

Warsh needs to separate his roles at the Fed

Financial Times Europe
04 giu 2026
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When Kevin Warsh was first nominated as a governor of the US Federal Reserve in 2006, at just 35 years old, a senator dispatched him for a particularly intimidating job interview — with Paul Volcker, the renowned Fed chair who resisted political pressure and fought inflation from 1979 to 1987. Volcker, in Warsh's telling, gave him two pieces of advice.



“He said, ‘Kevin, there’s something I need to tell you. This job you’re signing up for really is quite simple. It really only requires two things,’” Warsh told the How Leaders Lead podcast in 2023. “And he said: ‘The first thing is, you have to get interest rates about right.’” Warsh noted down this profound lesson from the master. “And he said: ‘The second thing is probably more important than the first. When you’re a governor of the Federal Reserve, probably the most important thing is to make sure you look like you know what you’re doing.’”

Twenty years on, Warsh is back at the Fed, in Volcker's old job, and he could do much worse than to heed his hero's advice.

Warsh's position as the new Fed chair is delicate. He has criticised the central bank's past performance, harshly, and promised reforms. He has flirted with the idea that productivity gains brought by artificial intelligence will let the US grow without inflation. He has vowed to be independent from the president who nominated him. Yet that president prizes loyalty above all, and constantly demands lower interest rates, even as his war in Iran pushes prices up.

Now Warsh must reconcile all of those threads with an extant group of colleagues on the rate-setting Federal Open Market Committee who do not all share his agenda. They include Jerome Powell, his immediate predecessor, who Warsh has slammed for “unwise choices”. As a lawyer by training, not an economist, Warsh will have to rely on the Fed staff on technical points of policy.

Given such a backdrop, how is Warsh to follow Volcker's deceptively simple advice, to get policy right and inspire confidence in his colleagues, in the public and in the markets? The best approach is to separate clearly his role as chair from his individual vote and voice on monetary policy.

To see how that might work, consider how the FOMC makes decisions. The next meeting concludes in a fortnight, on June 17. If Warsh follows the pattern of past chairs, he will talk with each member of the committee in advance, to understand their views. In the meeting itself, the Fed staff present three policy options — A, B and C — one hawkish, one in the middle and one easy. The chair controls the staff. If Warsh is wise then option B, the central choice, will match the opinions of his committee.

Alan Greenspan — the Fed chair from 1987 to 2006 and another Warsh touchstone — would speak first in FOMC discussions and say what he thought the committee should do. Warsh should instead follow the later pattern of Ben Bernanke, Janet Yellen and Powell, letting the other voters speak first. If he has prepared the ground well, a clear consensus will emerge.

Finally, having shown the committee his good faith as chair, Warsh can set out any divergent view of his own on policy. He can try to persuade his colleagues, and over time he may succeed. If he disagrees deeply with the consensus, he can even cast a dissenting vote. But by respecting a collective process that aims to make the right policy decision, he can disagree with the committee without harming his ability to lead it.

Shortly after an FOMC meeting, the chair is whisked off to hold a press conference, and here Warsh can follow the same strategy. Speaking on behalf of the committee, Warsh can present the consensus. The first question, almost inevitably, will be: "But you said X before you were nominated and the committee did Y. How come?" For the public, too, this gives an opportunity to understand the committee's view and the chair's as well.

It would be better if Warsh does not formally dissent. That does not look like you know what you are doing — it appears confused and impotent. If he is going to dissent, however, then better do so from the start. A future dissent by the chair will create a sense of crisis, whereas doing so on day one will show it can be done without catastrophe, and the moment of rejoining the consensus — perhaps when a difficult decision must be made — will carry a message of commitment and unity.

The nomination of a critic to lead any institution is always a tense moment. Most of the changes that Warsh has talked about, however, such as cutting back on forward guidance or running a smaller Fed balance sheet, are not first-order issues. They can be altered without prejudice to the central bank's fundamental mission: getting interest rates right in order to control inflation and support growth.

The oddity of Warsh as Fed chair is that Trump, who nominated him, wants interest rate cuts and to hell with inflation, whereas Warsh comes from a tradition that values con-

trol of inflation above all else. Consider his summing up of Volcker's lessons: "There's a certain theatre to it, there's a certain displaying of conviction . . . Does the person look like they know what they're doing? Does the person look like they have conviction about what the future is? Are they conveying a seriousness of purpose to beat inflation down?"

If Warsh can show that seriousness of purpose, he will do fine.