

Kevin Warsh's Fed confirmation faces tough tests

Kevin Warsh's confirmation hearing to be the next Fed Chair will see him having to tread a fine line between making the case for lower borrowing costs, which helped him get the nomination from the President, and preserving the Fed's inflation-fighting credentials. Politics and the DoJ case against the Fed mean a swift confirmation is unlikely



At his confirmation hearings, Kevin Warsh will have to balance calls for lower borrowing costs and the inflation-fighting credentials of the Federal Reserve

Kevin Warsh's challenge - the President & market credibility

The Federal Reserve has entered its quiet period ahead of the 29 April FOMC meeting, but it will still be drawing headlines given Kevin Warsh's confirmation hearing to become Federal Reserve Chair is being held tomorrow. Once viewed as a hawk when he previously served as a Fed Governor (February 2006-March 2011), he has been nominated by President Trump, who has demanded much lower interest rates from current incumbent, Jerome Powell.

Warsh will inevitably be questioned on how closely aligned he is with the President's thinking. We imagine he will indicate a belief that, over time, lower interest rates make sense. However, preserving market credibility is of paramount importance and there must be justification.

The Iran conflict-induced jump in motor fuel costs creates near-term challenges in an environment where both core and headline consumer price inflation have exceeded the 2% target throughout the past five years. He will be wary of coming across as too dovish. That could heighten market fears of potential unanchored market inflation expectations, prompting higher long-term borrowing costs.

Treasury Secretary Scott Bessent has emphasised that, in his view, the most important metric is the 10Y Treasury yield given its benchmark role and the impact it has on mortgage rates and corporate borrowing costs. He appears to be onboard with a delay to rate cuts, based on recent media comments, but the President is probably not going to be so keen. Nonetheless, if there is a swift conclusion to the conflict and fuel prices drop sharply, Warsh will strongly suggest there is the possibility of his support for rate cuts later this year.

Structurally speaking, Kevin Warsh will emphasise the opportunity for lower borrowing costs over the medium to longer term. He clearly buys into the idea that tech/AI investment will boost productivity and allow the US to grow faster without generating inflation. To be fair, there appears to be support for this view within the broader Fed, given that within the March forecast update, officials revised higher their long-run GDP forecast to 2% from 1.8%, without altering the long-term inflation prediction. The minutes suggested that "several participants... expected higher productivity growth, associated with technological or deregulatory developments, to put downward pressure on inflation."

The Fed's balance sheet

In addition to the productivity narrative, Kevin Warsh has another theory. Every US\$1tn of Fed bond holdings equates to 50bp on the policy rate (approximately). In consequence, balance sheet contraction, through bond roll-offs or outright selling, facilitates rate cuts. This is convenient, as Warsh also believes that the Fed continues to own too many bonds. The build of bond buying was a consequence of past crises, and now that they are no more, much of the bonds should be off-loaded. He's not been specific about sizes, but said that they should be significantly reduced. And he's identified Mortgage-Backed Securities (MBS) as a particular eye-sore that should be liquidated. And finally, he's advocated mostly a passive run-off, cognisant of market de-stabilisation risks.

Consider two scenarios. One is a reduction in the balance sheet right back to pre-Global Financial Crisis levels (5.5% of GDP). That would require some US\$4.5tn in bond liquidations. That's unlikely, but we do develop that narrative [here](#). More probable is a targeted sale of the US\$2tn of MBS holdings. This is currently rolling off at a slow trickle, as it's primarily long in duration. But it could be subject to outright sales. It could be softened by extra T-bills buying, to prevent repo market disruption.

The issue here, however, is the impact on bank reserves. Bank reserves sit on the Fed's balance sheet, and are remunerated by the rate the Fed pays on reserves. They are there as an echo of the prior bond buying undertaken by the Fed (effectively the other side of the Fed's balance sheet). In 2019 and again through the second half of 2025, we saw repo market tightness occur as bank reserves fell to critical levels. For no particular reason, circa 10% of GDP is a level below which tightness has tended to kick in.

Kevin Warsh has suggested identification of a target for bank reserves, and keeping to that. He's not been specific as to what that level should be. The unwritten level today is US\$3tn. That's sitting alongside Fed bond holdings of US\$6.3tn. Simplistically, if the Fed's balance sheet was shrunk by

US\$2tn, bank reserves could be pressured down to around US\$2-2.5tn. In today's setup, that would cause repo issues.

The simple solution would be to offset MBS sales with T-bills buying. Not technically QE (as bills buying is short in maturity and, in a sense, akin to open market operations), but would still leave the balance sheet bloated with government securities. Warsh needs a plan to deal with this. We'll be listening for more as he testifies, albeit perhaps a bit deep in the weeds for a Senate hearing. It is *really* important though. Apart from repo issues, MBS selling with a view to cutting rates, points to a steeper curve from both ends.

Chair Powell could continue beyond 15 May

Whether Kevin Warsh will be approved quickly is another matter given the Department of Justice's probe into Fed construction work overspending. The Senate Banking Committee consists of 13 Republicans and 11 Democrats, but Republican Thom Tillis has vowed to block the confirmation until the "vindictive prosecution" of Chair Powell is ended. Until Thom Tillis is satisfied, it will be a 12-12 vote, and it can't proceed to a formal Senate vote.

Jerome Powell's term as Fed Chair notionally ends on 15 May, but until Warsh is approved, Powell will stay in the role with his term as Governor scheduled to continue until 31 January 2028. As such, tensions between the Fed and the President are likely to remain elevated, but with strong rules of governance, we think the Fed's independence is not in doubt

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