

US Viewpoint

Kevin Warsh primer

A challenging start

Kevin Warsh's tenure as Fed Chair has started at a difficult time, with inflation surging and the economy facing several shocks. In this piece, we give our take on Warsh's stance on key policy issues, the challenges he might face, and market implications.

Is Warsh a hawk or a dove?

Although Warsh has historically been a staunch hawk, his recent comments suggest he will lean dovish as Fed Chair. But ongoing large upside surprises in inflation have led to a sharp hawkish turn in market pricing and Fed speak. We doubt Warsh will be able to convince the FOMC to focus on his favored trimmed-mean metric rather than core PCE. Such a shift that could be costly for Fed credibility, an issue he has often emphasized.

What has Warsh said about AI?

Warsh is bullish on AI. He thinks the Fed should cut rates in anticipation of disinflation due to stronger productivity growth. He has made an analogy to Greenspan's "bet" on productivity in the mid-90s, at the start of the tech boom. We think this analogy will be a hard sell to the FOMC. Most other policymakers prefer to wait and see on the AI impact.

What are Warsh's views on the Fed balance sheet?

Warsh is a balance sheet hawk. He is likely to succeed in moderating Fed balance sheet growth via liquidity changes & reduced bank reserve demand. We expect the reduction in reserve demand could be \$200-500bn. But it will happen slowly. In practice, Warsh may only be able to slow the pace of Fed balance sheet growth rather than make material cuts. Warsh will likely accelerate a balance sheet composition change. But the impact will be near-zero unless Treasury surprisingly offsets via larger long-end auction sizes.

What changes does he want to make to communications?

Warsh wants the Fed to speak less and eschew forward guidance and data dependence. He will probably go back to quarterly press conferences. We don't expect him to do away with the SEP anytime soon, even though he can probably do so unilaterally.

When should we expect to hear from Warsh?

Warsh's first substantive comments on policy will likely be at the June press conference. But we wouldn't rule out a TV interview before the blackout period starts on June 6.

What are the USD implications of a Warsh-led Fed?

The USD outlook will depend on which Warsh appears. Warsh's stated preference for lower rates has offset an otherwise more USD-bullish backdrop. If Warsh persuades FOMC voters to adopt a dovish stance in the face of inflationary pressures, the USD will suffer. If either a) he moderates his recent dovish views, or b) a critical mass of the committee resists, the USD should benefit from enhanced institutional credibility, relative to embedded "Fed independence" risk premia.

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B/S: balance sheet

SEP: Summary of Economic Projections

FOMC: Federal Open Market Committee

PCE: Personal Consumption Expenditures

Is Warsh a hawk or a dove?

Warsh was a staunch inflation hawk in his first term as a Fed Governor (2006-11). Even when the economy was weak following the financial crisis, he was concerned that easy Fed policy (particularly Quantitative Easing- QE) would cause an inflation problem down the line. That said, it's worth noting that Warsh never dissented in an FOMC vote.

Recently, however, Warsh has taken a dovish stance. Before his nomination for Fed Chair, he called for immediate interest rate cuts, arguing that the Fed is over-reacting to its error on inflation in 2021-22 by keeping policy rates elevated. At the nomination hearing, Warsh said the Fed should look through one-off changes in price levels due to tariffs and geopolitics. He said the Fed should focus on measures of “underlying inflation” and expressed a preference for median and trimmed-mean inflation over the traditional core.

The inflation picture has deteriorated significantly

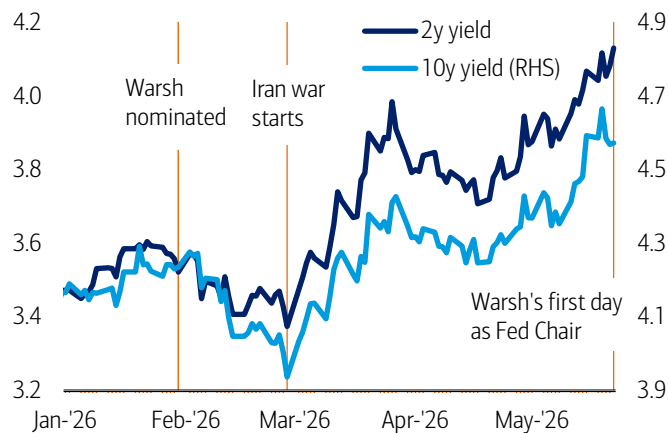
The challenge for Warsh will be that the narrative on inflation has changed substantially since his nomination. Headline PCE is moving toward 4% because of the energy price shock from the Iran conflict. Perhaps more importantly, core inflation has taken a big leg up, with much of the impact of the conflict still in the pipeline and housing disinflation now progressing much more slowly.

We expect core PCE to print at 3.3% y/y in April, with an annualized pace of more than 4% in the last five months. In response to the spike in inflation and resilient labor data, the 2y yield has jumped by over 60bp on net since the time of Warsh’s nomination (Exhibit 1). End-’27 Fed pricing has shifted from over two cuts to about one hike.

Importantly, the tone of Fed speak has also shifted markedly. Even last year’s doves, such as San Francisco Fed Daly and Governor Waller, have said that their base case is an extended hold. Waller went so far as to say that he prefers to remove the easing bias from the FOMC statement language and thinks hikes could be on the table if inflation expectations de-anchor.

Exhibit 1: The surge in yields since the start of the Iran war has jeopardized Warsh’s stated policy agenda

US 2-year and 10-year Treasury yields (%)

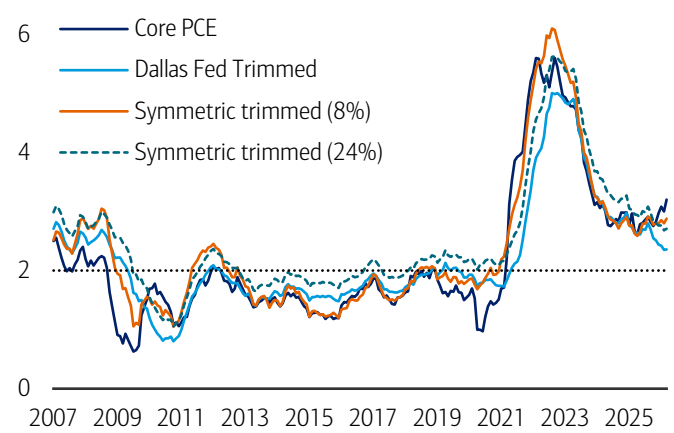


Source: Bloomberg

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Exhibit 2: The signal from trimmed-mean inflation measures can vary widely based on the definition of the trim

Core PCE (% y/y) vs. different types of trimmed-mean PCE inflation



Source: BEA, Dallas Fed, BofA Global Research. Note: the Dallas Fed metric trims 31% off the top of the monthly inflation distribution, and 24% off the bottom. Our symmetric trims take off 8% and 24% off both sides of the distribution.

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Trim your enthusiasm

Given this backdrop, we also find it unlikely that the committee will embrace a shift in focus to trimmed-mean inflation. The strength of trimmed-mean measures is that they are agnostic on what to exclude, whereas the core always excludes food and energy. But



we also see three major drawbacks (See our report: [US Economic Weekly: Trim your enthusiasm](#)).

First, the signal from the trimmed mean can vary meaningfully depending on how you trim (Exhibit 2). The Dallas Fed trimmed mean is intentionally asymmetric: it trims more off the top than the bottom, to reflect the fact that PCE inflation data are historically negatively skewed. However, the Dallas Fed also noted that the inflation distribution has been symmetrical (rather than negatively skewed) in recent months. That means that a symmetric trim might be a more appropriate signal of underlying inflation today than the standard asymmetric trim.

In March, the Dallas Fed’s asymmetric trimmed mean stood at just 2.4%. But we find that symmetric trimmed means are in the 2.7-2.9% range, which would have different implications for monetary policy. For reference, core PCE inflation was 3.2% y/y.

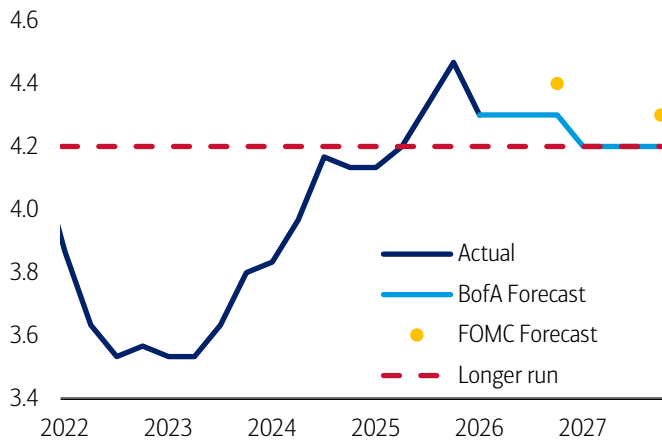
Another drawback of the trimmed measure is that it tends to lag core inflation around turning points. We saw this in 2008 and 2009, when core cooled sharply, and in 2021-2022, when core surged. This means that a focus on the trimmed mean could leave the Fed behind the curve.

Last, we are concerned about the credibility cost of shifting focus away from the core at this juncture. If the Fed were to adopt a new inflation measure that is coincidentally 80bp+ closer to the target when inflation has been overshooting for over five years, markets might view that as cherry-picking and start to question the Fed’s commitment to its inflation target. In this event, inflation expectations would de-anchor.

Interestingly, Warsh has been very focused over the years on maintaining the Fed’s inflation-fighting credibility and keeping inflation expectations anchored. In his nomination testimony, he stated that “inflation is a choice”. I.e., it is mostly driven by policy decisions rather than exogenous factors.

Exhibit 3: The u-rate troughed three years ago but has been little changed on net in recent quarters

Unemployment rate (SA, %)

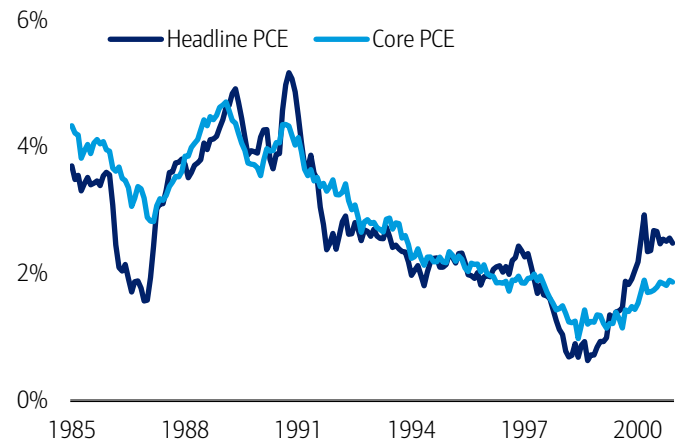


Source: BLS, Haver Analytics, BofA Global Research, FOMC Projections. Note: FOMC forecast is from the March Summary of Economic Projections (SEP) for year-end 2026 and 2027. Longer run is the longer run estimate in the March SEP.

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Exhibit 4: Inflation had been trending down for several years when Greenspan made his bet on productivity in the mid-90s

Headline and core PCE (% y/y)



Source: Bureau of Economic Analysis

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Limited labor commentary

Warsh has had much less to say on the labor market than inflation. In his nomination testimony, he said that it appears to be around full employment. This is close to the FOMC consensus and our own thinking. If he sticks with this view, it will be challenging to advocate for cuts.



What has Warsh said about AI?

Warsh's dovishness is also driven by his views on AI. He expects a disinflationary productivity boom due to AI adoption in coming years. He has even argued that the Fed should look through a potential pickup in inflation due to AI investment demand because it will be easily outweighed by the subsequent supply shock from adoption.

Warsh has argued that instead of reacting to the data, the Fed should make a forward-looking "bet" on AI-driven disinflation by cutting rates. He has said this would be analogous to Chair Greenspan's bet on productivity during the tech boom of the 90s.

In our view, however, this is another area where Warsh is faced with a tough sell. The analogy to the 90s is tenuous for two reasons. First, Greenspan did not advocate for rate cuts on the back of his prescient call on productivity. Rather, he resisted calls to hike rates despite falling unemployment, which other FOMC participants thought would cause a pickup in inflation. This makes sense because although productivity growth is disinflationary, it tends to raise the neutral policy rates. So cuts aren't necessarily warranted.

The other issue with the Greenspan analogy is that globalization was also driving disinflation in the late 90s (NAFTA went into effect in 1994), giving the Fed leeway to risk running the economy hot (Exhibit 4). At the moment, deglobalization, tariffs and supply chain disruption risks from the Iran conflict are creating upside risks to inflation.

Notably, Fed officials have already started pushing back against the "cut rates in anticipation of AI productivity" argument, even before Warsh has had a chance to present it as Fed Chair. St. Louis Fed President Musalem recently said that it's too early to count on a productivity boom.

Chicago Fed President Goolsbee went one step further, arguing that hikes might be warranted. His reasoning was that consumers pull forward their spending when a productivity-driven acceleration in economic activity is widely anticipated. This appears to be the case with AI. The result could be an inflationary demand boom, similar to the late-90s, when the Fed was forced to raise rates.

Governor Waller, who spoke after Goolsbee at the same event, pushed back against the need for hikes, arguing credit constraints would limit the upside to demand and inflation. But even he didn't argue for cuts.

What are Warsh's views on the Fed balance sheet?

Warsh is a balance sheet hawk. In his view, QE subsidized government borrowing. This encouraged fiscal expansion, which ultimately proved inflationary and precipitated rate hikes. There is little doubt that Warsh would like to shrink the Fed's \$6.7tn balance sheet. He has also argued that the Fed can lower rates to offset the financial tightening impact of Quantitative Tightening (QT).

Central bank balance sheet sizes, once right sized, are determined by its liabilities. The Fed right sized its B/S via QT until money markets reflected tightness in Q4 '25. To reduce sheet further, the Fed needs to shrink one of its three key liabilities: currency, TGA and/or reserves. We offer details on each liability in our report: [Warsh & Fed B/S: more bark than bite](#). Reserves are likely the best opportunity for the Fed to reduce its balance sheet.

Reserve reduction: bank friendly or unfriendly?

To reduce reserves, we think there are 2 paths: (1) bank unfriendly (2) bank friendly.

Bank unfriendly: Warsh can tell banks that reserves are capped or tiered (tier = some reserves not fully paid Interest on Reserves (IOR)). Reserve caps or tiers would make banks sub-optimally liquid. Sub-optimally liquid banks likely would be less willing to take risk (i.e. less market making, less loan growth willingness). Less bank risk = slower economy. We think that makes Warsh unlikely to pursue this option.



Bank friendly: Warsh is more likely to pursue bank friendly ways to reduce reserve demand via de-regulation. This would include allowing banks to pre-pledge collateral to Fed discount window for instant monetization. Pre-pledging collateral will expand bank High Quality Liquid Assets (HQLA). More HQLA = fewer reserves needed. We estimate this would result in reserves declining slowly by \$200-500b (~10% total).

This approach would shift the "reserve demand curve". Lower reserve demand will first put downward pressure on funding (Exhibit 5). Fed can later grow sheet slower / reduce sheet to normalize funding (Exhibit 6). Importantly, bank de-reg reserve demand drop will not tighten financial conditions (FCI). If no FCI tightening, no need for rate cuts.

Key question for funding markets: ample or scarce? We think ample

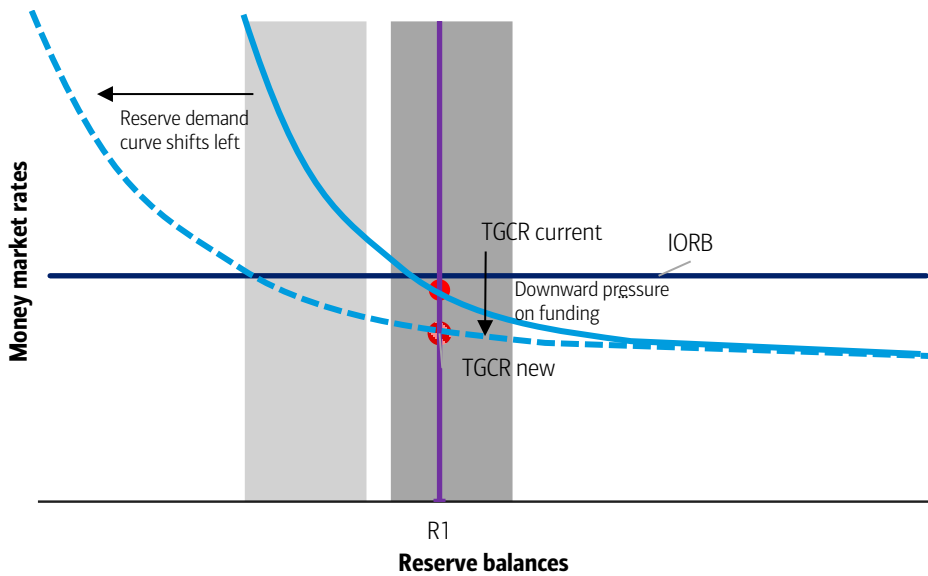
The most important question for funding markets will be: does Warsh support ample or scarce reserves? Our answer: ample. Fed definitions of ample & scarce, for a given move in reserves: ample = limited money market movement; scarce = large money market movement.

We strongly believe Warsh would support ample; if not, he would likely be forced to support it. Ample benefit = easy to implement, ensures banking system flush with cash, limits money market volatility, & supports modestly easier financial conditions. Ample cost = slightly larger balance sheet. Scarce benefits & costs are opposite of ample.

We expect Warsh would support ample because it underpins easy financial conditions. We believe President Trump cares much more about easy financial conditions than size of Fed B/S, and we expect Warsh to have an open ear for the President's policy preferences.

Exhibit 5: Stylized Fed reserve demand and supply curves if reserve demand curve shifts left

If reserve demand curve shifts left due to de-reg, it will place downward pressure on funding rates



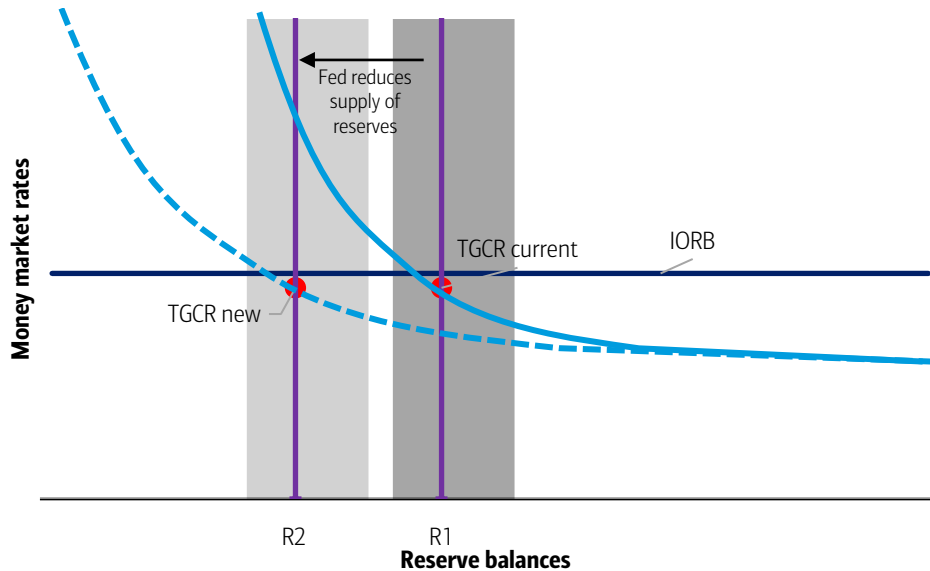
Source: BofA Global Research. Note: Dark gray shaded area signifies "ample" reserves in current reserve demand environment, light gray in new reserve demand environment.

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Exhibit 6: Stylized Fed reserve demand and supply curves if reserve demand curve shifts left and Fed reduces supply of reserves

If funding rates decline, the Fed can reduce the supply of reserves and bring money market rates back up to IORB but maintain "ample" reserves



Source: BofA Global Research. Note: Dark gray shaded area signifies "ample" reserves in current reserve demand environment, light gray in new reserve demand environment.

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Balance sheet reduction timing, composition, & impact

In his nomination testimony, Warsh said that balance sheet cuts would happen slowly and deliberately. We think this probably means Warsh has conceded the Fed will remain in an ample reserve regime. In turn, the main avenue for balance sheet cuts will be liquidity deregulation that reduces bank demand for reserves. In our view, regulatory changes are in the pipeline. We have estimated the Fed could reduce reserves by \$200-500b but expect the process will be slow. The FOMC would likely be amenable to cut the Fed's Treasury portfolio commensurately.

We doubt the committee will be on board with the second part of Warsh's arguments, i.e. that QT should be offset by rate cuts. For one, balance sheet policy is widely viewed as much less impactful for markets than policy rate adjustments. For another, liquidity deregulation already amounts to financial easing, which would arguably be offset by QT. So there wouldn't be a strong case to ease financial conditions further by lowering rates.

Warsh also said in his testimony that the Fed should only own Treasury Bills: it should get longer-dated securities off its balance sheet. We think the committee would be open to the idea that the Fed should not be taking duration risk.

We expect Warsh to impact Fed balance sheet composition via (1) return to mostly Treasury portfolio (2) shorten WAM of Fed's UST holdings. Both are happening now. Warsh likely to speed WAM shortening, but it won't impact markets b/c mechanics. The mechanics are detailed & in our report: [Warsh & Fed B/S: more bark than bite](#). Fed shortening of their UST WAM will not have a market impact unless the Treasury Secretary surprisingly offsets some of the mechanical impacts via larger long end UST auction sizes.

What changes does Warsh want to make to Fed communications?

Warsh wants policymakers to give fewer outlook speeches and opposes forward guidance. In his view, the more the Fed guides the markets, the less discretion it has in determining policy. He also opposes data dependence, because i) it makes policy



backward-looking, and ii) it could cause markets to be too responsive to the minutiae of data releases, even though these figures are just estimates with large error bands.

In terms of reducing communication, we think it's likely that Warsh will go back to quarterly press conferences. Powell started doing press conferences after every meeting in 2019. But before that, Bernanke (starting in 2011) and Yellen both did their pressers on a quarterly cadence.

Many clients have asked whether Warsh will get rid of the Summary of Economic Projections (SEP), or at least the dot plot. This would be consistent with his objections to forward guidance and data dependence. The SEP was introduced in 2007, and the dot plot was added in 2012. Neither addition required a formal vote. Therefore, in theory, Warsh could terminate them unilaterally. But we doubt he will. At least not anytime soon.

The Fed reviewed its communication strategy as part of its framework review that concluded last year. Powell, who is not a fan of the dot-plot, has noted that none of the potential changes that were discussed received strong support across the committee. Therefore, if Warsh were to do away with the SEP or dot plot, he would likely be doing so against the wishes of a large majority of the FOMC. We think the potential cost of antagonizing his colleagues in this manner at the start of his tenure would outweigh any perceived benefits.

We've also received some inquiries on whether Warsh can compel FOMC participants to give fewer speeches. Our understanding is that he cannot. The regional Presidents answer to their respective Boards and the other Governors answer to Congress, rather than to the Fed Chair.

When should we expect to hear from Warsh?

Given how far markets have moved since Warsh's nomination, his first policy comments will likely be a major event. The next blackout period starts on Saturday, June 6. We doubt there is enough time for him to work with his staff to formulate an outlook before then. Therefore, we expect his first substantive policy remarks to be at the June FOMC press conference, but we wouldn't rule out a TV interview this week or next.

There is substantial uncertainty about Warsh's tone at the June press conference. Our best guess is that he will try to downplay the rates decision and shift focus to his big-picture outlook, e.g. on productivity. He might say the Fed is on hold until there is more clarity on the impact of the conflict but his own base case is that inflation will start decreasing again. And in that scenario, the majority of the committee would support additional cuts.

After the June press conference (we assume there will be one), Warsh will get a chance to comment on policy at the semiannual testimony before Congress in June/July. Fed Chairs have typically not used these testimonies as an avenue to express market-moving views, but Warsh might choose to break that norm. Warsh will also get to speak at Jackson Hole. We think he will use that speech to focus on his longer-term agenda, rather than the near-term policy path. Especially because he would probably have given at least one policy speech by that stage.

What are the USD implications of a Warsh-led Fed?

In short, the jury is still out. The low of the DXY index over the past 4.5 years corresponds almost exactly to the announcement date of Kevin Warsh as Fed Chair nominee (30 Jan 2026), with the index up nearly 3% since then. (Exhibit 8) We view this as more of a coincidental "fun fact" above all else, as there have been bigger forces at play influencing the USD at that time. That said, however, there were other potential candidates perceived to be more "USD negative" than Warsh, so the directional reaction was reasonable.

But this has long been priced into the USD. Chair Warsh's stated preference for lower rates has served as a counterweight to what otherwise would be a more bullish USD



environment. (see our report: [Fading the USD Vibe-cession 13 May 2026](#)) But this would have most likely been the case with any of the likely Fed chair candidates. Since Chair Warsh has a history of a hawkish bias (prior to being considered for chair), the market will be listening intently to see just how committed he will be to combating upside inflation, perhaps at the political cost of higher rates.

If over time Chair Warsh pushes for rate cuts in a strong growth and inflationary environment, policy/market uncertainty would rise, presuming the balance of the other voting members disagree. The market would still weigh Chair Warsh’s views more than any other committee member, but a scenario where the Chair is outvoted in the hawkish direction ultimately should speak to institutional resilience—a prerequisite for USD strength.

So is Fed independence still a concern for the USD?

While concerns over “Fed independence” have quieted down they remain a key factor for the USD under the surface. As events of the past year have served to place “Fed independence concerns” towards the top of the list motivating USD bears, the Warsh nomination (by itself) did not add fuel to this fire, per se.

According to our FX and Rates sentiment survey, “Fed independence” has at times registered as the biggest potential catalyst for a leg lower in the USD among a plurality (not majority) of respondents. (Exhibit 7) More recently, those who view “excessively loose US monetary policy” as the biggest USD downside risk has waned. This is likely due in part to the resilient US data, and the diminished likelihood that a critical mass of voting FOMC members will advocate for easing amid the current inflationary backdrop. Indeed, respondents have shifted from seeing excessive Fed accommodation as the biggest USD-negative factor dropped notably from April to May.

Exhibit 7: Potential catalyst for the next leg lower in the USD?

Fed independence risk seen as the main risk for lower USD



Source: BofA Global Research FX and Rates Sentiment Survey

Exhibit 8: The DXY's cyclical bottom coincidentally corresponds with the announcement of Warsh as Fed Chair nominee

Noteworthy dates for the DXY index



Source: Bloomberg; BofA Global Research



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