Economic Commentary

QNB Economics
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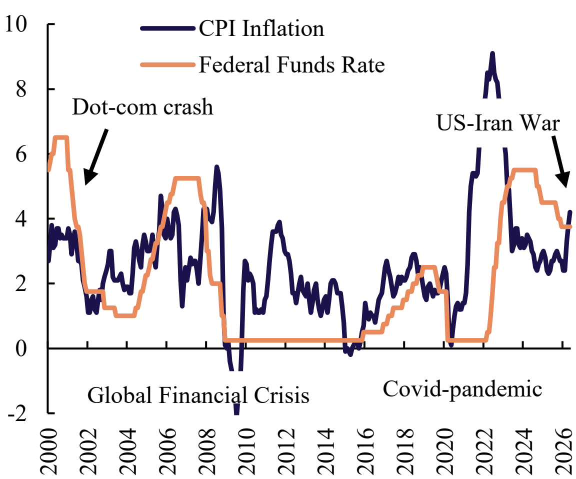
Will monetary policy change under Chair Kevin Warsh?

The recent passing of former Federal Reserve Chair Alan Greenspan provides an opportunity to reflect on how US monetary policymaking has evolved over the past twenty years. A central debate is how much guidance a central bank should provide regarding the path of interest rates. Greater transparency and forward guidance can reduce uncertainty and strengthen transmission, but excessive commitment to a policy path may reduce policymakers' ability to respond to large economic shocks. Finding the appropriate balance between policy commitment and flexibility is therefore one of the key challenges facing central banks.

In recent decades, the Federal Reserve has confronted an extraordinary series of major economic and financial shocks, including the collapse of the dot-com bubble, the Global Financial Crisis, the Covid-pandemic and, more recently, rising trade tensions and tariff-wars alongside geopolitical conflicts. These events have influenced the way monetary policy is conducted, moving from policy discretion to forward guidance.

US Inflation and Monetary Policy Rate
(%, year-over-year CPI inflation)



Source: Haver Analytics, QNB Economics

Now, with Kevin Warsh assuming the leadership of the Federal Reserve, there are indications that the approach may again be changing. In this article, we discuss how US monetary policy has changed over the past two decades and how the balance between policy commitment and policy flexibility could shift going forward.

Before communication became a central policy instrument, the Federal Reserve followed a markedly different approach. The Greenspan era (1987-2006) was characterized by a high degree of policy discretion and limited communication about the future path of monetary policy. This reflected the view that preserving flexibility was essential in an uncertain economic environment, allowing policymakers to respond to evolving conditions without being constrained by earlier commitments.

The Global Financial Crisis (GFC) during 2007–2009 marked a turning point in the approach to communication. As the crisis deepened, the federal funds rate was rapidly reduced to near zero, reaching the effective lower bound - the point at which policy rates cannot be lowered further. In this environment, influencing expectations through communication about the future path of interest rates and assessments of the economic outlook became an increasingly important tool itself. By signaling that policy rates would remain low for an extended period of time, the Federal Reserve could reduce longer-term borrowing costs and stimulate economic activity even when short-term interest rates were already close to zero. This transformation began under Ben Bernanke in response to the GFC and was later reinforced under Janet Yellen and Jerome Powell. As a result, forward guidance evolved into an integral component of the monetary policy framework.

The economic environment today differs markedly from that of the post-GFC period. Rather than weak demand and below-target inflation, policymakers are now facing recurring supply shocks, heightened geopolitical uncertainty, trade conflicts, and structural changes associated with artificial intelligence. As a result, preserving policy flexibility has become increasingly valuable, while the benefits of committing to a predetermined policy path may have diminished. Against this backdrop, Chair Warsh has established internal task teams to review key aspects of the Federal Reserve's policy framework, including its communication practices. These reviews suggest a willingness to reassess approaches that have become established over the past two decades.

All in all, the evolution of the Federal Reserve's communication strategy reflects the changing nature of the challenges confronting monetary policymakers. Greater transparency and forward guidance were well suited to the post-Global Financial Crisis environment. Today's environment may require a different balance between policy commitment and flexibility. While it remains too early to assess the long-term direction of monetary policy under Chair Kevin Warsh, the Federal Reserve could be moving in a new direction with the way it conducts and implements monetary policy.

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