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HARSH PATH FOR KEVIN WARSH

Berenberg Macro View

Less than a month left: Nothing moves in a straight line under Trump 2.0, and that includes the path for Kevin Warsh to succeed the current Fed Chair, Jerome Powell. In a smooth-transition world, Warsh would attend his confirmation hearing before the Senate Banking Committee (scheduled for today), get confirmed before May 15 (Powell's last day as a Chair), take office on May 16, and get a head start on fixing an "asset-rich, income-poor U.S. economy." Well, we certainly do not live in a world where transitions are smooth and rules-based order run like clockwork. The Senate Banking Committee (with a narrow 13-11 Republican majority) will most likely block President Donald Trump's nominee, Kevin Warsh -- courtesy of Republican Senator Thom Tillis, who will likely join the 11 Democrats on the panel to delay the approval as long as the Department of Justice's criminal investigation into Powell is ongoing. At the moment, it seems unlikely that the investigation into Powell (related to the Fed's renovation of its headquarters and Powell's testimony on this matter) will be wrapped up anytime soon. Just last Tuesday, members of Jeanine Pirro's team (the US attorney for the District of Columbia who opened the investigation into Powell) made an unannounced visit to the construction site at the Fed's headquarters. The next day, Trump threatened once again to fire Powell if he does not leave the Fed after his term as Chair ends. In the event that the Senate does not confirm Warsh by May 15, Powell indicated last month that he will continue to serve as Chair on a temporary basis until Warsh arrives. The Trump administration will most likely challenge this (even though it does not have a strong legal case) and try to appoint someone else as Chair (Vice Chair Philip Jefferson? or maybe Governor Christopher Waller?). The harsh path for Kevin Warsh as the next Fed Chair -- and the likely legal battles that will accompany it -- could revive the "threats to Fed independence trade": a weaker dollar and higher rates at the long end of the yield curve. So far, our forecast for a 25 bp rate cut in June holds, a call we have maintained since Powell's Jackson Hole speech last August. But the risk now is that if new leadership under Warsh does not take hold by mid-June, the Fed could delay that 25 bp rate cut and maintain a "wait-and-see" stance instead -- especially if volatility in energy prices resurfaces.

Time to lawyer up? Maybe it is good that Jerome Powell has a law degree, and that he would be passing the torch to another lawyer by training, Kevin Warsh, because the Fed nowadays is as busy with legal fights with the Trump administration as it is with its dual mandate of price stability and maximum employment. If Senate does not confirm Warsh by May 15, and Powell stays on as Chair, the Trump administration could open another case against him. It would not be the first time a Fed Chair's term expires before a successor is confirmed by the Senate. This has happened five times before, but in each instance the incumbent continued to serve as a temporary Chair, and no president opposed it. That said, the Trump administration has shown an ability to be the "first-ever" when it comes to challenging rules-based order. The tariff case file is a prominent example. Trump will likely fight against Powell remaining in the Chair position after May 15. The legal playbook appears to side with Powell -- the Fed has authority over delegation, and the President cannot simply appoint a Fed Chair without Senate approval. But would this prevent the administration from challenging it? Probably not. Powell, however, can remain a Governor until the end of 2028. Further attacks on the Fed's independence could make him more willing to retain his Governor role. Without an empty Governor seat, Trump cannot keep both Miran and Warsh at the Fed (the next available Governor vacancy is not until 2030, when Christopher Waller's term ends).

A no-brainer: The solution to all this kerfuffle seems quite simple. Trump would just have to drop the investigation into Powell. The only reason Senator Tillis wants to join the Democratic minority in the Senate to block Warsh's confirmation is the ongoing investigation into Powell. In the absence of the criminal probe, Tillis, who actually approves of Warsh's ideas, would not stand in the way of Warsh's approval, and Powell would be out as Chair in four weeks. Trump wants him out -- and Powell himself wants to leave when his term as Chair ends. Ironically, the case against Powell is actually making it harder for Trump to replace him. But even if Powell's investigation concludes, Federal Reserve Governor Lisa Cook's case is still ongoing. It is now at the Supreme Court and could take months to resolve. Democrats in the Senate, in the name of Fed independence, could convince Senator Tillis to join their side in blocking Warsh's nomination until both (and not just Powell's) investigations conclude. After all, both of these investigations are attempts to undermine the Fed's independence and force the institution to do Trump's bidding -- namely, lowering borrowing costs.