

Get Ready for an Overdue Fed Overhaul

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US Federal Reserve officials would rather “stick to their knitting” than confront the complex forces that are reshaping the economy. Unless the next Fed chair shakes the institution out of its complacency, continued policy-induced volatility and intensifying political attacks are all but guaranteed.

NEW YORK – Today, there is a level of discord within the United States Federal Reserve that has rarely been seen in modern history. Nearly all experienced market analysts agree that the coming Fed policy meetings could prove unusually divisive, owing to conflicting economic views, political sensitivities, and inherent biases. The tension is palpable and has led to wild fluctuations in what markets expect the Fed will do. But, while the media fixate on who will or won't support interest-rate cuts, what matters is not simply that the Fed is deeply divided, but how to make it more effective.

To answer this question, one must first understand the challenges the Fed is facing – beginning with insufficient data. Following the longest government shutdown in US history, the data the Fed is receiving are incomplete, uncertain, and subject to unusually large revisions. For a central bank that is highly data dependent, this is tantamount to flying blind.

This lack of clarity about the US economy's performance compounds the second challenge, arising from the Fed's dual mandate of targeting price stability and maximum employment. Historically, policies that advanced one objective did not undermine the other. Today, however, these imperatives are pulling in opposite directions – and dividing Fed officials. While the “hawks” remain focused on price stability, pointing out that both core and headline inflation are running around one

percentage point above the Fed's target, the "doves" are becoming increasingly concerned about weakening labor-market indicators.

Complicating this tug-of-war is the Fed's third, implicit mandate – ensuring financial stability – which is complicated by bubble-like developments in some markets, with risk-taking and dubious funding practices on the rise. Coping with these challenges would be difficult in the best of times, but it is especially tough with the end of Fed Chair Jerome Powell's tenure looming. A "lame duck" Fed chair may find it harder to muster the authority necessary to unite a fractured board.

Against this backdrop, whatever the Fed decides in the upcoming meetings will come with risks. There is no "safe" path. Given this, markets are now gripped by a profound sense of uncertainty. In less than a month, the likelihood of a December rate hike has swung from over 90% to under 30%, then back up to 90%. This level of volatility is highly unusual and points to an institutional failure: A Fed that values "forward policy guidance" in fostering stability and predictability is not sending credible and consistent signals. Given America's position as an anchor of the global economic and financial order, the consequences are far-reaching.

But if we stop here, we get only half the story – and the unhelpful half, at that. The harsh truth is that the appointment of a new chair will not solve the Fed's problems. A robust "refresh and reform" program is also needed.

The Fed's recent history is littered with missteps. Misguided analyses and flawed forecasting have led to [wrong conclusions](#), including the assumption that the inflationary surge that emerged in 2021 would prove "transitory," and to [delayed action](#), which has left policymakers playing catch-up. Meanwhile, poor communication has muddied market outlooks, and allegations of financial malpractice have been brought against five Fed officials (though not all have been proven). These issues reflect a weak institutional culture, a lack of strategic vision, and intellectual stagnation, all of which have eroded the Fed's credibility and fueled escalating political threats to its independence.

Addressing the Fed's shortcomings could not be more urgent. We are on the brink of a transformational productivity boom, driven by innovations like AI, robotics, and life

sciences. These technologies have the potential to increase the speed limit for non-inflationary growth, creating a promising scenario of high output without high prices. But they also raise the risk of new policy mistakes, especially if employment is decoupled from growth. In this new era, a strong economy may be accompanied by a weakening labor market.

So far, Fed officials have shown insufficient curiosity about the coming transformation. “Sticking to their knitting” is more comfortable than confronting the complex forces that are reshaping the global economy. But complacency is a luxury monetary policymakers can no longer afford. The next Fed chair’s primary task must therefore be to shake the institution out of its structural inertia. It is time for the Fed to get comfortable with being uncomfortable.

This will require a thorough review of Fed operations and the embrace of a more flexible, nuanced approach. Priorities must include determining the best way to set the inflation target amid high supply-side volatility, developing better intermediate policy tools, establishing structural defenses against groupthink within the Fed Open Market Committee, increasing accountability, strengthening compliance culture, and improving forecasting capabilities.

It is a daunting agenda. But challenging internally-led reforms are far preferable to the alternative: a Fed that continues to generate policy-induced volatility, faces intensifying political attacks, and fails to provide the stability and predictability needed for the US and global economies to prosper.