Bank of Nassau
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Weekly Economic Flash

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"But seek the testimony of few; and number not voices, but weigh them."

Immanuel Kant

Fed Chair Kevin Warsh testifies before Congress this week as he delivers the Fed's semi-annual monetary policy report as required by the Full Employment and Balanced Growth Act of 1978 (also known as the Humphrey-Hawkins Act). Here, we provide the historical backdrop for this testimony and also discuss what Chair Warsh may or may not say.

A Brief History Lesson

It's easy for us to take for granted just how much the Fed has evolved even though it has only been in existence for a little more than one hundred years.

As we noted in a previous piece here, the Fed as we know it was created by the Federal Reserve Act of 1913. Before the creation of the Fed, the US banking system was highly decentralized and prone to banking panics. Indeed, the Fed was created when the US was just emerging from a financial crisis in 1907. Without a central bank in place then, the US government was forced to rely on a private sector bailout arranged by John Pierrepont Morgan (the man, not the bank). The Fed was thus created in order to help prevent future banking panics and financial crises. The Fed provides an excellent historical account of the 1913 act here.

The next major phase of the Fed came with the Federal Reserve Reform Act of 1977, which explicitly required the Fed to "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote the goals of maximum employment, stable prices, and moderate long-term interest rates." Over time, this third mandate disappeared and was replaced by an unofficial third mandate of financial stability. The Fed provides an excellent historical account of the 1977 act here.

Lawmakers quickly followed up with the Full Employment and Balanced Growth Act of 1978. This act has become known as the Humphrey-Hawkins Act because of its two main sponsors, Senator Hubert Humphrey and Representative Augustus Hawkins. The legislation championed by these two lawmakers built upon the Federal Reserve Reform Act of 1977 by requiring the Fed to conduct monetary policy in order to achieve "maximum employment and stable prices." The Fed was required to set explicit targets for unemployment and inflation and to then regularly explain to Congress (and therefore the people) how it would meet these targets. The Fed provides an excellent historical account of the 1978 act here.

The Monetary Policy Report

The Fed has already released its Monetary Policy Report in advance of Chair Warsh's testimony and can be found here. The summary notes that "Inflation has risen this year and remains elevated relative to the Federal Open Market Committee's (FOMC) longer-run objective of 2 percent, in part reflecting supply shocks that have driven price increases in certain sectors, including energy. The labor market has been broadly stable, with the unemployment rate changing little and remaining at a low level. Labor productivity growth is strong. Meanwhile, real gross domestic product (GDP) grew at a moderate pace in the first quarter, with capital investment rising considerably but household consumption increasing only very modestly. Overall, economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East."

The report also addressed the recently announced task forces, noting that "Over the remainder of the year, independent task forces led by the very best minds from inside and outside of the economics profession, supported by key subject-matter professionals within the Federal Reserve, will examine five areas that are central to the Federal Reserve's conduct of monetary policy: (1) communications, (2) balance sheet policy, (3) the quality of existing data sources, (4) productivity and jobs in an era of transformation, and (5) frameworks for analyzing the drivers of inflation . Each task force will start with first principles, ask hard questions, examine current practice, consider alternatives, and, ultimately, propose next steps for the Federal Reserve's consideration."

Warsh's Debut

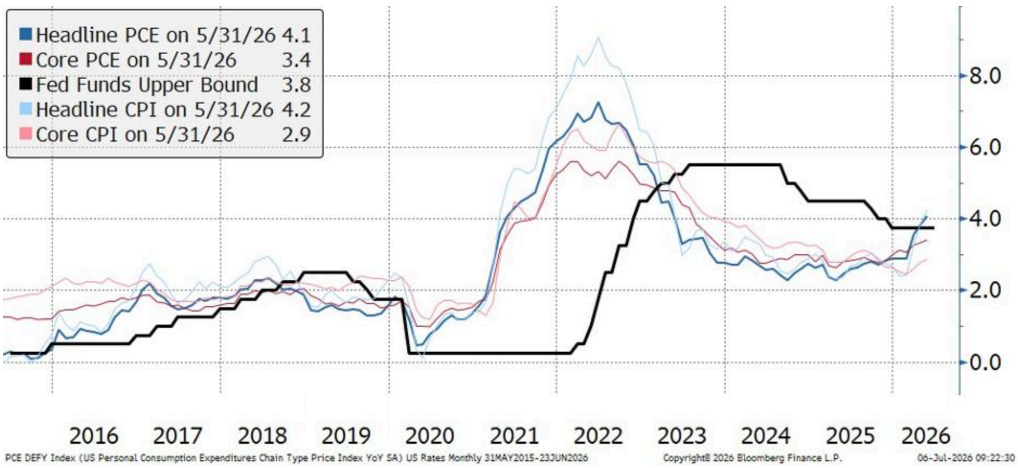
Chair Warsh first testifies before the House Financial Services Committee Tuesday at 10 AM ET. He then testifies before the Senate Banking Committee Wednesday at 10 AM ET. This will be his first Humphrey-Hawkins testimony and we expect we will basically get a repeat of his first press conference back on June 17. Recall that he stressed then that "We've missed the inflation goal for five years and we're going to fix that."

These Humphrey-Hawkins testimonies often turn into political theater, especially in the House. We can recall many occasions where previous Fed Chairs are forced to ask a lawmaker "Is there a question there?" When pressed by lawmakers on certain specifics, Warsh is likely to rely on his stock answer from the June press conference: "There's a task force for that."

We expect some lawmakers will criticize the Fed for the current bout of inflation. Warsh can reply that it was caused mainly by tariffs and supply shocks from the Iran conflict, both of which are beyond its control. However, Warsh is likely to repeat the Fed's new mantra that"The Committee will deliver price stability."

Bottom line: Given Warsh's distaste for forward guidance, we do not expect any hints about future Fed policy. Nor do we expect any other surprises from Warsh. From what we can tell, he prefers a disciplined communication style where the less said, the better. When all is said and done, however, we expect a hawkish message will be delivered by Warsh.

US Rates



Fed Summary of Economic Projections June 2026 (March)

	2026	2027	2028	Longer Run
GDP Growth	2.2% (2.4%)	2.3% (2.3%)	2.2% (2.1%)	2.0% (2.0%)
Unemployment	4.3% (4.4%)	4.3% (4.3%)	4.2% (4.2%)	4.2% (4.2%)
PCE Inflation	3.6% (2.7%)	2.3% (2.2%)	2.0% (2.0%)	2.0% (2.0%)
Core PCE	3.3% (2.7%)	2.5% (2.2%)	2.1% (2.0%)	n/a (n/a)
Fed Funds Rate	3.8% (3.4%)	3.6% (3.1%)	3.4% (3.1%)	3.1% (3.1%)

We will get June CPI and PPI data this week. Headline CPI inflation appears to have peaked in May, but these latest hostilities between the US and Iran certainly complicates matters. For the most part, the Fed will likely look through the volatility in headline inflation and focus on core inflation measures to gauge potential second round effects.