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QUICK VIEW: KEVIN WARSH'S NOMINATION AND THE NEXT ERA OF U.S. MONETARY POLICY

Head of Global Short Duration and Liquidity Daniel Siluk discusses what President Trump's nomination of Kevin Warsh as the next chairman of the U.S. Federal Reserve could mean for markets and the future path of monetary policy.

Key takeaways:

- Kevin Warsh's nomination suggests a policy regime that is more flexible on rates, more disciplined on the balance sheet, less communicative in its forward signaling, and influenced by a structural productivity narrative shaped by AI.
- Following the announcement, front-end yields drifted lower on expectations that rate cuts may come sooner than previously projected, while longer-dated yields have risen as investors anticipate less willingness to use the Fed balance sheet to suppress term premiums.
- We believe markets should prepare for a Fed that is simultaneously more unpredictable and more orthodox – a blend that marks a genuine shift in the post-crisis monetary landscape.

President Trump's nomination of Kevin Warsh to succeed Jerome Powell marks one of the most consequential U.S. Federal Reserve (Fed) chair transitions in over a decade, not because Warsh represents an extreme break from the institution's norms, but because he blends hawkish instincts with a willingness to rethink the Fed's tools for a new economic environment. Warsh is neither a Powell-style gradualist nor a political loyalist. Rather, he appears prepared to reshape the mechanics of policy while preserving the Fed's long-term independence.

A smaller balance sheet, paired with lower rates

A defining feature of Warsh's framework is his belief that the Fed's balance sheet has grown far beyond what is necessary for effective policy. He has long criticized the post-Global Financial Crisis expansion of asset holdings and has signaled support for renewed balance-sheet reduction. But unlike prior debates around "tapering", Warsh links this shrinkage explicitly to the possibility of lower policy rates, arguing that removing the distortions created by an outsized portfolio can reopen space for conventional rate cuts without jeopardizing financial stability.

That balance-sheet-smaller/rates-lower combination stands out as the first major shift in the Fed's theoretical playbook, even if operationally it evolves gradually.

A new Fed–Treasury dynamic

Warsh is also expected to be more comfortable working closely with the Treasury Department on issues such as debt management and ways to reduce the government's interest expense without undermining market functioning. While not a return to the 1951 Accord era, the market anticipates a more coordinated, though not subordinate, relationship between the institutions. Such cooperation could help smooth balance-sheet runoff while minimizing disruptions to mortgage markets and Treasury liquidity.

Less forward guidance, more market volatility

Warsh has been explicit that the Fed's heavy reliance on forward guidance has outlived its usefulness. He is likely to reduce the volume and specificity of policy signaling, steering the institution back toward a more opaque, data-driven approach reminiscent of the pre-2000 era. We believe markets should expect wider swings in rates as investors receive fewer verbal guardrails from policymakers, with each data release taking on greater significance.

1990s redux: productivity, AI, and a higher-growth world

One of Warsh's more forward-leaning views is his embrace of a "new productivity cycle" driven by artificial intelligence (AI) diffusion, an echo of the Greenspan-era thesis that stronger potential growth can coexist with easing policy and subdued inflation. If Warsh interprets incoming data through that lens, he may be willing to cut rates even with solid GDP prints, arguing that rising productivity offsets inflationary pressure.

This framework offers a philosophical rationale for easing in a strong-growth environment, though critics warn it risks replaying the late-1990s mistake of falling behind the curve if the productivity story proves overstated.

Independence first – even if it alienates the White House

Despite alignment with some of the administration's policy preferences, Warsh has a long record of stressing institutional independence. He is unlikely to remain a political loyalist if the data push him in a different direction. His historical willingness to dissent, and even leave the Fed, over policy disagreements underscores that independence.

What it means for markets

The market reaction across the yield curve reflects the duality of Warsh's stance:

- **Front-end yields have drifted lower** on expectations that rate cuts may come sooner than previously projected.
- **Longer-dated yields have risen** as investors anticipate less willingness to use the balance sheet to suppress term premiums, producing a **bear steepening** dynamic.
- **Rate volatility is likely to rise**, given diminished forward guidance and ongoing uncertainty about the interaction between balance-sheet policy and rate decisions.

Bottom line

Kevin Warsh brings an unusual combination of hawkish instincts, openness to innovation, and deep respect for Fed independence. His nomination suggests a policy regime that is more flexible on rates, more disciplined on the balance sheet, less communicative in its forward signaling, and influenced by a structural productivity narrative shaped by AI.

We believe markets should prepare for a Fed that is simultaneously more unpredictable and more orthodox – a blend that marks a genuine shift in the post-crisis monetary landscape.

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