New Leadership at the Federal Reserve

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Summary

- Kevin Warsh has been nominated to replace Jerome Powell as Fed Chair, with little reaction from markets.
- The Federal Reserve remains a committee-driven, independent institution, constructed to limit political influence. The Chair is influential but ultimately one vote among 12 FOMC members.
- We do not expect significant policy changes before this transition, and future policy moves will remain driven by inflation and labor market data.

Kevin Warsh has been announced as the next Chair of the Federal Reserve, replacing Jerome Powell, whose term as Chair ends in May. The news was not a surprise, and the immediate market reaction was negligible. Warsh will need to be approved by the Senate.

Warsh is not new to the Federal Reserve. He previously served as Fed Governor from 2006 to 2011, when the Federal Open Market Committee (FOMC) cut the federal funds rate to near zero, introduced forward guidance, and implemented quantitative easing (QE) to help stabilize the financial markets during the Great Financial Crisis. At that time, he voiced concern over the threat of prolonged easy policy towards inflation. In more recent years, he has at times criticized the Fed for not bringing rates down more quickly once inflation began to moderate. The evolution in his perspective has led some to question how he might approach policy in the current environment.

Ultimately, the structure of Federal Reserve and its mandate should give investors a good sense of what to expect when the Fed Chair changes.

Fed 101: Mandate and Structure

The Federal Reserve operates under a dual mandate from Congress: price stability and maximum employment. This means balancing inflation risks against labor market conditions. When inflation runs too high, policy typically tightens. When unemployment rises meaningfully, policy may ease. As we've seen in the past several years, these goals can be at odds with each other.

Structurally, the Fed is designed to be a committee-driven institution:

- The Board of Governors consists of seven members, appointed by the President and confirmed by the Senate.
- Governors serve staggered 14-year terms.
- The Chair and Vice Chair serve four-year leadership terms.
- The Federal Open Market Committee (FOMC) has 12 members responsible for voting on policy: the seven Governors, the President of the New York Fed (a permanent voter), and four of the remaining eleven regional Fed presidents on a rotating basis.

While the Chair plays a critical leadership role and is the face of the institution, he or she is ultimately just one vote. Policy decisions are determined by a majority of the FOMC.

Chair Powell's term as Chair ends in May 2026. Importantly, his term as Governor extends beyond that date, and he has the option to remain on the Board should he choose. Chair Powell has not indicated whether he will do so.

What to Expect

The Federal Reserve is structured to operate independently of day-to-day political influence. While administrations past and present have expressed views on the desired direction of monetary policy, the Fed's credibility rests on its ability to pursue its dual mandate without direct political interference. The appointment of a new chair does not automatically translate into aggressive rate cuts or a policy pivot designed to align with political preferences. Markets appear to understand this, which likely explains the muted reaction to the announcement.

Until Kevin Warsh provides greater clarity over the coming months and throughout the confirmation process, it will be difficult to assess his approach to Fed leadership.

The Fed is scheduled to meet two more times before Chair Powell's term concludes. As we have previously communicated, we believe Powell has likely delivered his last rate cut of his term. Absent a sharp deterioration in the labor market or a renewed acceleration in inflation, we do not expect significant policy changes at upcoming meetings. The June meeting, which will be the first under the new Chair, will include an updated Summary of Economic Projections. Investors will be focusing on this "dot plot" for signals about how the Committee's rate expectations may evolve under new leadership. The current dot plot implies one additional cut in 2026 and one in 2027. While leadership transitions matter at the margin, economic fundamentals matter more, and we believe the Fed will remain data dependent.

Implications for Markets and Portfolios

In the short term, we do not expect significant market disruption stemming solely from this leadership transition. After all, the Chair is one vote within a 12-member committee.

In the Treasury market, the primary forces driving rates remain intact: economic growth, inflation, fiscal deficits, and global demand for U.S. assets are keeping upward pressure on long term interest rates (10 years and longer); while the Fed's desire to normalize rates to accommodate a slowing but stable labor market should continue to move short term rates lower. At Madison, we believe rate movements from here will continue to be dictated by income data and these broader macro forces. Not by a change in leadership.

Disclosures

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