GLOBAL X INSIGHTS

Hearing Warsh: Growth Along the Watchtower

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The nomination of Kevin Warsh as the next chair of the Federal Reserve (Fed) sent stocks and precious metals lower to close the week of January 26. Markets reacted to concerns that the White House selected an inflation hawk unlikely to deliver on expected rate cuts this year, a narrative that we believe is too simplistic. In our view, Warsh's policy track record is more nuanced and merits a close look by investors as they consider his potential influence at the Fed.

Key Takeaways

- Warsh has consistently talked about improving economic growth through investment and productivity; lower rates would serve as a catalyst.
- Warsh's preference for reducing the Fed's balance sheet to promote market-driven asset pricing and financial system deregulation aligns with stated White House priorities.
- This nomination may eventually prove stimulative for investment in secular themes like AI and energy, as well as cyclical sectors such as commodities and industrials.

Growth Plus Mandates

Labeling former Fed Governor Kevin Warsh an inflation hawk is somewhat misleading because it misses his primary concern: the Fed's broader role in the economy. If Warsh has his way, the Fed fades into the background and economic forces like investment and productivity do the heavy lifting. This stance is neither hawkish nor dovish and should reassure investors. Warsh may also bring some fresh perspective to the institution, revisiting existing policy on inflation targeting, economic forecasting, and policy communication.[1]

This growth-first mindset is somewhat contrary to the emerging narrative painting him as a policy hardliner. During his time on the Board of Governors from 2006 to 2011, Warsh was concerned about price stability, but always in the context of growth. In 2010, he talked about the sluggish economic recovery and the importance of business investment and profitability in stimulating the job market, while also highlighting concern about deflationary pressures.[2] A Fed chair predisposed to near-term rate cuts who also has a credible inflation-fighting record could prove beneficial as the Fed walks the tightrope between above-target inflation and a softer labor market.

Balance Sheet Pivot

Warsh seems to believe that the Fed's responses to recent crises may have been an impediment to unlocking the economy's full potential. During the Global Financial Crisis and the COVID-19 pandemic, the Fed used its balance sheet to add liquidity and stabilize financial conditions, aiming to bolster asset prices and nominal growth. Warsh was openly critical of quantitative easing (QE), citing the risks of manipulating asset prices and crowding out private investment, but he ultimately voted in favor of the balance sheet expansion in 2008.[3] He did not support QE2 in 2010, and he has been critical of the balance sheet size since.

Reducing the Fed's $6.6 trillion balance sheet, perhaps best for the economy, will not be easy. Fed assets have not been below $2 trillion since 2009, peaking around $9 trillion (35% of GDP) during the pandemic.[4] Prior to the financial crisis, the balance sheet was about 6% of the S&P 500 market cap, but averaged 20% since 2020. Increasing market supply via balance sheet reduction runs the risk of driving rates higher, and Fed holdings are largely medium and long duration. Financial system deregulation, however, could mitigate the increase. If the Fed eases capital requirements on bank holdings, it could free up resources to invest in more securities, helping to keep long rates stable.

Warsh has noted that the inflationary pressure of lower rates could be offset by balance sheet reduction.[5] This perspective is particularly noteworthy following last week's surprise acceleration in producer price levels and consumer inflation remaining above the Fed 2% target.[6] The tricky part is the Fed's limited control; while it dictates short-term rates, long-term rates largely determine the cost of capital that drives investment. The long end of the curve has already moved higher over the past 18 months amid Fed rate cuts, which may be the market voting on the trajectory of fiscal policy. As a result, calibrating the pace of balance sheet reduction is critical.[7]

A Productivity-Led Future

Contrary to the headline narrative, the Warsh nomination may check off several White House economic priorities. By simultaneously pursuing lower rates to stimulate growth, reducing the Fed's influence on the economy through balance sheet reduction, and using financial deregulation as a tool in the process, a Warsh-led Fed may deliver a policy trifecta for the White House.

For investors, this framework offers potential tailwinds for both growth and cyclical sectors, especially those tied to AI.[8] Warsh views AI as an important contributor to productivity and a disinflationary force that can help bolster U.S. competitiveness, outcomes that could help drive further investment across the broader AI ecosystem to include hardware, software, data centers, and energy providers. His interest in fostering investment to unlock economic growth could also benefit cyclical areas such as industrials, materials, and commodities.

Footnotes

1. De Costa, P.N. (2025, April 28). MNI Policy: Warsh Could Reshape Fed on Rates, Communication. MNI. https://www.mnimarkets.com/articles/mni-policy-warsh-could-reshape-fed-on-rates-communication-1745848295730.
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3. Ibid.
4. Global X analysis with information derived from: Bloomberg L.P. (n.d.) [Data set]. Retrieved on February 2, 2026.
5. De Costa, P.N. (2025, May 9). MNI Brief: Warsh-Smaller Fed Balance Sheet Would Help Economy. MNI. https://www.mnimarkets.com/articles/mni-brief-warsh-smaller-fed-balance-sheet-would-help-economy-1746809733278?utm_source=chatgpt.com.
6. Global X analysis with information derived from: Bloomberg L.P. (n.d.) [Data set]. Retrieved on February 2, 2026.
7. Ibid.
8. Markman, J. (2026, February 2). Kevin Warsh's New Playbook: AI, Productivity And A Deflation Bet. Forbes. https://www.forbes.com/sites/jonmarkman/2026/02/02/kevin-warshs-new-playbook-ai-productivity-and-a-deflation-bet/.
