A Fed in Transition, An Economy Being Rewired

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Key takeaways

- Supply shocks, one after another, are rewiring the economy: the pandemic, two wars disrupting energy, tariffs, heightened policy uncertainty, and emergent technology. Rules of thumb and policy approaches from times dominated by demand shocks can be misleading.
- Against this shifting backdrop, the Fed is in a leadership transition. A new Chair says less, and the committee says more, with a lag. Policy keeps moving; communication has not caught up.
- The Fed's institutional integrity is at risk, which would be a substantial rewiring of its own. The White House's efforts to remove Governor Cook and pressure Powell off the Board remind us that Fed independence remains under threat.

The economy is being rewired by supply shocks.

The Fed is being rewired by a new Chair.

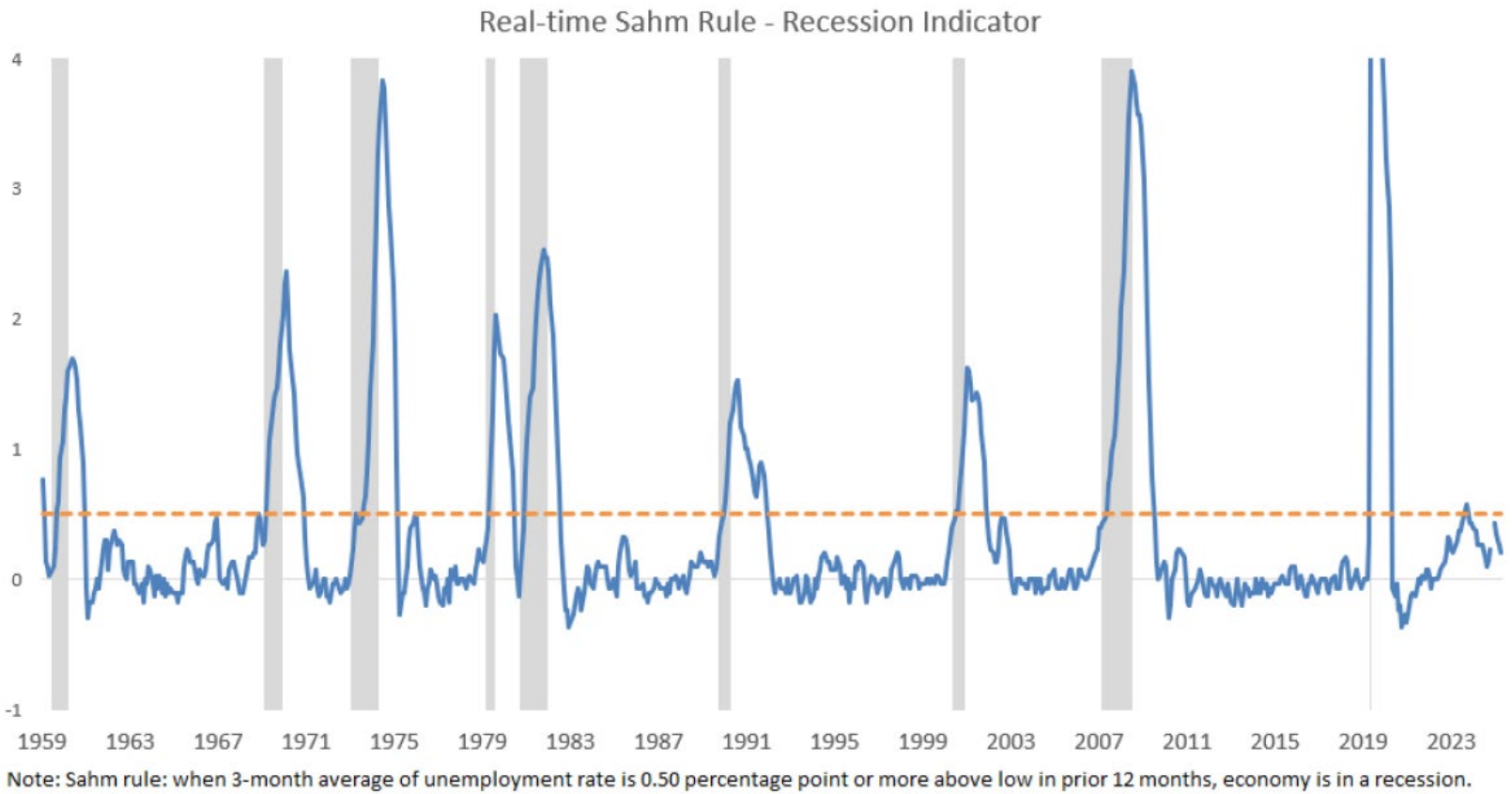
The old rules for reading both no longer work cleanly.

1

Supply shocks complicate reading the economy and setting policy

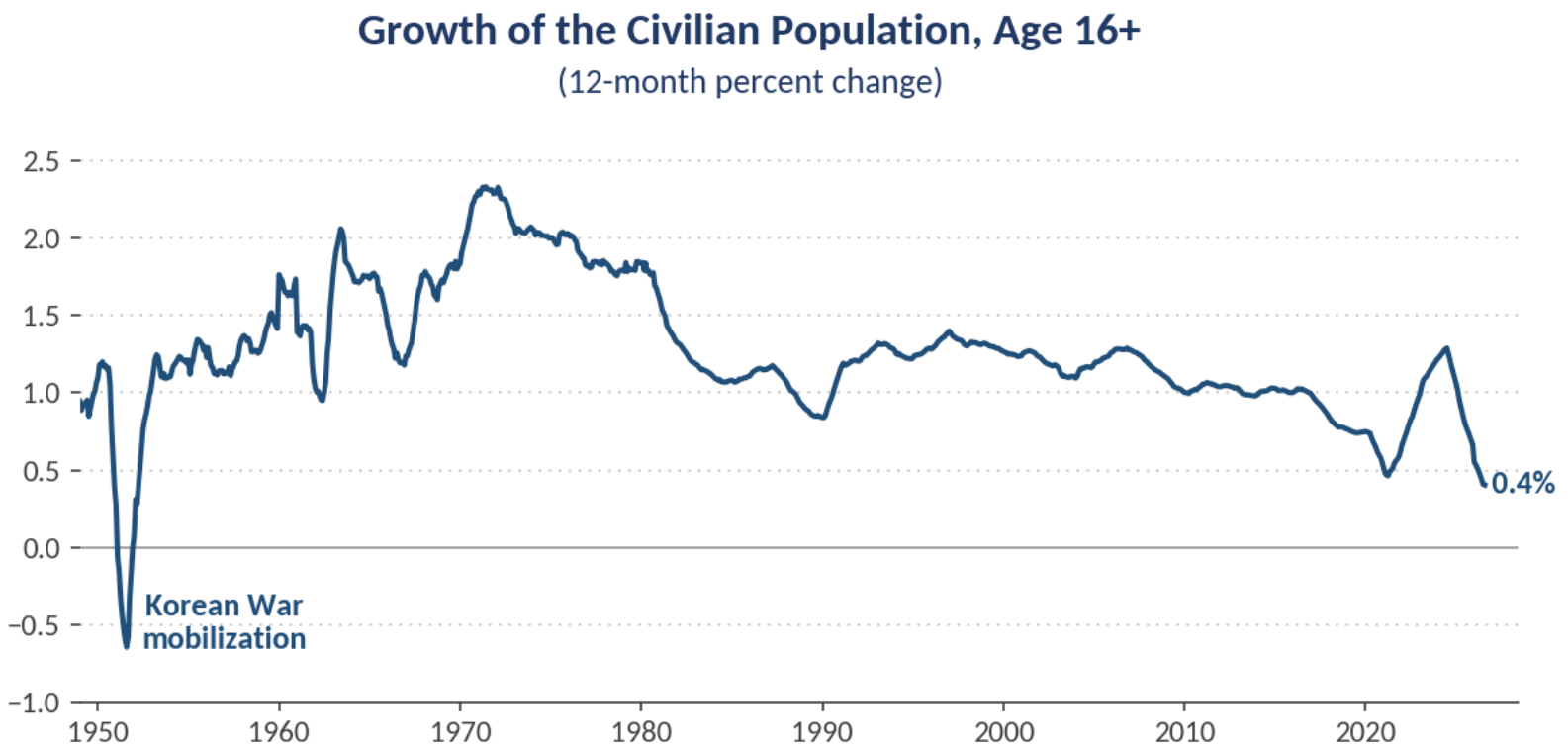
Low job creation looks recessionary when the workforce barely grows. First-round price jumps look like inflation that fades, until the second round arrives.

My recession indicator triggered in 2024. No recession came.



- To propose a new automatic stabilizer, sending out checks as soon as a recession starts, I developed a recession indicator in 2019.
- Since 1970, a half-percentage-point rise in the unemployment rate over the prior year had occurred only early in a recession.
- By July 2024, unemployment had risen enough to trigger the rule, but it was clear that we were not in a recession. Weakening labor demand wasn't the whole story this time.

Unemployment rose in 2024 because more people were looking for work

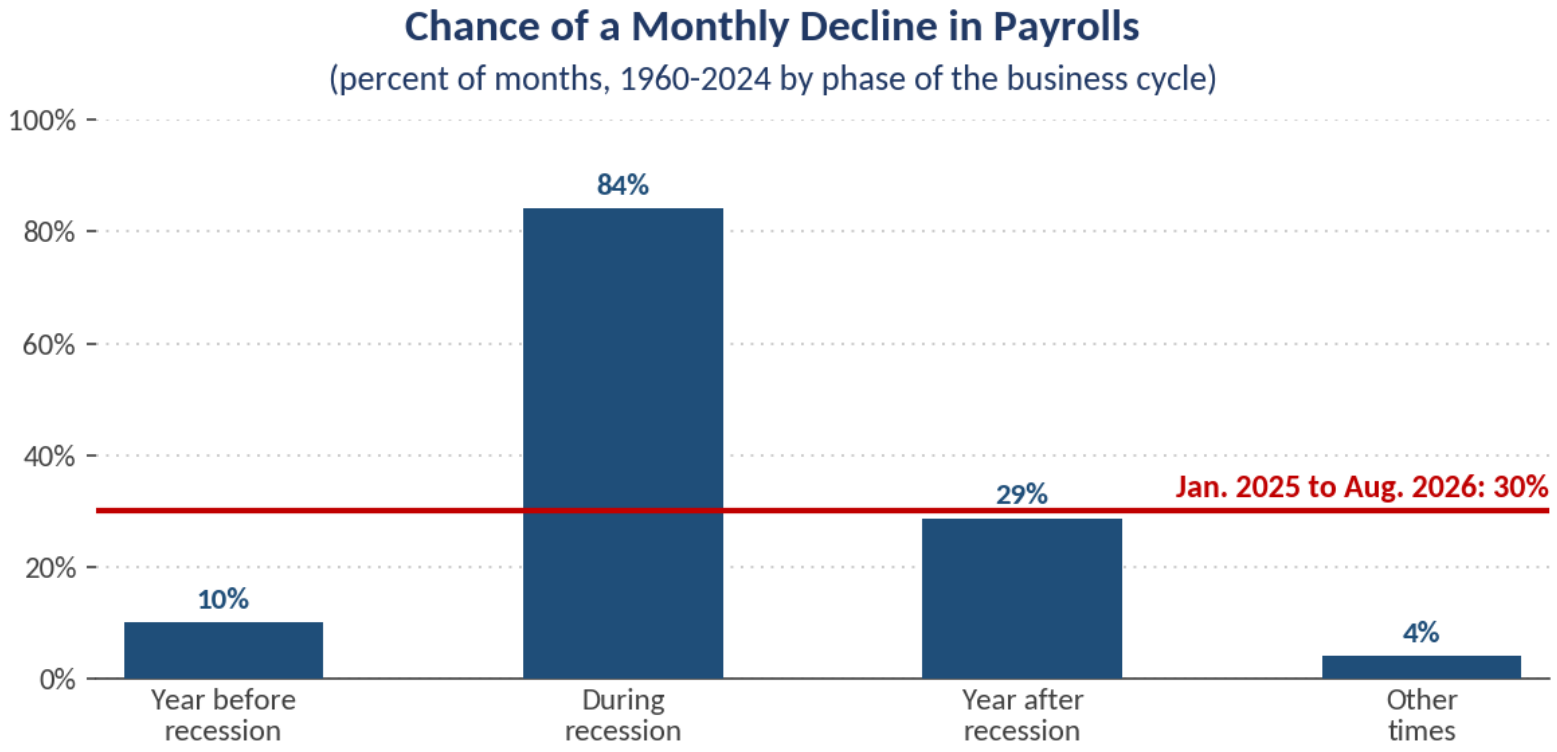


Source: BLS harmonized data from Coglianese, Murray, & Nekarda (2025) through Dec. 2025; BLS published data spliced on thereafter.
Note: Civilian noninstitutional population, age 16 and over. No Oct. 2025 data. Through Aug. 2026.

Labor supply was strengthening.

- A sharp increase in immigration after the pandemic pushed up population growth.
- Prime-age workers came back. By 2024, their participation had fully recovered from the pandemic and was near a 25-year high across many demographic groups, not just immigrants.

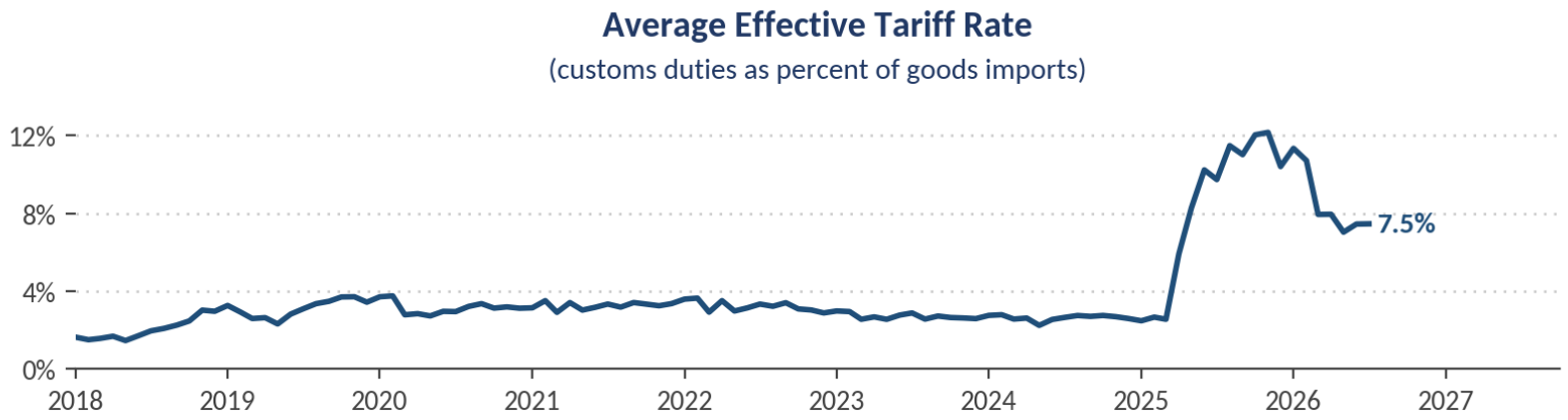
Now, payroll declines are frequent because the workforce is hardly growing

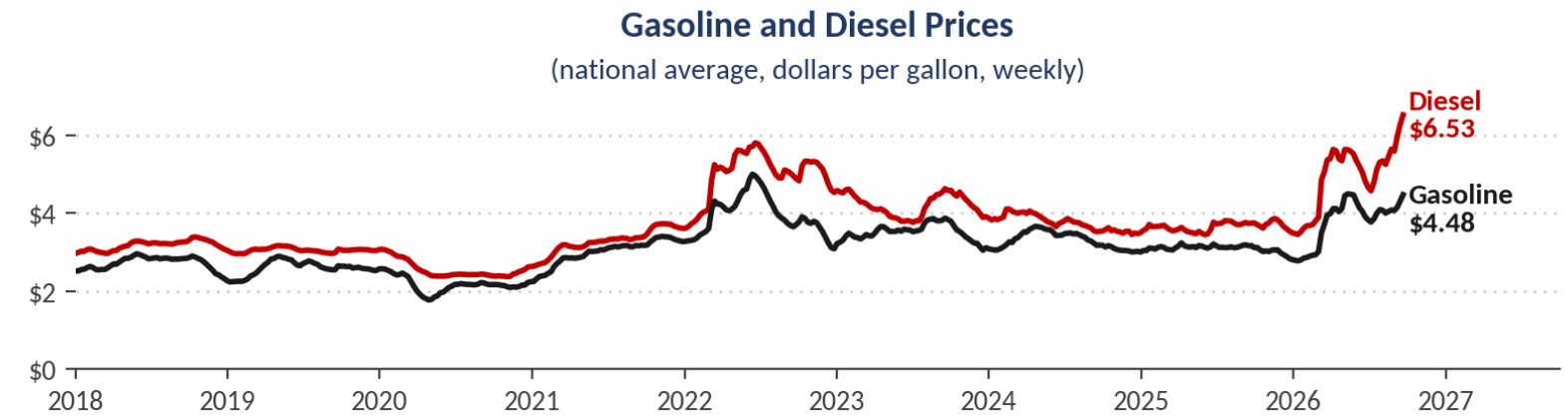


Source: Bureau of Labor Statistics, NBER. Note: Nonfarm payrolls as currently published. Recession phases from NBER dates; "year before" and "year after" are the 12 months around each recession. Recent share is 6 of 20 months.

- Since mid-2024, immigration has dropped sharply. Some immigrants have lost their work status, and deportations have risen. The result is very low labor force growth.
- So it takes little job creation to keep unemployment steady. Since 2025, payrolls have grown about 38,000 a month on average. With the average near zero, ordinary month-to-month swings produce frequent declines.
- Historically, payroll declines have been rare except in and around recessions. The declines now reflect a weak supply of workers more than weak demand for them.

Supply shocks – one after another – are affecting many parts of the economy

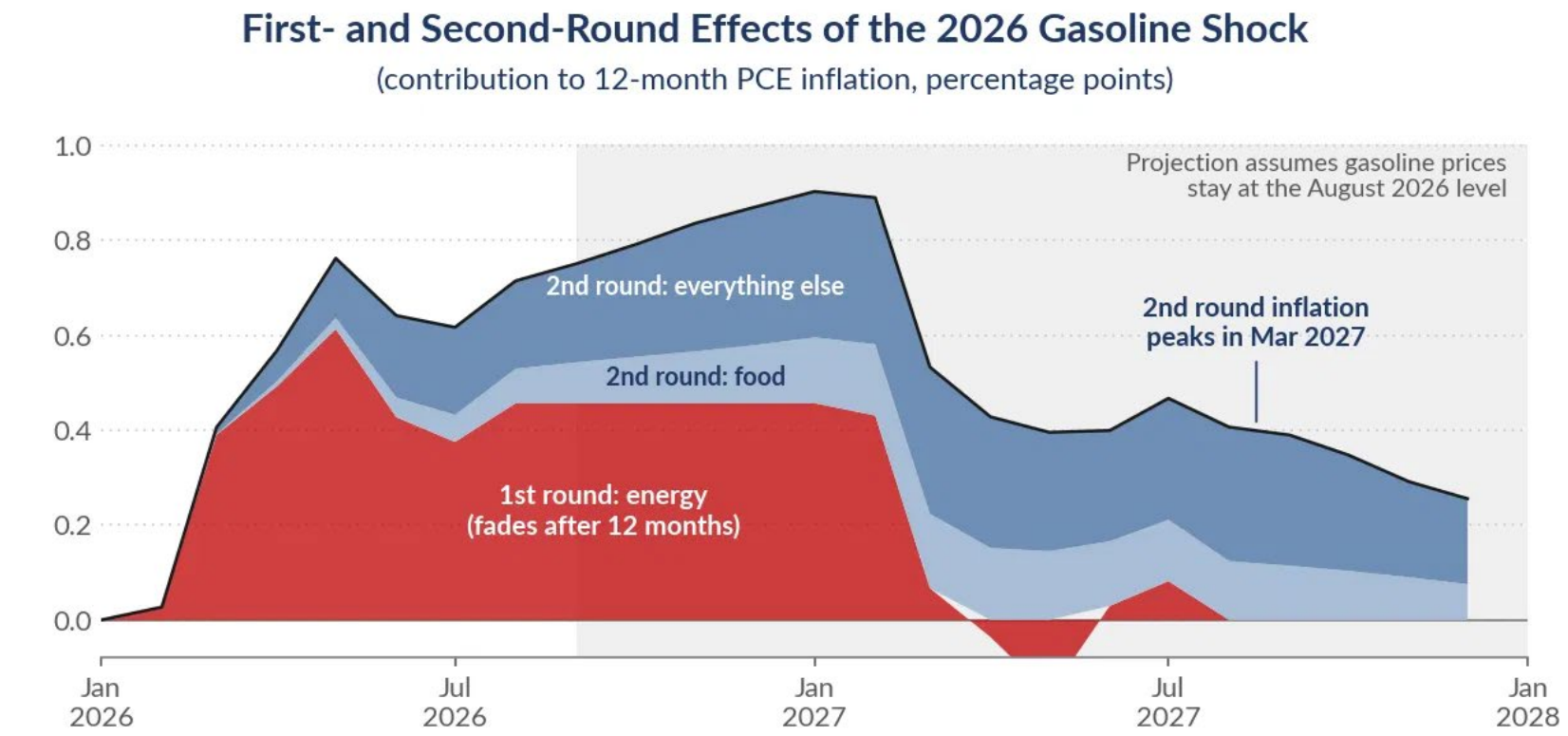




Source: Monthly Treasury Statement, Census Bureau, NCA calculations (tariff rate, through Jul. 2026); U.S. Energy Information Administration via FRED (fuel prices, weekly through Sep. 21, 2026).

- Supply chain disruptions during the pandemic and Russia's attack on Ukraine pushed inflation above 9% in 2022, the highest in four decades. The effects slowly unwound.
- In 2025, the Trump administration raised tariffs on goods from most US trading partners. Businesses found ways to lower the bill but still pay about triple the prior tariff rate.
- In 2026, a US and Israeli attack on Iran severely disrupted global energy supplies. Unlike the 1970s, the US now produces more oil than it uses, avoiding fuel shortages. But oil is priced on a world market, and US prices rose, too.

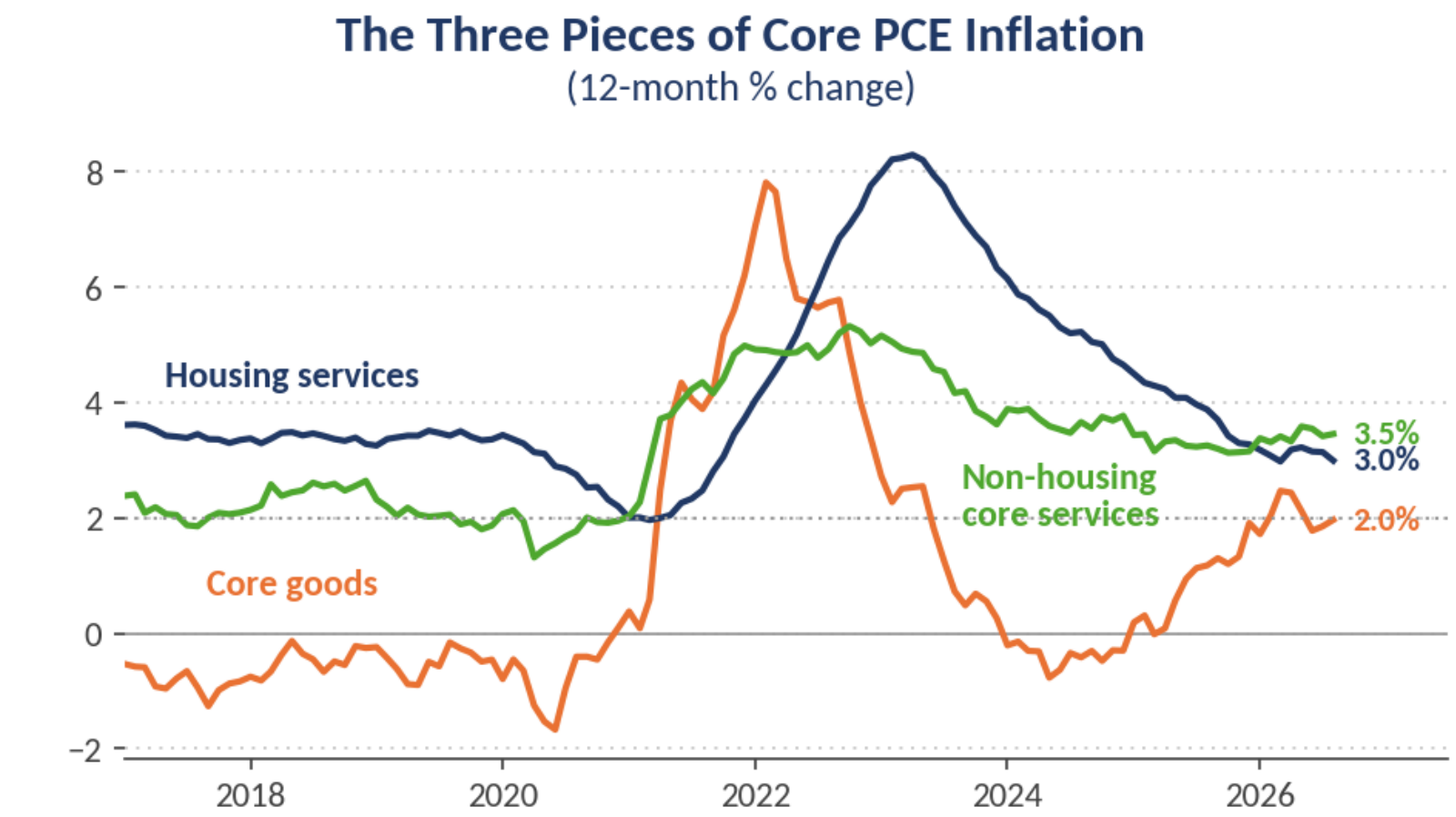
Supply shocks have complicated the rule of thumb on inflation, too



Source: Bureau of Economic Analysis, author's calculations. Note: First round is the direct contribution of gasoline and other energy goods (1.9% of spending) given the actual price path since Feb. 2026 (+27% through Aug 2026). Second round (food, core) applies historical pass-through profiles (2000-2026, ex 2020-21) to that path; the food and core-ex-airfares pieces are imprecise, roughly half to double the value shown. Both scaled to headline PCE.

- Supply shocks push up on prices and down on growth, which pulls the Fed's two goals, stable prices and maximum employment, in opposite directions.
- Typically, the Fed 'looks through' shocks like tariffs or energy prices, because the first-round inflation effect fades even if prices stay high.
- The second-round inflation effects on non-energy spending build over time if prices stay high. That risk is why the Fed raised rates.
- Rate hikes alone won't bring inflation down. The current shocks need to unwind, and policy needs to stop adding new ones.

Underlying inflation: slow progress, and the easy part may be ending

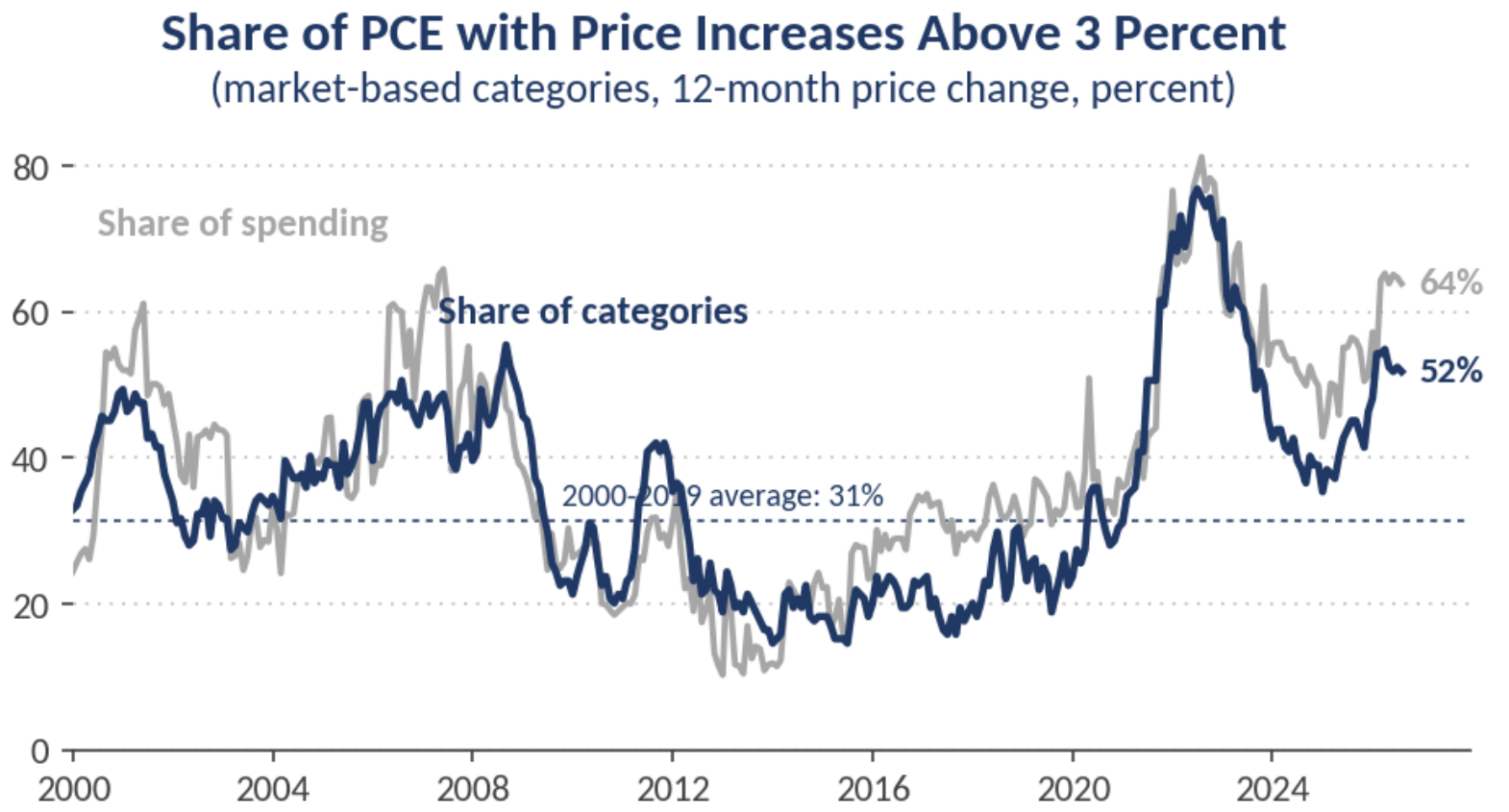


Source: Bureau of Economic Analysis; NCA calculations. Note: Data through August 2026.

- Core PCE inflation is 3.0%, well above the Fed's 2% target. It has three pieces: housing, non-housing services, and core goods.
- Slower housing services inflation has offset higher energy and tariff pass-through this year. With higher rates and slowing residential construction, that source of disinflation may fade.
- Core goods inflation, near zero for a decade before the pandemic, is back above 2% on tariffs and, more recently, chip shortages from the AI buildout.

Source: Bureau of Economic Analysis, NCA calculations.

Price increases are broad, which is where the new Chair looks first



Source: Bureau of Economic Analysis, NCA calculations from 164 detailed PCE categories, excluding imputed (nonmarket
Data through August 2026.

- The share of PCE categories with prices rising more than 3% is high relative to history, though below the pandemic peaks.
- The distribution of price changes is the metric Chair Warsh has highlighted, in his confirmation hearing and again at Jackson Hole.
- Breadth is the bridge from supply shocks to policy: a few big relative-price moves can be looked through; broad increases cannot.

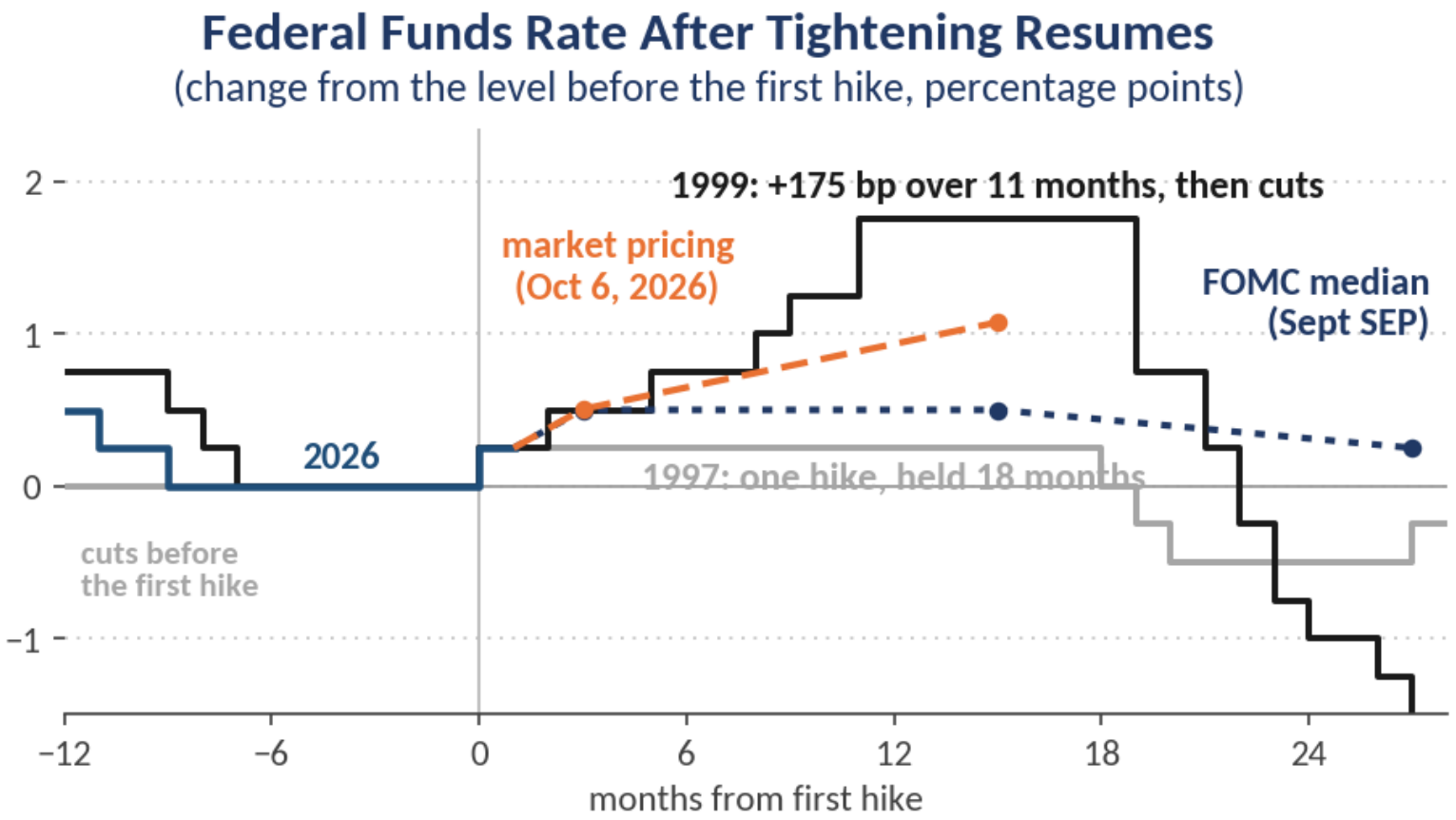
Source: Bureau of Economic Analysis, NCA calculations from 164 detailed PCE categories.

2

A new Chair and new communication challenges

Chair Warsh says less and speaks less for the committee. The committee's reasoning still gets out, three weeks late, through the minutes.

The Fed resumed hikes in September as risk management, not a new cycle

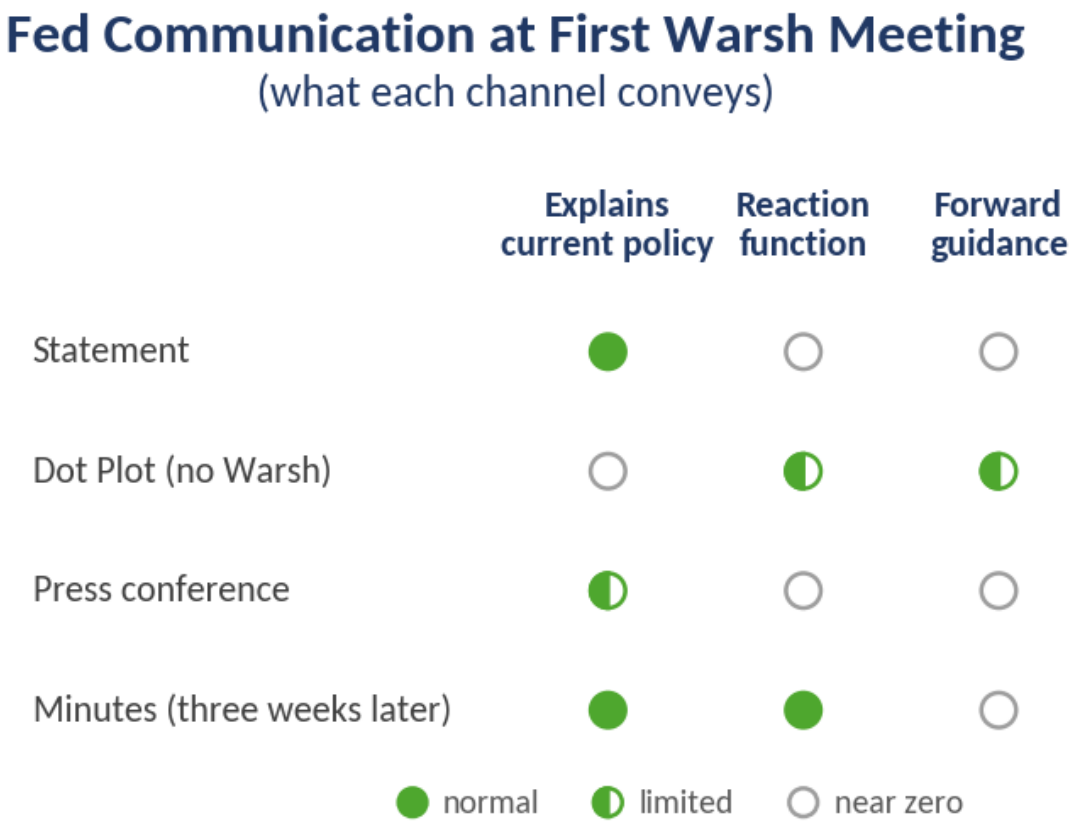


Source: Federal Reserve via FRED (target rate; midpoint of range from 2008); Summary of Economic Projections, Sept 20
CME FedWatch (probability-weighted midpoint, Dec 2026 and Dec 2027). First hikes: Mar 1997, Jun 1999, Sep 2026.

- The Fed raised rates a quarter point in September, the first hike since 2023, on a unanimous vote. The statement said it would support a timelier return to 2% inflation.
- Officials' projections, excluding Chair Warsh, who does not submit one, center on one more hike this year and none next year, far less than a typical hiking cycle.
- Markets pricing more, especially next year, partly reflecting the Chair’s growth emphasis.
- Three weeks later, minutes revealed risk management, not growth, was the primary reason.

Source: Federal Reserve, Summary of Economic Projections (Sept 2026); CME FedWatch (Oct 6, 2026); NCA.

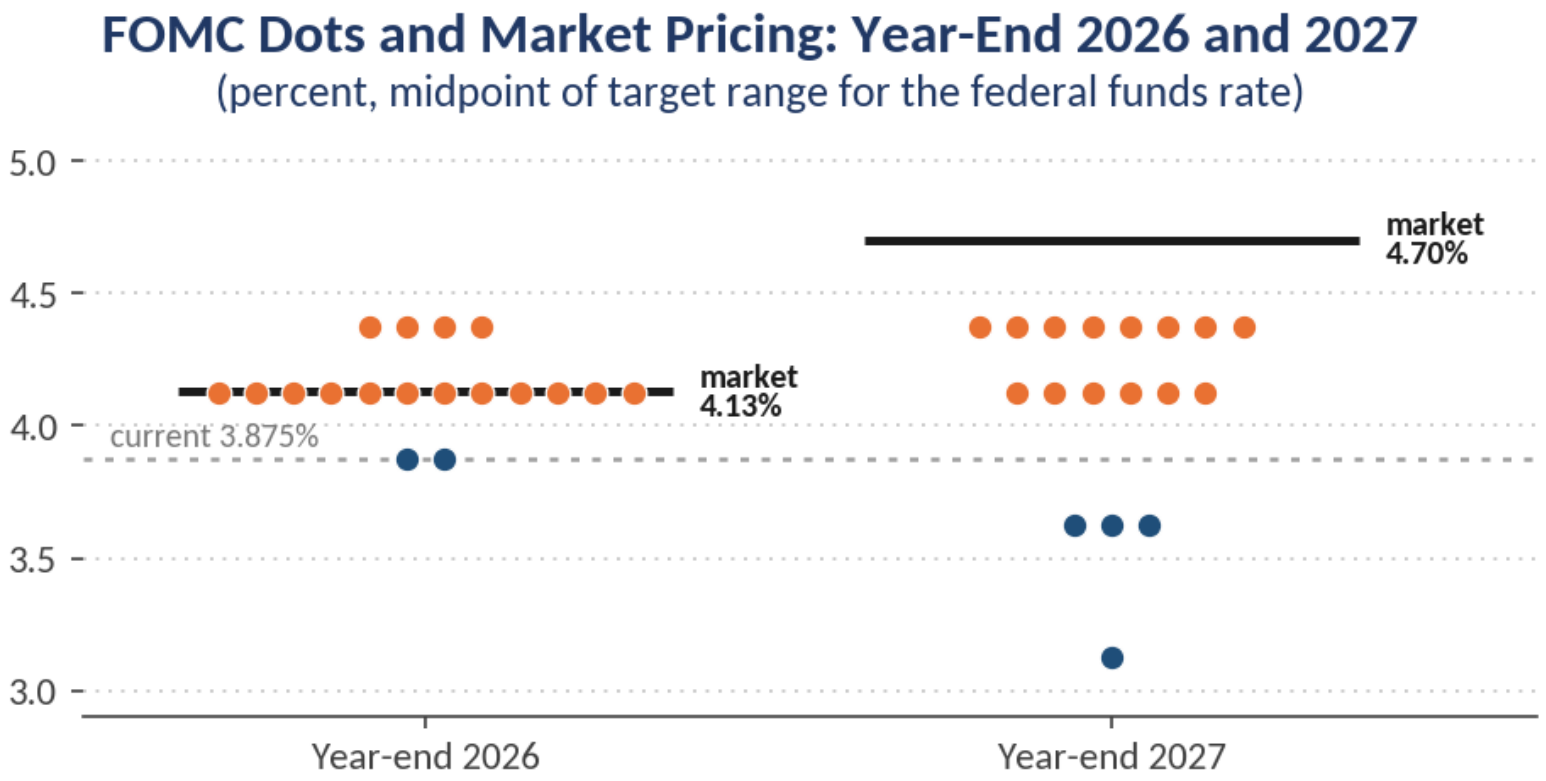
The Chair says less. The committee's reasoning still gets out, with a lag.



- Chair Warsh has dropped forward guidance and does not fully explain the committee's decision at the press conference. The statement is short on rationale.
- The minutes under Warsh have continued to carry the committee’s reasoning, but they come out with a three-week lag.
- My advice since July: read the minutes, fade the presser. Downweight what the Chair says, upweight what the committee writes.

Source: Author's assessment of Federal Reserve communications since the May 2026 transition.

Markets hear a more hawkish Chair than the committee's projections show



Source: Federal Reserve, Summary of Economic Projections, Sept 15-16, 2026; CME FedWatch, October 6, 2026.
Each dot is one of 18 participants: orange above the current 3.75-4.00% range, blue at or below.
Market: probability-weighted midpoint for the Dec 2026 and Dec 2027 meetings.

- September dots: 12 of 18 participants at one more hike this year. For 2027, a split, with no further hikes in the median. Warsh is not in the dots.
- Futures price roughly two more hikes by the end of 2027 than the committee's median. A Chair who talks up growth and never mentions risk management leaves markets to fill in the gap.
- Speeches by Williams and Jefferson brought this year's pricing in line with the committee. Next year's gap remains.
- Unintended tightening is a risk of confused communication.

Source: Federal Reserve, Summary of Economic Projections (Sept 15-16, 2026); CME FedWatch (Oct 6, 2026).

Task forces alone are unlikely to rewire the Fed

Warsh Task Forces

(announced July 9, 2026; three outside experts lead each)

1 **Communications**	How the Fed communicates policy decisions amid economic uncertainty
2 **Balance Sheet Policy**	Costs, benefits, and institutional implications of current balance-sheet practices
3 **Data**	Quality and timeliness of the economic signals informing policy decisions
4 **Productivity and Jobs**	Economic impact of general-purpose technologies, particularly artificial intelligence
5 **Inflation Frameworks**	The Fed's understanding of inflation drivers and policy responses

- Announced in July, each led by outside experts: communications, the balance sheet, data, productivity and jobs, and inflation frameworks.
- Jackson Hole settled two things: 2% PCE remains the target, and the funds rate, not the balance sheet, is the tool. Both had been needless confusion.
- The Fed did a framework review in 2020 and 2025, covering most of these topics. Task forces could be helpful to Warsh's thinking, but unlikely to move the committee. Look for slow, marginal changes.

Source: Federal Reserve.

What has settled, what has not, and a fix

Settled

- 2% PCE inflation is the target.
- The funds rate is the tool; the balance sheet is not.
- The September hike was insurance that supply-side disinflation is enough, not demand destruction.

Unsettled

- No forward guidance from Chair, stretched to cover not explaining the latest decision.
- The Chair gives his own views and says the committee agrees. On decision day, no one can check.
- A Summary of Economic Projections without the Chair is no longer a committee document.

A fix

- Put the committee's reasoning in the statement on decision day, as the minutes do three weeks later.
- Let the press conference be the Chair's views, and say so.
- Center communications on accountability. A quieter Fed is a less accountable Fed.

3

Fed independence remains under threat

The Supreme Court treated the Fed as special. Lisa Cook's case and Jay Powell's seat on the Board are where that protection is still being tested.

The Supreme Court treated the Fed as special. So far, independence holds

Trump v. Cook, June 29, 2026

- 5-4: the President cannot remove Governor Cook while her case proceeds. The Court did not decide whether 'cause' exists; that goes back to the lower courts.
- For-cause protection for Fed governors is constitutional, grounded in the Fed's unique history. 'Cause' has a substantial threshold tied to a governor's duties.
- Same day, Trump v. Slaughter struck the same protection for the FTC. The Fed is the only exception, for now.

What it means

- Congress built the Fed's protections for a moment like this. Credibility lives in what people believe the central bank will do under pressure.
- Appeasement does not work. Barr stepped down as Vice Chair for Supervision in early 2025 to avoid a fight; the fight came anyway, to Cook and then to Powell.
- The election calendar is not a data point. Since 1984 the Fed changed rates in 43% of the two months before federal elections, versus 45% of all two-month windows. The Fed raised in September.

Risks remain: the Cook case proceeds, and pressure on Powell continues

Where things stand

- White House restarted its efforts to remove Cook in August, and a White House hearing is set for early November. Unclear what the Supreme Court will accept as removal for cause.
- Powell's term as Chair ended in May 2026. His term as a governor runs to January 2028. He stayed. In September, the Fed's Inspector General found the headquarters renovation poorly managed, with no illegal activity. The President demanded Powell's resignation the same day.

Why it matters

- Each seat the President cannot fill at will is a seat that still belongs to the institution.
- The protection the Court upheld only matters if governors use it. Staying under pressure is itself the signal.
- It has played out about as well as could be expected: a lot of drama, and policy keeps moving forward. The threat to Fed independence will continue until the President decides to stop.

A Fed in transition can still deliver.

The committee, not the Chair, is the signal to watch.

What I'm watching next

Inflation

- Second-round effects of energy and tariffs through 2027. They will shape the Fed's rate path.
- Whether the shocks unwind: Middle East, Canada tariffs, AI bottlenecks.

The Fed

- Oct 27-28 meeting: the statement on the day, the minutes three weeks later.
- Who speaks for the committee. The committee is a clearer signal than the Chair.

Independence

- Cook's case on remand: what counts as 'cause.'
- Pressure on Powell's seat, and on the Chair, after the midterms.

Thank you

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