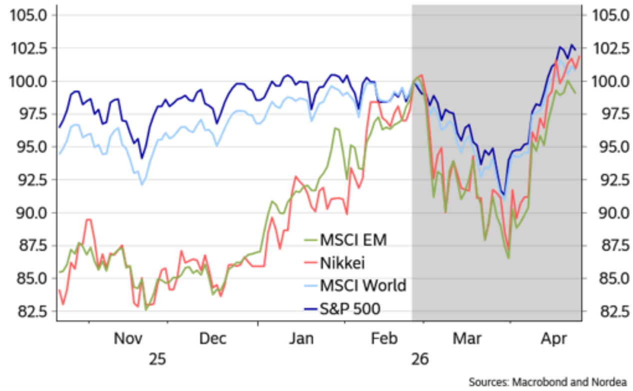
Equity markets reached new all-time highs this week, supported by optimism about a potential de-escalation involving the US, Iran and Israel, as well as continued enthusiasm for AI. Following last week's strong rally, momentum has moderated somewhat amid a renewed rise in oil prices. Brent crude moved above USD 100 per barrel as tensions surrounding the Strait of Hormuz intensified, with ongoing disruptions to shipping flows. Higher oil prices have contributed to an increase in long-term yields, with the US 10-year Treasury yield rising to around 4.31%. The dollar strengthened modestly this week. While a further escalation in Middle East tensions could support the dollar in the short term, we continue to expect USD weakness in the medium to longer term.

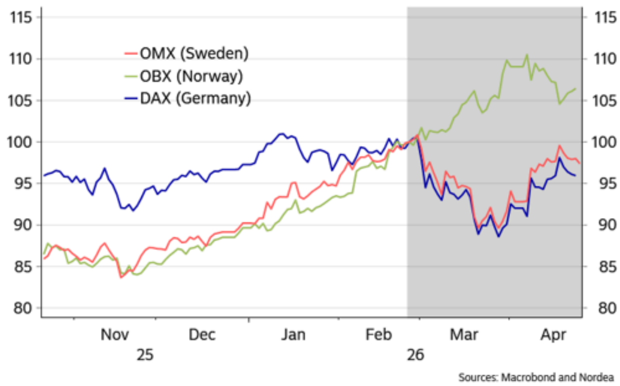
Macro data: Early signals from April

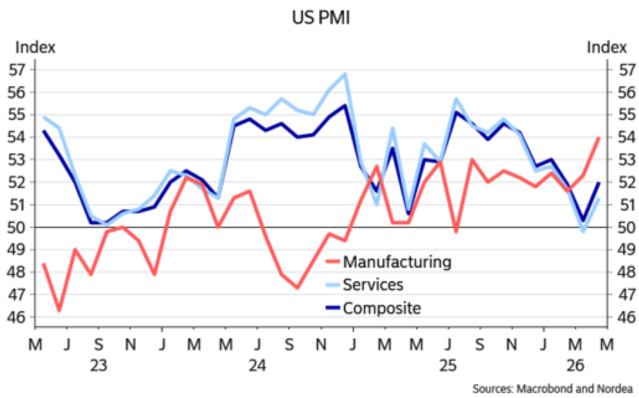
This week's data provide early indications of economic activity in April across the US and the euro area, offering insight into how firms and households are adjusting to higher energy prices.

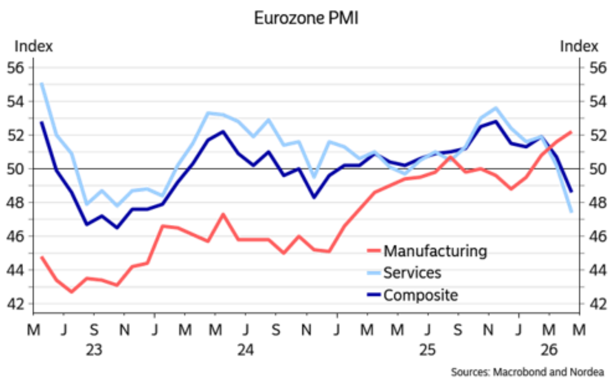
US retail sales surprised on the upside in March, rising by 1.9% excluding autos. In addition, the US PMI figures showed more optimism than feared, particularly in the manufacturing sector. Meanwhile, PMI data suggest that higher energy prices are weighing on the European services sector, with the index falling below 50 in April. However, Eurozone manufacturing also appears more resilient than feared.

With many price indicators becoming more worrisome for the ECB at the same time, while the central bank usually pays a lot of attention to hard data, this week's data releases do not materially change our view on the European Central Bank, where we continue to expect four rate hikes this year. Risks to this view are tilted towards fewer hikes, though.









Note: There will be no Macro & Markets publication next week due to the holiday on 1 May.

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