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Paradigm Shift at the Fed?

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Kevin Warsh became Chair of the Federal Reserve System on May 22, succeeding Jerome Powell. There are 12 voting members of the Federal Open Market Committee (FOMC) which determines monetary policy. They are:

- The 7 Board of Governors of the Federal Reserve System, including Chair Warsh;
- President of the New York Federal Reserve Bank (permanent voter)
- Presidents of 4 of the other 11 regional Federal Reserve Banks that vote on a rotating one-year basis. For 2026, they are Philadelphia, Cleveland, Dallas, and Minneapolis.

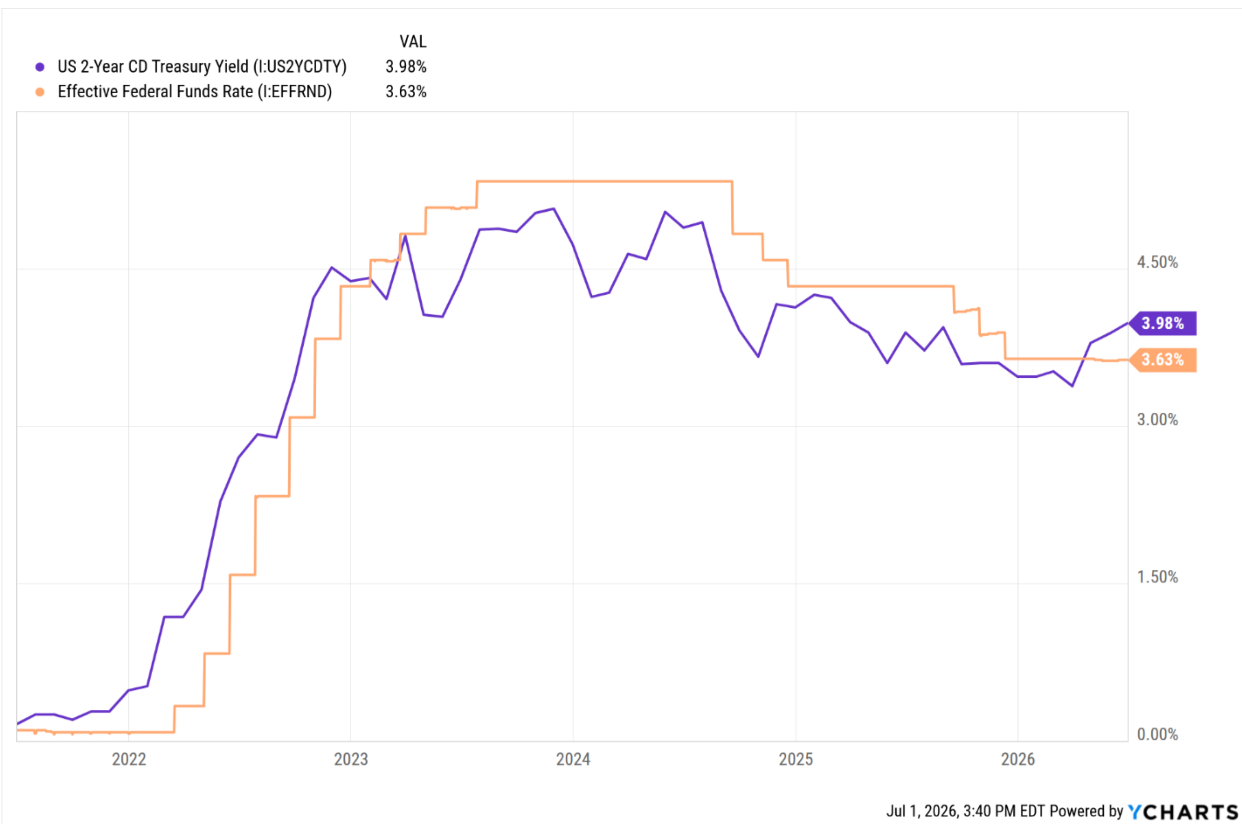
The other 7 regional Reserve Bank presidents attend meetings and participate in discussions, but do not have a vote in 2026. These currently include the presidents from Atlanta, Boston, Chicago, Kansas City, Richmond, San Francisco, and St. Louis.

In April 2025, Kevin Warsh gave a speech at the Group of Thirty conference in Washington, DC. It was coordinated with the IMF and World Bank Spring meetings. Warsh outlined changes that he intended to make as Fed Chair if selected:

- Reduce forward guidance – he argued that the Fed provides too much information about their future policy intentions and economic forecasts.
- Shrink the Fed's role in financial markets – he has been a critic for many years of the Fed's quantitative easing (QE) and large-scale asset purchases. He has a strong preference for a smaller balance sheet for the Fed and is less concerned about supporting market prices of assets.
- Refocus on the core mandates – inflation control and full employment.
- Reform forecasting and economic models – he criticized the Fed's reliance on backward-looking and heavily revised government data and questioned the usefulness of many Fed forecasts. The Fed should make greater use of real-time market indicators and private-sector data.
- Restore inflation credibility – the Fed should have less tolerance for inflation overshoots. In the past, the Fed has dismissed reports of higher inflation rates as temporary in nature.

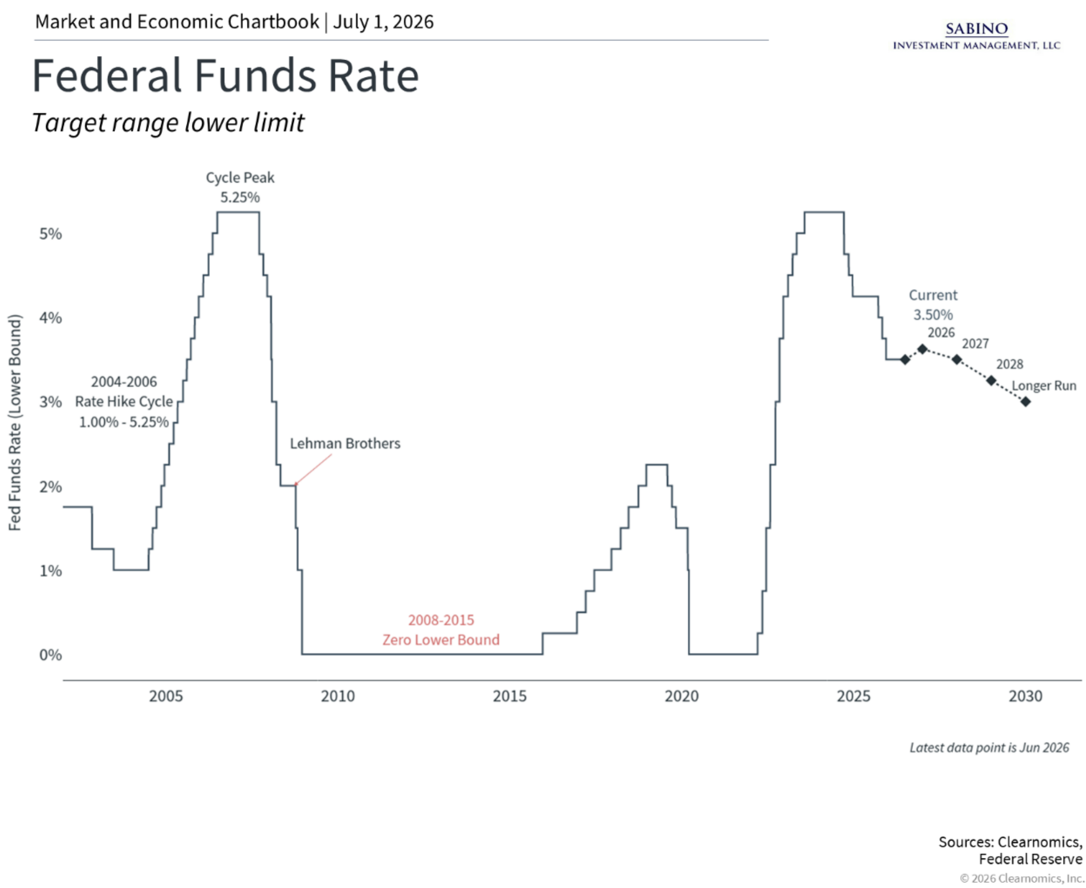
The Chair of the Federal Reserve System is the most influential person at the Fed with the loudest public voice. It appears that Chair Warsh has indeed had an influence on other members of the Governing Board. The obvious implication for investors is that the Fed is much less likely to provide a "put" for the financial markets, that is intervention to support prices on securities when investors and speculators do foolish things.

Jeff Gundlach, CEO and Chief Investment Officer at Doubleline Capital, has often said that the Fed responds with a lag to the market price of the 2-year US Treasury bond when they set the Fed funds target rate. The 2-year CD Treasury yield has not exceeded the Fed funds target rate since January 2023. Although the FOMC made no change in the Fed funds target rate at the June 16-17 meeting, it now appears that a Fed funds target rate increase is due at the July 28-29 FOMC meeting.



In the chart below, Clearnomics shows the lower limit of the Fed funds rate (solid line) and a dotted line to indicate the FOMC participants' median assessment of the appropriate path for the Fed funds rate in the future, based on the Fed's Summary of Economic Projections.

There is a conflict between Chair Warsh's desire to reduce the size of the Fed's balance sheet and the FOMC's intention to reduce interest rates in the future. As one of my economics professors at Haas Business School said, the Fed can control the monetary base (of money supply), or it can control interest rates, but it can't control both.



If you have any questions or comments, please contact me.

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