



SALT INSIGHT

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18 May 2026

What might a Kevin Warsh-led Fed look like?

Kevin Warsh's confirmation as the next Fed Chair has sharpened what was already a fascinating debate around the future direction of US monetary policy. At first blush, markets were inclined to view Warsh as more dovish than his historical reputation might suggest, largely because of his more recent criticism of the Fed's reluctance to cut rates and his apparent openness to the idea that AI-driven productivity gains could be disinflationary over time. But the environment he is inheriting has changed materially. Inflation is again moving higher, the Iran war has pushed energy prices sharply higher, and bond markets have already tightened financial conditions through higher long-term yields.

That matters because it increasingly looks as though Warsh may not have the flexibility to deliver the easier policy stance many initially assumed. In fact, one of the more interesting developments over recent weeks is that markets have started pricing a non-trivial probability that the Fed's next move could eventually be a hike rather than a cut. The irony is that Warsh may enter office with a reputation for being more sympathetic to growth and supply-side arguments yet find himself constrained by precisely the kind of inflation persistence that has defined the post-pandemic period.

The bigger intellectual shift under a Warsh Fed may therefore be less about the near-term level of interest rates and more about the framework underpinning monetary policy. As we have pointed out previously, Warsh cannot unilaterally deliver a materially more dovish Fed. Monetary policy decisions are made collectively by the FOMC, and with inflation risks again rising, it is difficult to see a broad committee consensus emerging around aggressive easing

in the near term. Instead, any dovish tilt under Warsh is more likely to come through structural changes in how the Fed interprets and delivers on its dual mandate, including a greater emphasis on supply-side dynamics, productivity growth and the economy's productive capacity, rather than simply responding to cyclical fluctuations in demand and inflation.

That aligns with Warsh's broader critique that the Fed became overly reactive to every incremental data release and too reliant on unconventional policy tools and forward guidance. A Warsh-led Fed may ultimately place less emphasis on fine-tuning short-term demand conditions and more emphasis on the economy's longer-run productive capacity. It may also imply a greater tolerance for short-term inflation volatility if policymakers believe underlying supply-side improvements are lifting the economy's non-inflationary growth potential. In that respect, the AI debate becomes highly relevant.

Warsh has argued that AI could become a significant disinflationary force, effectively allowing stronger growth without the same inflation consequences. But this is where we would continue to exercise some caution. As we've discussed previously, there is a difference between believing AI may eventually improve productivity and assuming those gains will arrive quickly enough to materially change the inflation outlook in the next couple of years. If anything, the current phase of the AI buildout arguably looks more inflationary than disinflationary, given the extraordinary capital spending requirements around data centres, electricity infrastructure and semiconductors. The risk is that policy leans too heavily on a productivity dividend that has yet to clearly appear in the macro data.

There is also an important institutional question hanging over all of this - Fed independence. Warsh has publicly defended Fed independence, but markets remain sensitive to the perception that the White House wants materially lower rates. Ironically, one reason bond yields may have moved higher following his confirmation is that investors are demanding a higher term premium until they are convinced the Fed will remain firmly anchored around price stability.

Ultimately, our sense is that a Warsh Fed could look quite different stylistically from the Powell era - less faith in forward guidance, less enthusiasm for large balance sheets, more focus on structural supply-side dynamics and perhaps greater tolerance for market volatility. But the immediate reality is that he is taking over at a time when inflation is again proving stubborn, fiscal deficits remain enormous, and geopolitical shocks are complicating the outlook. In that environment, the market may end up forcing monetary discipline regardless of who occupies the Chair.

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