

Economic Special Report



How Kevin Warsh May Reform the Fed: Monetary Policy, Mandate, and Deregulation

After a protracted selection process, the White House ended months of speculation on 30 January 2026 by nominating a figure who had long hovered near the top of the list but did not emerge as the favourite until the final hours: Kevin Warsh. While Warsh had been a perennial candidate in previous succession cycles, his eventual nomination represented a profound shock to the status quo. The announcement triggered an immediate and strong jolt across global financial markets including precious metals, FX, and risk assets. This broad-based volatility reflects a realisation that this is not merely a leadership transition but a strategic reset of the Federal Reserve (Fed).

Warsh's Profile: A Rare Talent with Wall Street, Public Policy, and Central Banking Expertise

While not holding a PhD, Kevin Warsh (55) brings a distinctive background, combining high-stakes Wall Street deal making, public policy implementation and think-tank advisory experiences.

The Wall Street Years: Warsh holds a B.A. in public policy from Stanford and a J.D. from Harvard Law School. He spent his formative years (1995-2002) at Morgan Stanley, rising to Executive Director in the Mergers and Acquisitions (M&A) department.

The Washington Pivot: In 2002, Warsh joined the George W. Bush administration as Special Assistant to the President for Economic Policy. In the same year, Warsh married Jane Lauder, daughter of Ronald Lauder, who is a prominent Republican donor, a billionaire heir to the Estée Lauder fortune as well as a former classmate of Trump's at the Wharton School.

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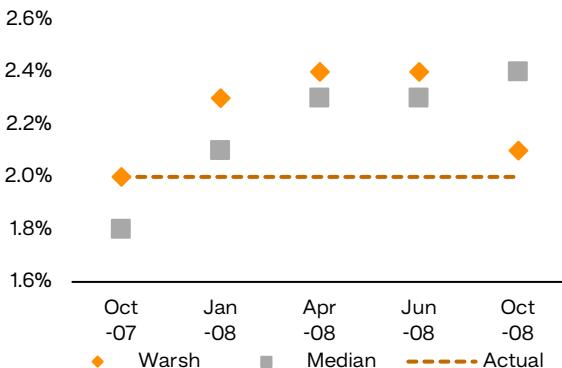
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The 2008 Crisis Tenure: Appointed to the Federal Reserve Board of Governors in 2006 at the age of 35, Warsh was the youngest person to join the Fed in the central bank's history. During the Global Financial Crisis (GFC) in 2007-2008, he served as the Fed's primary bridge to Wall Street, leveraging his private sector network to facilitate critical deals including the rescue of AIG and JPMorgan's acquisition of Bear Stearns. However, Warsh resigned from the Fed in 2011, as he opposed a second round of asset purchases intended to bolster a weak economic recovery. His warning proved prescient. In spite of a series of quantitative easing (QE), the post-GFC recovery turned out to be the weakest in the post-war period.

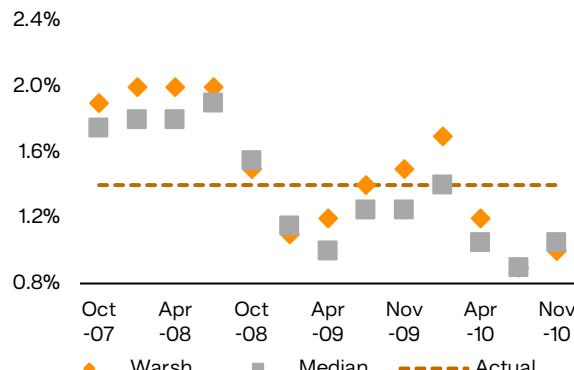
A Long-standing Critic of the Fed's Mission Creep: Since leaving the Fed, Warsh has served as an adviser to the Duquesne Family Office (which had previously hired Treasury Secretary Scott Bessent) and a fellow at the Hoover Institution. Warsh has also advised Trump on economic matters for years and emerged as a leading voice for reforming the Fed, arguing in essays, speeches and interviews that the institution has gone astray. There're two dimensions of the Fed's alleged overreach, i.e. how it conducts monetary policy and how it ventures beyond its mandate. On monetary policy, the Fed has resorted to unconventional asset purchases and made them a staple of its tool kit. Meanwhile, it also attempted to tackle social issues that had little to do with its official mandate. Warsh also argued that 'inflation is a choice' and the Fed should focus on safeguarding its core mandate: price stability. Overall, Kevin Warsh represents a break from continuity. His nomination signals a pivot toward a narrower and less interventionist central bank, leaving a smaller footprint in the economy.

Monetary Policy Stance: Lower Interest Rates and a Normalised Balance Sheet

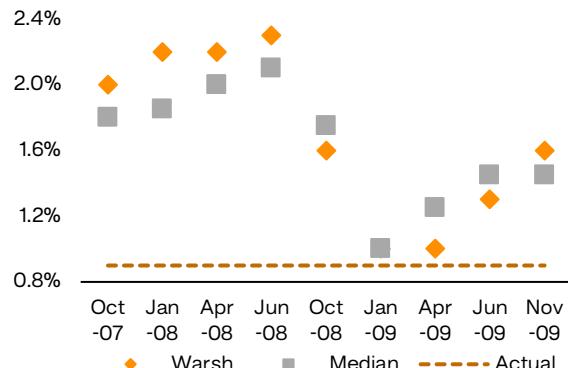
Kevin Warsh was considered a hawk with a sharp focus on inflation risks. During his tenure as a Fed governor from 2006-2011, Warsh consistently expressed his concerns about upside risks to inflation, opposing zero percent interest rates during the GFC. The Fed has been releasing the projections of members in the Federal Open Market Committee (FOMC) since October 2007. According to the records, Warsh's projections for core personal consumption expenditure (PCE) inflation were generally higher than the FOMC median, with 4 out of 5 projections above the median for 2008, 5 out of 9 projections for 2009, 9 out of 13 projections for 2010, and 8 out of 10 projections for 2011. Across all projections, Warsh's average forecasts for core PCE inflation were 2.2%, 1.7% and 1.5% from 2008 to 2010, exceeding the actual values of 2.0%, 0.9% and 1.4%, respectively.

Projections of 2008 Core PCE Inflation


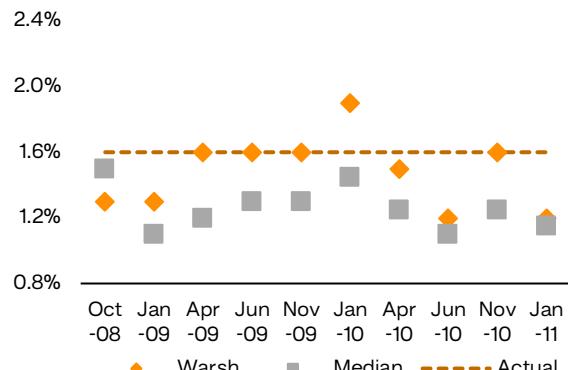
Source: US Federal Reserve

Projections of 2009 Core PCE Inflation


Source: US Federal Reserve

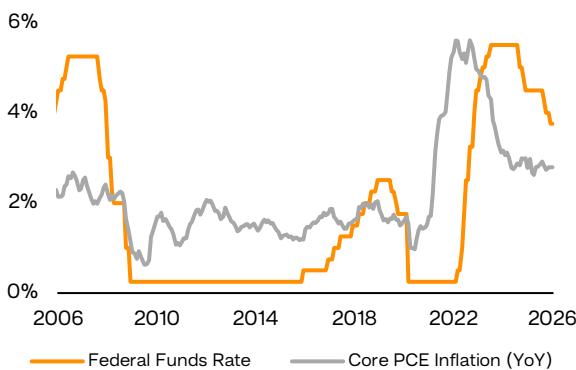
Projections of 2009 Core PCE Inflation


Source: US Federal Reserve

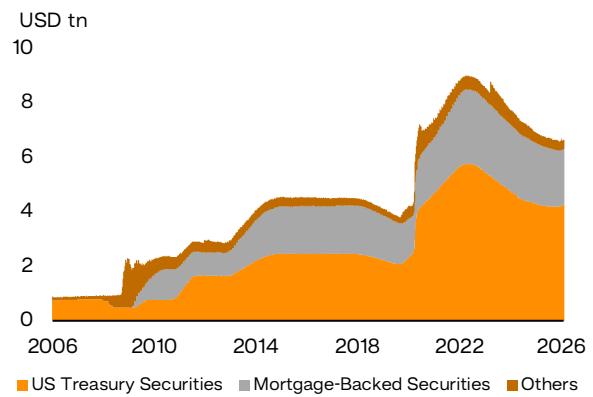
Projections of 2011 Core PCE Inflation


Source: US Federal Reserve

A combination of rate cuts and balance sheet normalisation formulates Warsh's latest monetary policy orientation. Despite his historically hawkish track record, Warsh supported lowering interest rates in 2025, as productivity gains from artificial intelligence (AI) may become a disinflationary force. In his view, AI could reduce costs across the economy by boosting efficiency, resulting in higher real wages. Moreover, Warsh opined that inflation was primarily caused by excessive government spending and QE by central banks. He argued that the Fed's bloated balance sheet, designed to provide support during previous crises, should be reduced significantly.

US Fed Funds Rate & Core PCE Inflation


Source: US Federal Reserve, US Bureau of Economic Analysis

US Fed Balance Sheet


Source: US Federal Reserve

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Warsh proposes coordination between the Treasury and the Fed to shrink its balance sheet. Warsh has long criticised the post-GFC QE programme, arguing that persistent asset purchases by the Fed subsidised government borrowing and blurred the line between fiscal and monetary policy. He calls for a new "Treasury-Fed accord", similar to the 1951 agreement that ended the Fed's wartime commitment to pegging interest rates at low levels for government borrowing and restored central bank independence in monetary policy. Under the new framework, the Fed Chair and the Treasury Secretary would clearly and deliberately set the target size of the Fed's balance sheet, while redefining the boundaries between the Fed and the Treasury. Treasury Secretary Scott Bessent supported the idea, emphasising that the Fed should conduct unconventional QE policies only in true emergencies and in coordination with the rest of government. In January 2026, President Trump ordered Fannie Mae and Freddie Mac to purchase up to USD 200 billion in mortgage-backed securities (MBS), which served as a counterbalance to the Fed's previous reduction in MBS holdings.

Forward guidance's role may fade under Warsh's leadership. Warsh is sceptical of the benefits of forward guidance and of heavy reliance on data, which could constrain policy flexibility. He has also called for reduced interaction between Fed officials and the media to lower the Fed's footprint in financial markets.

Deregulatory stance: Market Friendly Vision

Kevin Warsh's policy outlook aligns closely with the Trump administration's deregulatory approach, which emphasises rolling back post-2008 financial regulations to promote growth and competitiveness. This agenda is based on the view that excessive regulation constrains lending, dampens investment, and discourages risk-taking, with Warsh expressing similar concerns about regulatory overreach and the proper scope of central bank authority. Warsh's deregulatory stance is most evident in his criticism of the compliance burdens imposed by post-GFC reforms such as the Dodd-Frank Act. While acknowledging that some rules were intended to strengthen financial stability, he has argued that elements of the regulatory framework became overly burdensome, reducing credit availability and raising costs for banks, particularly smaller institutions. He is widely seen as a free-market advocate, favouring a recalibration of these rules while preserving core safety objectives, contending that easing regulation could help lower inflation by improving productivity and bringing down costs.

In the banking sector, Warsh has argued for streamlined compliance requirements to reduce costs and expand lending capacity. He has suggested that smaller businesses and households would be among the primary beneficiaries, given their greater sensitivity to credit constraints.

Warsh also extends his deregulatory philosophy to emerging technologies. He has recognised AI as a driver of productivity gains and supported capital flows into AI-driven sectors, viewing them as critical to long-term competitiveness. His openness to financial innovation is further reflected in his views on cryptocurrency. Warsh has described Bitcoin as a kind of "new gold" for younger investors, acknowledging its role as a legitimate store of value. This signals a willingness to embrace technological change rather than resist it.

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Notwithstanding these potential benefits, Warsh's deregulatory stance may also present risks. Easing regulatory constraints too aggressively could weaken safeguards designed to prevent financial crises. A narrower interpretation of the Federal Reserve's regulatory mandate may reduce its capacity to identify and mitigate emerging vulnerabilities. As with all policy deliberations, the key is to strike a fine balance between potential benefits and costs. Nonetheless, given the Fed's far-from-stellar regulatory record, a fresh approach should be welcomed.

The policy implications of Warsh's stance are significant. A Federal Reserve under his leadership will likely encourage financial innovation, support lending growth, and adapt to new technologies in ways that align with the administration's pro-growth narrative.

Warsh's Critics of the Fed: Overreach and the Erosion of Independence

Mission creep with institutional bloat. Warsh strongly argues that the Fed has undergone a fundamental shift from a narrowly defined central bank to a general-purpose policy institution with an increasingly discretionary remit. In his view, modern US central banking has experienced significant 'scope creep', moving beyond its core mandate on maximum employment and price stability. Warsh also highlights the Fed's growing engagement with politically charged priorities, such as climate-related initiatives and "inclusive employment", targeting the jobless rate for certain demographic groups. These policy choices, he contends, should fall under the elected branches of government rather than technocratic extensions of the Fed's dual mandate. Warsh emphasises that this institutional expansion coincided with the Fed's failure to maintain price stability and its excessively expanded asset holdings. By blurring the line between monetary policy and political decision-making, the Fed risks weakening the legitimacy and long-term durability of central bank independence.

The erosion of the fiscal–monetary boundary. Warsh argues that QE has gradually shifted from an emergency measure to a structural policy tool, blurring the fiscal-monetary boundary. He notes that the Fed's repeated large-scale Treasury purchases, following the GFC and the Covid pandemic, have turned QE into a quasi-permanent instrument rather than a temporary crisis response. This persistence encouraged the federal government to run ever-larger deficits, suppressed market signals, and lifted inflation. He rejects QE2-style logic as routine Treasury purchases risk creating fiscal dominance, where the Fed becomes a de facto financier of government debt. This dynamic creates an implicit subsidy to sovereign borrowing, compresses term premiums, and distorts price discovery. For Warsh, this regime shift rewards fiscal profligacy and forces markets to treat the Fed's balance sheet as a permanent backstop, ultimately pushing the US fiscal trajectory toward an unsustainable path.

Scepticism of data dependence and market signalling. A recurring theme in Warsh's critique is scepticism toward excessive "data dependence". From a market perspective, this translates into three concerns. First, high-frequency data can induce policy overreaction, increasing interest rate volatility rather than reducing it. Second, forward guidance tied too closely to near-term indicators weaken the informational content of long-end yields. Third, markets increasingly trade on the central bank's interpretation of data rather than macro fundamentals. In this sense, Warsh's critique aligns with investor worries about policy-signalling noise and declining clarity around the Fed's

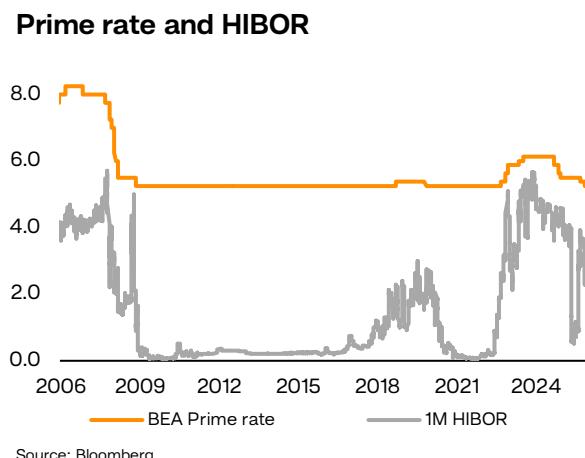
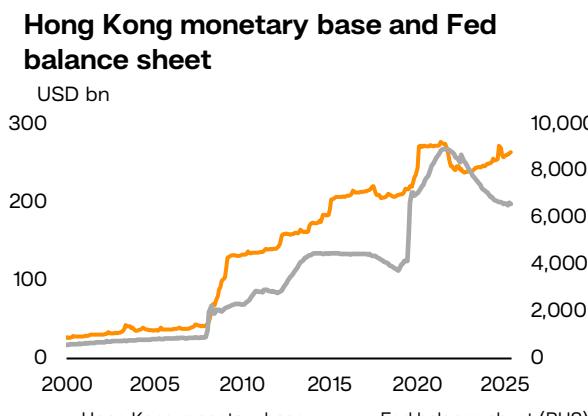
medium-term objective function. Warsh argues that an excessive focus on near-term data, short-run forecasts, and repeated verbal calibration creates "false precision" and leaves policymakers "prisoners of their own words". He therefore calls for a more disciplined, low-profile approach, which would restore policy optionality and strengthen credibility.

Impact on Hong Kong: Largely Stable Market Liquidity and Lower HIBOR

Warsh's opposition to balance sheet expansion may lead to largely stable market liquidity in Hong Kong. During previous periods of QE, the surge in global liquidity led to significant capital flows into Hong Kong. Hong Kong's monetary base rose in tandem with the Fed's QE programme. Under the linked exchange rate system, interest rates in Hong Kong track closely with those of the US. During the QE episodes with excessive global liquidity, capital inflows also enlarged Hong Kong's aggregate balance.

However, with Warsh at the helm, the Fed is expected to adopt a more restrained approach to its balance sheet. Known for his criticism of aggressive balance sheet expansion, Warsh is unlikely to support new rounds of QE and may even favour a resumption of balance sheet reduction. As a result, the possibility of another wave of excessive global liquidity appears slim. This will probably imply stable market liquidity in Hong Kong under Warsh's tenure.

Hong Kong dollar prime rate remains unchanged, but further downward adjustments to HIBOR are likely. Following multiple rounds of Fed rate cuts totalling 175 basis points, Hong Kong's prime rate has already fallen to its historical low. Therefore, any additional Fed easing is unlikely to lower the HKD prime rate further. However, there is still room for HIBOR to decline, as it remains responsive to changes in the fed funds rate. As Warsh is expected to align with President Trump's preference for lower interest rates, the Fed's rate-cutting cycle remains intact, portending a further decline in HIBOR.



Conclusion

If confirmed, Warsh will likely attempt to reform the Fed. Indeed, the trajectory of future interest rate adjustments, while undoubtedly important in the short term, may turn out to be less

consequential than other policy deliberations.

For instance, Warsh's preference for a small balance sheet at the central bank may make the setting of monetary policy more transparent and straightforward by significantly reducing the Fed's reliance on QE, once considered unconventional but now a fixture of policy tools. With a smaller balance sheet, the smooth implementation of monetary policy will then require deregulation measures that would lower reserve requirements and free up liquidity for banks. Meanwhile, having been highly critical of the Fed's alleged overreach, Warsh's focus will be far narrower, which may increase the chance of success in meeting the Fed's core goals and ensuring financial stability.

Last but not least, given Warsh's apparent opposition to forward guidance, the Fed may eventually discontinue the publication of projections of major indicators and the dot plot. Theoretically, this potential change could provide the Fed with more operational flexibility and make it less beholden to the gyrations of financial markets. In any event, the case for forward guidance has been dubious at best, as the views of the members of the FOMC shift from one meeting to the next and their assessment of economic activities is sometimes at odds with their interest rate projections.

The direction of a Warsh-led Fed may thus be summarised in three words – back to basics.

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