FROM THE OFFICE OF THE CIO

Federal Reserve Chair Hearing: Kevin Warsh's Senate Testimony and Outlook

Overview

On April 21, Kevin Warsh, nominated by the Trump administration to succeed Jerome Powell as Chair of the Federal Reserve, appeared before the Senate Banking Committee for his confirmation hearing. The senators' questions, while wide-ranging and often split along party lines, focused primarily on the credibility of the Federal Reserve under Warsh's leadership rather than on any immediate changes to interest rate policy.

Warsh faced extensive questioning about his ability to uphold the Fed's independence, especially amid ongoing public pressure from the White House to cut interest rates. He emphasized that monetary policy decisions should be independent, forward-looking, and based on data, asserting that he would not serve as a "political instrument" for any administration.

Lawmakers further pressed Warsh on his approach to interest rate cuts in the context of rising inflation, which has been influenced by higher energy prices due to the conflict in Iran. Warsh declined to commit to any specific near-term rate actions, instead advocating for a mandate-driven approach centered on price stability and long-term economic growth.

Proposed Changes to the Federal Reserve Structure

During his testimony, Warsh proposed several potential reforms to the Fed's current practices and policymaking process. He showed interest in introducing a new framework for tracking inflation data and modifying how the Fed communicates with the public.

> *"The Fed must stay in its lane. Fed independence is placed at greatest risk when it strays into fiscal and social policies where it has neither authority nor expertise."*
>
> *Kevin Warsh*

Warsh was critical of the Fed's previous actions. He attributed the post-pandemic inflation surge to flaws in the Fed's existing framework, which he argued damaged its credibility by pursuing a politically motivated agenda. He also noted that elevated prices remain a challenge for Americans.

Among Warsh's proposed changes, modifying or ending the Fed's quarterly economic forecasts and interest-rate projections, or "dot plots," could be seen as contentious. He stated, "Unlike many of my colleagues past and present, I don't believe in forward guidance," adding that he does not support previewing future rate decisions as is the current norm.

Warsh also addressed the economic impact of artificial intelligence. While he did not repeat previous claims that AI would significantly boost productivity and reduce inflation, he suggested that AI is fueling an innovation cycle that could improve consumer pricing and ease the Fed's responsibilities over time. He also commented that AI could affect the health of the labor market, which needs strong consideration when setting policy.

Warsh expressed concerns about the size of the Fed's $6.7 trillion balance sheet, stating that any reduction in size should be gradual and well-communicated to the markets. Although he did not specify a target, he expressed favor for a smaller balance sheet and asserted that the Fed should avoid holding long-term Treasury debt, calling it "fiscal policy in disguise."

Outlook

Overall, the hearing unfolded as expected with Warsh successfully addressing two hours of questions from senators whose votes are needed for confirmation. His remarks did not incur disruptions to the markets, nor did they appear to offend the administration that nominated him.

Should Warsh be confirmed, we anticipate changes to the Fed's operations and interactions with market participants. We view his comments around inflation, specifically the calculation methodology, as a potential positive but are mindful that the data from his suggested approach may be seen as a way to expeditiously lower rates. At the same time, we see Warsh's comments about making Fed policy more forward-looking in its decisions as positive. Warsh's remarks on digital currency and the broader impact of AI on the economy are also noteworthy, though further details are awaited. Warsh's ability to implement change may be limited by the slow, deliberate turnover of the Fed Board of Governors and his capacity to persuade colleagues within the Federal Open Market Committee.

Next Steps

The clock is quickly ticking toward May 15, when Jerome Powell's term as chair is scheduled to conclude. No clear timetable emerged for Warsh's confirmation process, which is complicated by an ongoing Justice Department investigation involving Chairman Powell. Powell has indicated he will serve as chairman *pro tempore* if his successor is not confirmed by the official transition date. In the meantime, markets and investors are closely monitoring developments to determine whether the leadership transition proceeds smoothly.