

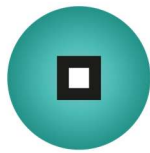


Kevin Warsh Earns Some Monetarist Credibility

By John Greenwood

Introduction

- In IMM#55 I pointed out that Fed Chairman Kevin Warsh had enunciated a set of principles at the Kansas Fed's Jackson Hole Symposium in Wyoming, among which was the welcome assertion – in contrast to his predecessor, the anti-monetarist Jerome Powell – that money growth had something to do with inflation.
- Specifically, "Sixth, money matters. [...] We should pay attention to money created by the central bank and money that comes from the banking and financial systems."
- Previously, across his speeches and writings, Warsh has consistently emphasized monetary aggregates.
- He is one of the very few modern Fed officials to explicitly argue that money supply growth should be monitored.
- He has downplayed interest rates as the core policy variable. This is central to monetarism: interest rates are not the true stance of policy; money growth is.
- Like Friedman and other monetarists, he has warned about velocity instability but still insists money matters. For example, in his Jackson Hole speech he said, "It's true that financial innovations and other factors alter the mechanics that link the monetary base, the velocity of money, and the broader economy. But that is scarcely a reason to ignore the ultimate effects of money on financial conditions and prices."
- He advocates a "quiet Fed" focused on rules and discipline.
- Monetarists traditionally favour rule-based policy over discretionary forward guidance.
- In contrast to most central bank models which have inflation reverting to target after a disturbance, Warsh argues that inflation is not mean-reverting.
- Monetarists believe inflation must be actively controlled through monetary restraint, (i.e. managing the quantity of money) not passively expected to fall.



Restoring Monetarist Language

Building on what we know about Kevin Warsh's positive attitude toward monetary analysis, it is especially interesting to review his remarks at the post-FOMC meeting press conference on Wednesday, 16 September 2026.

While one should always be careful about judging the performance of an institution by the character, attitude and words of its leader, there was much to like in yesterday's press conference hosted by Fed Chairman Kevin Warsh.

First, he shares the language that monetarists like to use about individual price changes and inflation. Higher energy prices or food prices do not "cause" inflation. He said the Fed cannot address any individual prices (food, energy etc), but the Fed can ensure that relative price changes do not have second and third order effects. In other words, the Fed is responsible for **overall** price changes, not **relative** price changes.

As a monetarist, I would go a step further. Unless there has already been excess money growth over the preceding year or so, **relative** price changes cannot translate into sustained changes in the **overall** price level. For this reason, I tend to discount the validity of discussions about second (or third) round effects.

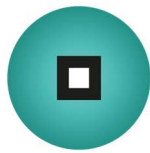
For example, in March of this year, in my presentation to the IEA's Shadow MPC I argued that despite President Trump's attack on Iran and the consequent steep rise in oil prices, because broad monetary growth in the UK -- and numerous other economies -- had been subdued, there was no serious threat of an outbreak of inflation in 2026 or early 2027. (The US was an exception to this generalization because the Fed had allowed a gradual build-up of rapid broad money growth since late 2025.)

Fed Goals: Sticking with Economic Aggregates

Second, asked about how the Fed's rate hike would affect lower income groups in the US, Chairman Warsh said the Fed does not deal in questions of distribution. The Fed looks at aggregates like the labour market, GDP, total spending, and overall inflation. Having said that, he conceded that the lowest income classes -- those without financial assets and those who tend to live from paycheck to paycheck -- would benefit most from stable prices.

What Matters to the Fed: Trends, not Datapoints

Third, asked if the most recent CPI data had influenced the Fed's decision to raise rates he said that was not the case. "Datapoints are noisy", he argued. What mattered was the trend, and the trend of inflation was still too high.



This accords precisely with the monetarist view that short-term forecasts of inflation are simply not feasible. There is too much noise in the data. Monetarist analysis can provide a range or channel for price levels (or inflation) over a 1- to 3-year horizon, but not a month-to-month forecast.

The Role of Interest Rates

Fourth, asked about the level of the Federal Funds rate relative to its “neutral” rate (or r^*), Warsh replied that as a student of economics he had studied the neutral rate, or what was called the Wicksellian real rate. The concept, he declared, was of academic interest but had no bearing on the Fed’s practical decision-making. Again, this comports with my monetarist views on interest rates. Administered rates such as the Fed funds rate and short-term market interest rates can be both a driver of **future** money growth and a consequence of **prior** monetary growth. For example, if the money growth rate doubles, the first effect is to lower rates, but then, as the economy recovers, the demand for credit increases and inflation rises, the second effect is to raise rates. This is exactly what happened during and after the Covid pandemic.

Because changes in broad money growth have this two-stage effect on interest rates, it makes no sense to rely on a Wicksellian framework of equilibrium or neutral interest rates. The Quantity Theory of Money, however, provides a fairly precise guide to the appropriate rate of money growth for an economy. It is therefore always better to rely on the rate of broad money growth as a better guide to the stance of monetary policy than on the abstract concept of an equilibrium interest rate.

On at least two occasions during the press conference Chairman Warsh said that he would have been hard-pressed in recent months to describe financial conditions as restrictive. Judging the level of interest rates against an unobservable “neutral” rate would clearly have been challenging. Instead, although he did not say so, the rather high rate of broad money growth over the past 6-9 months would have provided a clearer metric on the state of monetary and financial conditions: the rate of broad money growth in the range 6-8% has clearly been too high. It needs to be reduced. Raising the Fed funds rate is a way to achieve that.

Conclusion

After a shaky start with his first two press conferences, Chairman Warsh appears to be gaining confidence as he starts to articulate a framework that is consistent with what monetarists would recommend. It is probably too early to expect him to use explicitly monetarist language since that might antagonise his FOMC colleagues more than it would persuade them. But Warsh seems to be on the right track.