

Fed Take: Kevin & His 2 Ex-es

“There is nothing more deceptive than an obvious fact.” – Sherlock Holmes

In a Nutshell:

1. The **prominent presence** of *ex-Fed Chair Powell* amongst the Board of Governors (of the FOMC) and Warsh's desire to bring to the table *inflation ex-extremities* (trimmed mean) are the **2 “Ex-es” that will not challenge, but in fact boost** precious (but threatened) **credibility** and **provide** critical **policy cover**.
2. “Ex” Number One - Powell: Specifically, the presence of **ex-Fed Chair Powell** has prevented a stacking of the FOMC with Trump nominees. Hence, **helps avoid perceptions** (justifiable or otherwise) **of a politicized Fed**. This in turn inadvertently, but very helpfully, **provides Warsh with policy credibility**.
3. “Ex” Number Two - Ex-Extremities (Trimmed Mean) Inflation: Making **a convincing case for trimmed mean inflation** (that *omits tail extremities of inflation* components) will **help to formalize an easing bias** (under current “Iran shocks”).
4. All else equal, **enhanced credibility and policy cover ought to diminish USD debasement risks** and **check any sharp rise in term premium**.

Kevin's Ex-es – Not Awkward, but Assets

- **Having 2 Ex-es in the room** (at, and beyond, the first date) **might have been awkward for anyone else**.
- But **for the new Fed Chair Kevin Warsh**, who will helm his inaugural FOMC later this week (17th June), it **may in fact be an asset**.

Ex Number One – Jerome Powell

- Having the **ex-Fed Chair on the Board of Governors** might justifiably be **construed by some as a challenge, or at least unwelcome comparison**.
- **But** contrary to such perceptions, our take it that **it helps to boost Fed/FOMC credibility** – the *best currency any Fed Chair could wish for*.
- To prove this point, just **imagine the counter factual**. Whereby **Powell's departure** would arguably create the **impression of the FOMC being stacked with political appointees**.
- In this instance, **Warsh would have been in the unenviable position of having to constantly defend aspersions cast on independence**.
- Whereby his **ability to justifiably cut is consequently compromised** by perceptions of **political bias/influence**.
- So, the *fist “Ex” is a welcome and precious gift of credibility* lent to **Warsh to work through policy flexibility and framework changes** that he seeks.

Ex Number 2 – Inflation Ex-extremities

- What's more, "**ex-extremities**" **inflation**, as *measured by trimmed mean**, has **potential to reasonably dial-back policy perceptions of inflation risks**, hence legitimize rate cuts.
- But critically only **if Warsh can convince his fellow FOMC members and the wider markets** that this is the pertinent measure of underlying inflationary pressures.
- All else equal, **this "Ex" (inflation) formalizes easing bias* *within widely understood, and accepted, "Taylor rule-based" policy decision-making.***
- Consequently, **diminishing the risks of any rate cuts** (or for that matter, ***even an absence of hikes***) being **perceived as loss of independence from undue to political pressure or bias.**
- In which case, this second "Ex" is critical policy cover for Warsh to **legitimately express his preference for lower rates** *without undermining independence and/or credibility.*

Diminishing Debasement Risks & Checking Term Premium

- All else equal, the two "Ex-es" in, shoring up credibility and policy cover, help to simultaneously
 - a. *diminish USD debasement risks* ordinarily **associated with loss of policy credibility** and **consequent debt monetization risks**, and;
 - b. *check sharp rise in term premium* associated with **USD debasement risks** alongside **fiscal deterioration** and **runaway inflation expectations.**

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