2026.2-3

ECO

WSJ Print Edition

The market reaction to his nomination suggests he is likely to do the right thing as Fed chairman.

EDITOR AT LARGE

Kevin Warsh and the Parable of the Two Sons

A perennially resonant Gospel parable is the one about the vineyard owner with two sons whom he summoned to work on his property. The first refused, but then thought better of it and went and did as his father asked. The second unctuously told his father he would comply but then went off and did something else.

Jesus tells the story as a lesson that we should pay less attention when people loudly tell us what we want to hear and more heed to what they actually do. I suspect it is a good basis for understanding the implications of President Trump's nomination of Kevin Warsh to be chairman of the Federal Reserve.

The president has long been looking for a compliant underling to run the troublesome Fed vineyard in the way he wants—with looser monetary policy. Mr. Trump being a more intimidating figure than the father in Matthew's Gospel, no one in this version of the story was willing to play the defiant son. Instead the final four candidates for the job were a range of eager submissives, each straining to appear enthusiastic to pick up the pruning shears and start cutting rates by the bunch: Kevin Hassett, chairman of the National Economic Council at the White House, a once-orthodox conservative economist who has become a reliable mouthpiece for Mr. Trump's wildest heresies; Rick Rieder, the BlackRock executive who has been a consistent advocate of easier monetary policy; Christopher Waller, until recently a mainstream Fed governor who weeks ago in--sisted he was in no rush to cut rates but submitted a last-minute bid to impress the president last week in the form of a dissent from the Federal Open Market Committee's decision to leave rates unchanged; and Mr. Warsh, who has spent the past year berating Chairman Jerome Powell and calling for lower rates.

Note

It is a curiously convoluted tribute to Mr. Trump's judgment that in Mr. Warsh he has ended up with the man who almost certainly is the least likely of the four to do what the president wants and the most likely to do the right thing.

To anyone who has followed Mr. Warsh's record in and out of government (he joined the Fed as a governor when I was still covering the central bank as a reporter), the balance of his career suggests he was the most hawkish of the final slate of candidates. A fierce opponent of quantitative easing, Mr. Warsh's tight-money credentials are so solid that he expressed skepticism about QE even in the midst of the 2008-09 global financial crisis. Thereafter, in and out of the Fed, he repeatedly warned about the risks of rising inflation, even though the rate declined and stayed low for a decade. And in the years after Covid he again warned that policy was too loose (when inflation actually did take off). ← but why?

Then for some reason—beginning, a cynic might say, somewhere on the evening of Nov. 5, 2024—Mr. Warsh began having second thoughts and argued that, even though the Fed has failed to meet its inflation target for five straight years, policy should be looser.

Note

He now argues that artificial intelligence is so dramatically increasing the productive capacity of the economy that the Fed can do what it did in the 1990s: let the economy run hotter without risk of inflation. The real federal-funds rate is mildly restrictive, and Mr. Warsh seems to think it could be neutral or even negative. There may be something to this, but it's as yet an untested theory with little data to back it up.

Note — Note

His stance against quantitative easing is principled and consistent, but it's unclear that it will lead to the kind of policy outcomes he and the president seem to want. Mr. Warsh has a strong case when he calls out "mission creep" at the Fed and demands "regime change." He rightly says its bloated balance sheet is distorting the U.S. economy—interrupting market signals, propping up irresponsible fiscal policy, and providing a de facto "Fed put" under asset prices. He also blames it for contributing to inequality, although that's less clear.

Note

But unwinding it not only will be difficult, given rising concerns about market liquidity; it also may not produce the more equitable economic benefits he wants. If the Fed lowers short-term rates and shrinks its balance sheet, as he proposes, the resulting steepened yield curve will be a bonanza for banks and bad news not only for holders of capital but for anyone who wants a mortgage.

Whether you take a cynical view of Mr. Warsh's recent easy-money advocacy or think it a genuine conversion, it doesn't look as if investors think it matters either way: They seem to believe he'll be the inflation hawk he was.

In Matthew's Gospel the virtuous figure of the parable is the first son, the one who initially refused his father's instructions but then did his will after all. In today's version the market reaction to Mr. Warsh's nomination— stable fed-funds futures, higher bond yields, and a stronger dollar—suggests the hero this time will be the one who promised to do what the boss wanted and then went off and did exactly what he had intended to do in the first place.

By Gerard Baker