A Little Less Conversation

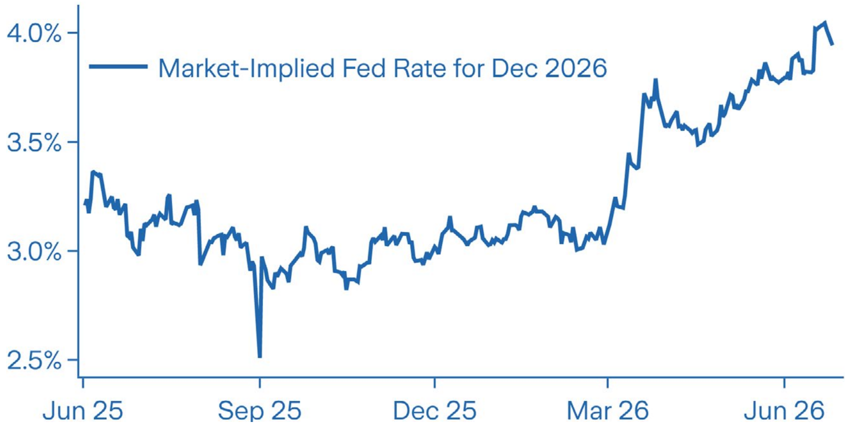
The new Chair of the Fed comes with a hawkish message, strengthening his credibility.

The first policy signals under Kevin Warsh point to continuity in the short term but potentially meaningful change in the Federal Reserve's operating framework over the medium and longer term. While the FOMC unanimously held rates steady, the updated dot plot revealed a distinctly more hawkish bias across the committee with Warsh declining to add his own forecast. More importantly, Warsh used the occasion to outline a broad strategic review, announcing five task forces that could reshape the conduct of US monetary policy in the years ahead.

A Hawkish Bias with Conditional Flexibility

Warsh's rhetoric left little ambiguity about his priorities. His repeated assertion that inflation is ultimately a policy choice underscores a strong commitment to restoring and maintaining price stability. This messaging suggests that the bar for rate cuts has risen meaningfully and that further tightening cannot be ruled out. The risk of rate hikes has increased, but mixed signals from the labour market and a struggling housing market may keep the Fed on hold, nonetheless.

Chart 1: The risk of rate hikes has increased



Source: Bloomberg

Recent declines in energy prices, stabilising inflation expectations, and signs that tariff-related price pressures are fading offer some relief. At the same time, the Fed remains sensitive to labour market risks. Small firms' reluctance to hire and seasonal softness in youth employment may weigh on employment in coming months. The result is a Fed that is more hawkish in rhetoric and bias, but still data-dependent in execution.

The Five Task Forces: A Blueprint for Change

Warsh's announcement of five task forces underlines his intent to review and potentially change the way the Fed operates, with each task force targeting a core pillar of monetary policy.

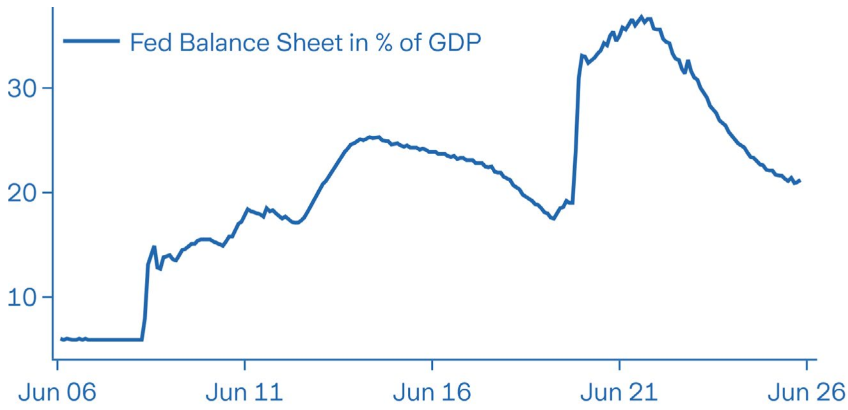
Communications Framework

The Fed will reassess its entire communication toolkit, including forward guidance, the dot plot, the Summary of Economic Projections, and meeting minutes. Warsh has long been sceptical of forward guidance, arguing that it may have outlived its usefulness outside of crisis conditions such as the zero lower bound era.

Balance Sheet Policy

A review of the Fed's balance sheet strategy—including the ample reserves regime—is likely to be one of the most consequential structural shifts. Since 2019, the Fed has officially operated a price-based system, using administered rates rather than actively managing reserve quantities. This framework has been effective in stabilising short-term rates, but it has also reduced the Fed's control over the size of its balance sheet.

Chart 2: The ample reserve regime has boosted the Fed's balance sheet



Source: Bloomberg

This put the Fed in a situation where it was forced to expand its balance sheet not to ease policy, but to maintain ample reserves so that commercial banks could meet Fed-imposed regulatory requirements. A possible way to deal with this would be to adjust liquidity regulations, allowing banks to reduce reserves while maintaining the ample reserves regime.

A full return to the pre-2008 'scarce reserves' system appears unlikely. However, incremental adjustments such as easing liquidity regulations or allowing banks to operate with lower reserve buffers could reduce the system's rigidity. This would give the Fed more flexibility to shrink its balance sheet without destabilizing funding markets.

Data and Methodology

The Fed aims to incorporate more real-time and high-frequency data sources to improve policy responsiveness. The emphasis is on actionable intelligence rather than backward-looking indicators.

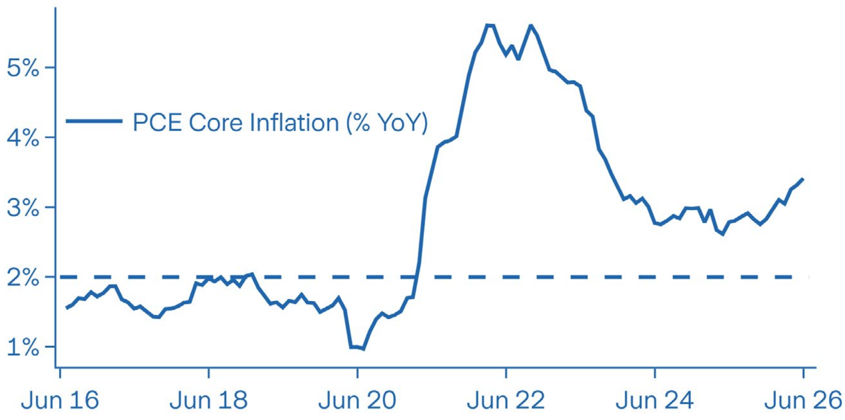
Productivity and Labour in the Age of AI

Warsh has been vocal about the potential productivity gains created by technology in general, and Artificial Intelligence in particular. This task force will analyse how technological change could significantly alter labour dynamics, productivity growth, inflation, and the neutral rate of interest.

Inflation Framework

The 2% target remains intact, at least for now. Raising the inflation target after not having reached it for five years in a row would undermine the Fed's credibility. This was also emphasised by Warsh. In this task force, the Fed will revisit the underlying drivers of inflation and assess how its framework performs in a structurally changing economy.

Chart 3: The Fed missed its inflation target for five years in a row



Source: Bloomberg

The task forces are expected to provide an update by the fall, with conclusions likely by year-end.

Less Transparency, More Volatility

A key implication of Kevin Warsh's new approach is a potential shift toward reduced transparency. If forward guidance and the dot plot are scaled back or eliminated, markets will lose important signals about the Fed's reaction function. While this restores policy flexibility, it also increases uncertainty.

Less pre-commitment from the Fed could lead to greater market volatility, particularly around data releases and policy meetings. Rate expectations may become more reactive and less anchored, amplifying swings in yields and risk assets.

Conclusion

Warsh's early moves suggest a Federal Reserve that is more hawkish and wants to become less pre-committed. The hawkish shift increases the probability that policy rates will remain elevated for longer, particularly given Warsh's emphasis on reaching the inflation target after years of failing to do so. While immediate policy settings remain unchanged, the institutional reforms now underway could redefine how monetary policy is conducted.

Reduced reliance on forward guidance and less explicit signalling will likely lead to larger market reactions to incoming data and more volatility around FOMC meeting dates as part of the price-finding process.

Uncertainty about the future policy framework—especially balance sheet policy—could push term premia higher, at least temporarily.

If the Fed incorporates substantial AI-driven productivity gains into its framework, estimates of potential growth and the neutral rate would change. This could have significant long-term implications for financial markets.

The combination of less forward guidance, a reassessment of the balance sheet framework, and a stronger emphasis on real-time data points to a more flexible—but also less predictable—Fed. For markets, this implies a transition from an era of guided expectations to one of greater uncertainty, where policy is inferred rather than signalled. The Fed under Warsh is about to become more hawkish and harder to read—which is not a bad thing.

Disclaimer and cautionary statement

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