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Why Warsh wants the Fed to keep quiet

di Gillian Tett

The incoming chair thinks that constant ‘incantations’ do more harm than good.

A dozen years ago, an anthropologist called Douglas Holmes published an ethnographic study of central bankers entitled *Economy*

of Words. This posited that it was entirely wrong to view the mandarins of central banking as mere “engineers”, who shape our economy by pulling monetary levers.

Instead, this tribe also acts like quasishamans, who use words to steer the economy by casting verbal spells. Hence the use of “forward guidance”, the tool that central banks use to inform the public about the likely course of monetary policy, especially of interest rates.

Is this a good thing? It is a crucial question now that the US Senate has finally confirmed Kevin Warsh as the next Federal Reserve chair. Particularly because Warsh is assuming the position armed with a pledge to unleash “regime change”, supposedly to bolster the Fed’s credibility.

By any measure, Warsh faces a hellishly difficult task. President Donald Trump is demanding big interest rate cuts, and such pressure risks undermining Fed independence.

Meanwhile consumer and producer price inflation just hit 3.8 and 6 per cent respectively. Worse, ten-year bond yields are nearly 4.5 per cent.

Warsh’s proposed remedy is to shrink the Fed’s balance sheet, co-ordinate better with the Treasury department and narrow the central bank’s mission. He also hopes (or prays) that an artificial intelligence boom will produce the productivity miracle that will enable him to cut rates.

However, there is another, less noticed, aspect to his plans too: “a reform to [Fed] communications,” as he told Congress. As he observed in a speech last year, “Once policymakers reveal their economic forecast, they can become prisoners of their own words. Fed leaders would be well served to skip opportunities to share their latest musings.”

Or as he told Congress this month: “The Fed tells the whole world what their dots are going to be . . . [and] hold on to those forecasts longer than they should.” In plain English: he prefers silence.

This is ironic. We live in a deafeningly noisy era and Scott Bessent, the Treasury secretary, frequently deploys verbal intervention himself. Meanwhile Trump uses social media as a megaphone.

Or as Warsh told Congress: “Presidents [always] tend to be for cutting rates. The difference is President Trump expresses it quite publicly.”

Moreover, silence is at odds with recent trends among central bankers. They used to revel in opacity. But “their communication has gone [in recent decades] on a long journey from close to zero

information to a high degree of transparency and accountability,” as Otmar Issing, the European Central Bank’s former chief economist, has observed.

That is partly because central banks need political legitimacy, and think this can best be served by embracing the three “Es” of “Explanation, Engagement and Education,” to cite a Bank of England paper.

But, more recently, their talk also reflects policy expediency (or desperation): when western central banks slashed rates to zero after the global financial crisis, they needed new tools to fight deflation and verbal intervention seemed a handy option.

Fair enough. However, the challenge for central bankers now is that the world has now changed. Interest rates are no longer at zero in most economies and it is increasingly hard for anyone to make credible forecasts. While economists can analyse demand cycles, they struggle to predict supply-side shocks, let alone domestic politics and geopolitics. Radical uncertainty rules.

Institutions have responded to these difficulties in different ways. The Bank of England has for some time released “fan charts” of possible inflation outcomes, to show that it is not an infallible oracle. The Fed has its “dot plots” that show where different members of the Federal Open Market Committee think interest rates will be. The IMF recently decided to issue not one but three forecasts to reflect the heightened uncertainty. And when central bankers discuss policy today, they increasingly frame those discussions as “data dependent”, reactive to events, not set by prior forecasts.

All this seems sensible. However, one problem with being data dependent is that it undermines any forward guidance. Another is that it can create investor uncertainty and market volatility. Warsh concludes, therefore, that “moving markets with rolling Fed incantations is tempting, but unhelpful”. Thus while he is likely to support the publication of Fed reports and press conferences (to show accountability), he may shrink or scrap those dot plots and other forward guidance.

Is this wise? Many media and market participants may argue not. No wonder: they feed off the rituals around central bank communications. And, as critics will note, a policy of silence can sometimes create as much market volatility as excessive noise.

But I, for one, have some sympathy with Warsh’s arguments. After all, as Holmes notes, verbal magic stops working when it is overused, or is at odds with the “real” world. So the question for the Fed is whether silence can indeed pay. Will Warsh be an effective economic engineer or a monetary shaman?