

Want Fed Independence? Cut Government

It wasn't that long ago that Kevin Warsh's leading critics were saying his biggest problem was that he wasn't "independent" from President Trump, that if Trump told him to "jump" he'd ask "how high?" Or, in this particular situation, "how low should interest rates go?"

And yet at only his third meeting at the helm, Chairman Warsh didn't cut rates; he raised them. In addition, the "dot plot" from the Federal Reserve strongly suggests another rate hike later this year, which we think will arrive in December.

Some may argue that Warsh was "forced" to raise rates because inflation remains a problem. But higher energy prices since February are the result of the conflict with Iran as well as the Russia-Ukraine War, which have combined to reduce oil flows as well as the production of refined products. Excluding energy, consumer prices are up 2.5% from a year ago, the smallest increase since the first year of COVID. So all of the acceleration in inflation versus a year ago is due to energy, and monetary policy has zero chance of clearing blockades in the Middle East or bringing peace to eastern Europe.

In addition, the growth of the M2 measure of the money supply has been slower in the last few years than in the decade prior to COVID when the Fed's preferred measure of inflation hovered below 2.0%.

In other words, the recent rate hike was not required, and Warsh was not "forced" to raise rates.

Warsh was never going to be the rubber stamp for Trump that his critics claimed, and at least so far, he is more independent than former Chairman Jerome Powell, who has broken long-term norms by keeping his regular member seat on the Fed Board even though his term as chairman has expired.

It was the Powell Fed that twiddled its thumbs and came up with excuses for not acting against inflation in 2021 under President Biden, even as the M2 measure of money exploded and CPI inflation was headed toward 9.0%, making up excuses about the surge in inflation being "transitory." It was also Powell that made it easy for the Biden Treasury to borrow trillions by buying Treasury debt and holding rates down.

The biggest surprise for today's critics was the relative calm with which Trump reacted to the increase in short-term rates. We think much of this is due to Treasury Secretary Scott Bessent, who we understand recommended that Trump nominate Warsh

in the first place, and who appears to have convinced Trump (at least for the time being) that accepting Warsh's decisions on monetary policy would be best for the country as well as Trump's political position.

To understand this, you must look back on President Reagan in 1981-82. He counted on Chairman Volcker to do the right thing for the long term, even if it hurt in the short term. And Volcker aggressively raised rates even as the country was then experiencing one of the deepest recessions since World War II. Inflation came down, and the economy took off.

An independent Fed that is insulated from politics will help maximize economic growth. But if we want an independent Fed that can ignore politics, we need a government that stops interfering with the economy.

A highly regulated economy is a slower-growing economy. With slow growth, politicians lean on the Fed to artificially boost growth even if the sugar-high from easy monetary policy is temporary. And don't forget, with Powell at the helm, the Fed supported regulations...even on wasteful green energy.

The same goes for when the government spends too much. The Trump Administration has made some progress on spending so far. Adjusted for inflation, total federal outlays in the past twelve months (September 2025 – August 2026) are down 3.3% from the last twelve months of the Biden Administration (February 2024 – January 2025), a notable achievement given higher interest costs, more military spending, and aging Boomers.

However, spending is still too high and annual interest paid on the national debt as a percent of GDP is greater than the personal saving rate for the first time on record.

It doesn't matter who leads the Fed in the next few decades: if the government is too big, politicians of both parties are going to try to pressure it to keep interest rates low to make it easier to finance the federal debt. In addition, it will be even harder to enact growth-enhancing tax cuts that would help the Fed pursue price stability like it did in the 1980s and 1990s.

The bottom line is that Fed independence is not just about the personality of the person who sits in the Oval Office; it's about the big picture policy environment in which the Fed has to operate. A smaller government would help us reach that goal.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-24 / 7:30 am	Initial Claims – Sep 19	200K	200K		196K
7:30 am	Q2 Current Account Balance	-\$256.2 Bil	-\$273.7 Bil		-\$226.8 Bil
9:00 am	New Home Sales – Aug	0.616 Mil	NA		0.607 Mil
9-25 / 7:30 am	Durable Goods – Aug	-0.3%	-0.2%		+1.1%
7:30 am	Durable Goods (Ex-Trans) – Aug	+0.6%	+0.6%		+0.4%