

Changing of the Guard

This morning Jerome Powell likely gavel open his last FOMC meeting as Chair. Although the exact timing is somewhat up in the air, Kevin Warsh's confirmation is now almost certain. Practically, it was never really in doubt, since the administration controls the investigation that has been the holdup. Either way, our base case remains that Warsh chairs the FOMC at the June meeting.

That makes this a useful moment to think through what a Warsh Fed might actually look like, because he will be setting U.S. monetary policy for at least the next four years.

Less hawkish than advertised

Warsh is well known to Wall Street and broadly respected. He served as a Fed Governor through the 2008 financial crisis, so he has credibility on the operational side that matters when markets are stressed. His public reputation was structurally hawkish, but that label is a few cycles out of date. He sounds more neutral now and probably leans modestly dovish on the underlying inflation picture, even if he may not be in a hurry to cut.

The clearest tell came at his confirmation hearing. Warsh repeatedly emphasized trimmed-mean and median measures of inflation, which strip out the largest price swings, over the core PCE the Fed currently uses. The arithmetic matters: the Dallas Fed's trimmed-mean PCE is currently running at 2.3% year-over-year and the Cleveland Fed's median around 2.8%, well below the 3.0% core PCE that anchors the Fed's forecasts. Adopting one of those gauges would put the Fed roughly 20-70 basis points closer to its inflation target on day one, without changing a single policy setting.

He paired this with a forward-looking case for easing built around AI rather than the labor market. The argument runs that AI will lift potential output and dampen inflation pressure on the policy-relevant horizon via a productivity mechanism. If AI capex actually flows through to faster productivity growth, supply expands alongside demand, and the Fed gets room to ease without needing the labor market to soften first. That is a different framework than the labor market dovishness of the Yellen-Powell era, and in steady state it leans to easing rather than tight or tighter.

A first move that probably is not a cut

Rates traders already agree the Fed is on hold after their two-day meeting tomorrow, with markets pricing in almost certainty of no change in policy rate. More striking, the curve is still pricing zero cuts across all of 2026. That may be the base case short term, but the medium-term and long-term direction is likely more dovish.

The reason is institutional. Warsh inherits a credibility problem of his own making. He considers the post-pandemic episode the Fed's most consequential policy error in decades, argues the institution has drifted off course, and is promising a wholesale overhaul of how it operates. He has also been nominated by a President who has been unusually public about wanting lower rates.

His first job is to demonstrate those two facts are unrelated. Cutting in his opening months, absent a clean data trigger, would undo that work before it starts. The independence point is essentially the whole job in the early innings.

Balance sheet hawk, rate dove

This is where Warsh's framework gets interesting and a little underappreciated. He remains, by his own description, a balance sheet hawk. The Fed's balance sheet sits at roughly \$6.7 trillion, took 18 years to build up, and Warsh treats the long-duration US Treasuries inside it as effectively fiscal policy that the Fed should not be running. He wants the Fed out of that business.

The likely combination is unusual: slow, deliberate runoff of longer-dated holdings on the asset side, paired eventually with a lower policy rate. The two instruments work in opposite directions, with quantitative tightening at the long end and rate easing at the front end. That is closer to a rebalancing than a one-way ease, but the net effect leans toward a slightly steeper yield curve.

Mortgage rates are tied to the long end, so this part of the program will be watched very carefully. Warsh clearly knows that, which is why he stresses a slow, deliberate pace with plenty of advance notice.

Fix the Fed

Beyond rates and the balance sheet, Warsh wants to overhaul how the Fed measures, talks, and debates. His list is fairly long:

- A large-scale new price-survey project, drawing on roughly a billion observations, to replace gauges he views as imperfect
- Less forward guidance, and possibly fewer press conferences
- Less choreographed FOMC meetings with more open internal disagreement
- A narrower remit that pulls the Fed back from fiscal arguments and adjacent policy territory

Some of this needs Committee buy-in that he does not yet have, and we should probably expect resistance from some of the current Board on the pace, if not the direction. In transition, less Fed communication usually means higher uncertainty risk premia and more rate volatility. That is the cost of regime change. Whether the steady state ends up cleaner depends on whether a quieter Fed actually communicates better when it does speak.

Net net

We think Warsh ends up positive for both bond and equity markets over a multi-year horizon, mostly through credibility. A Fed that says less, owns its mistakes, holds fewer US Treasuries, and updates its measurements of inflation is, on balance, a Fed that earns a lower term premium. Getting there likely will not be smooth. The transition phase brings more volatility, especially around communication, and the first cut may be further out than the equity market would like.

For now, Powell's last meeting is the easy part. The interesting question is what comes next.

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