

FED SHADOW

Jay Powell: Alien Enemy

Monday, April 21, 2025

Donald Luskin**Trump would have to massacre the whole Board and replace Powell with Stephen Miran.**

FIRST, A QUICK WORD ABOUT TARIFFS As much as we don't like Venezuelan gang members prowling the streets of America, we like even less the pretextual use of inapplicable laws to eject them. So we are delighted by the [Supreme Court's order on Saturday](#) – an action affirmed by seven justices including all three of President Donald J. Trump's appointees – to enjoin deportations under the [Alien Enemies Act](#). We only mention this because we think *this is a perfect template for what the Supreme Court is likely to do when presented with the question of imposing sweeping tariffs under color of the [International Emergency Economic Powers Act](#)*, which as we pointed out from the get-go (see ["They Called His Bluff on Tariffs"](#) February 2, 2025), doesn't even mention the word "tariffs." *Yes, the tariff tax-hike nightmare could end. Just. Like. That.* Which may be one reason why, in the face of an historical policy blunder, markets have really barely reacted.

NOW, ABOUT POWELL We're not sure why markets – [and President Trump](#) – reacted so badly to Fed Chair Jerome Powell's [Chicago speech last week](#). *There's just nothing new about it.* He said,

"The level of the tariff increases announced so far is significantly larger than anticipated. The same is likely to be true of the economic effects, which will include higher inflation and slower growth."

Which is literally the same thing he said in [his prior speech](#) two weeks earlier:

"...it is now becoming clear that the tariff increases will be significantly larger than expected. The same is likely to be true of the economic effects, which will include higher inflation and slower growth."

Which is pretty much the same thing he said in [the press conference](#) after the March FOMC:

"...we kind of know there are going to be tariffs, and they tend to bring growth down. They tend to bring inflation up ..."

Update to strategic view

US MACRO, FEDERAL RESERVE: The Supreme Court order preventing deportations under the Alien Enemies Act is a template for overturning Trump's use of the International Emergency Economic Powers Act to impose tariffs. Powell has drawn new criticism for the same old statements about the effect of tariffs on inflation and growth. Said to be hawkish, futures-based rate expectations have only gotten more dovish. And the suspension of QT means easing has already begun. There is no gain for Trump to fire Powell, and we don't think he will. He would have to fire the entire Board of Governors. Warsh, a fundamentally hawkish conservative, would be no improvement for Trump. His ideal pick would be Miran with his radical trade, debt and currency agenda, making him the fourth of the last five Fed chairs to have chaired the CEA first. Powell is wrong to assume tariffs will be inflationary (they weren't last time). He is wrong to emphasize inflation expectations that are highly biased and have no predictive record.

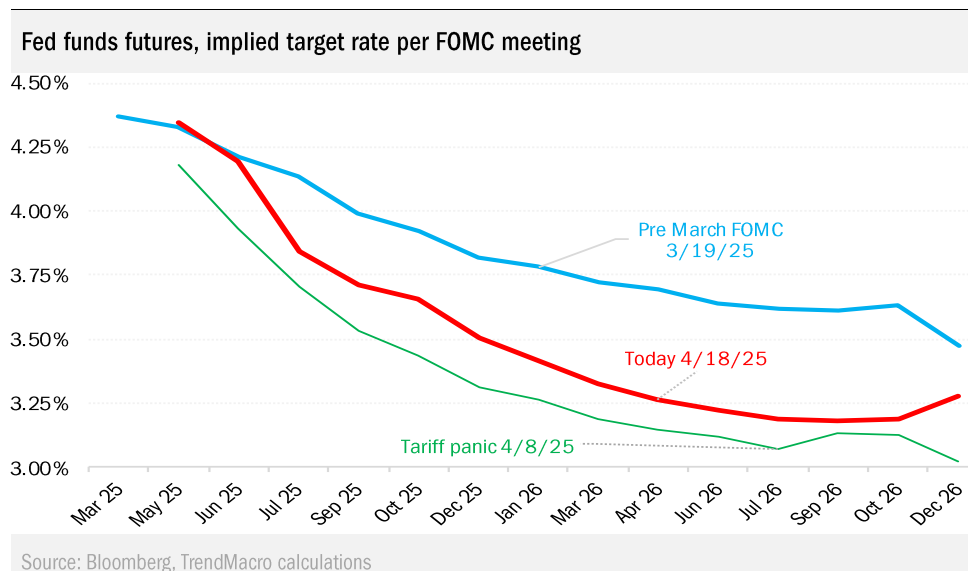
[\[Strategy dashboard\]](#)

The chatter is that this is all terribly hawkish, though on the face of it, it actually puts the Fed's two mandates into irreconcilable conflict (see [“On the March FOMC: Dots in the Headlights”](#) March 19, 2025). But on all three occasions Powell fell back on two familiar hawkish mantras – that the price stability mandate has pride of place, being ultimately necessary as a precondition for maximum employment; and that the greatest risk to price stability is the unhinging of inflation expectations that could be triggered by tariffs. And the story – carried under the byline of no less a Powell-whisperer than our friend Nick Timiraos (see [“Video: TrendMacro conversation with Nick Timiraos on Powell's crisis response and the inflationary aftermath”](#) March 28, 2023) – is that Trump is well-advanced in plans to fire Powell and replace him with our friend Kevin Warsh.

There's so much that's so wrong with every part of this, we barely know where to begin.

MARKETS DON'T REALLY SEE POWELL'S STANCE AS HAWKISH

Since before Powell made the first of these supposedly hawkish statements, the expectations curve for the future policy rate path has gotten increasingly dovish, not hawkish. Before the first of Powell's statements at the March FOMC, 2.4 rate cuts were expected this year. At the zenith of the tariff panic after “Black Monday” following “Liberation Day” (when stocks made their intraday lows, so far, in this correction), markets gave Powell credit for a dovish reaction-function, upgrading expectations to as many as 4.1 rate cuts. Today expectations are only slightly less dovish than that, at 3.6 rate cuts, more than one additional rate cut compared to just before Powell's first statement supposedly hawkish statement about tariffs at the March FOMC (please see the chart below).



THE EASING HAS ALREADY BEGUN At the March FOMC, the Fed all but ended so-called quantitative tightening. This has the property of ceasing to force the banking system to take more duration risk in markets, as so-called excess reserves, a zero-duration asset, have to be redeployed by banks in Treasury issuance at whatever the average maturity is.

Contact TrendMacro

On the web at trendmacro.com

Donald Luskin
Dallas TX
214 550 2020
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625

tdemas@trendmacro.com
Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

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Remember – AI can be funky. This is still experimental. Check it out and let us know what you think.

- If nothing else, this de-risks the banking system at the margin, and encourages lending activity by opening up space in banks' risk budgets. That's how QE and QT work.

THE TRUMP ADMINISTRATION SHOULD BE GLAD FOR ALL THIS

Surely at least Treasury Secretary Scott Bessent should understand what's going on here. After all, Bessent's hand-picked Chair of the White House Council for Economic Advisors, Stephen Miran, came to his attention as co-author with Nouriel Roubini of [a paper](#) describing exactly this dynamic in Treasury markets. Apparently Bessent thought this was quite a unique insight, but we can't resist pointing out we've been saying exactly this for over a decade (see, among very many, "[Video: What you're not hearing about the Fed's 'quantitative tightening'](#)" January 6, 2022).

FIRING POWELL WOULD ACCOMPLISH NOTHING FOR TRUMP The [Federal Reserve Act allows](#) the president to remove any member of the Board of Governors "for cause." It does not say what "cause" means. A forthcoming Supreme Court ruling in [Trump v. Wilcox](#) could clarify the president's authority. But in the meantime, removing Powell would likely be contentious, with a markets-rattling period of uncertainty as to who was helming the ship. The Act does not provide for the president to demote a chair to a mere governor, despite many [press accounts](#) we have seen to the contrary.

- But Powell is only one vote on the FOMC. From what we can tell, none of the other committee members feel any differently than Powell about the policy implications of tariffs. So to assume effective control over policy, Trump would have to remove Powell and all the other six members of the Board of Governors – not just firing an individual, an outright massacre. And then he would have to replace them with people he hopes will be more like-minded, and the Senate Banking Committee would have to approve his nominees. Good luck.
- He has no power to remove the five regional reserve bank presidents who sit on the FOMC ([they can be removed](#), "at pleasure," by their banks' respective boards of directors).
- Except to intimidate the Fed – which would likely backfire by solidifying it against him – we can't see why Trump would fire Powell. We don't expect he will.

CHOOSING WARSH TO REPLACE POWELL WOULD ACCOMPLISH NOTHING

Well, that's not quite right. We've known Kevin Warsh well for over twenty years, and he would make a fine Fed chair, probably a better one than Powell. But appointing Warsh would accomplish nothing for Trump, because Warsh is in no way a Trump loyalist, and comes from an even more conservative and inflation-wary policy tradition than Powell.

- While it makes no policy sense for Trump to appoint Warsh, Trump does have a habit of picking people *like* Warsh – well-known conservative brand-names such as Stephen Moore and Judy Shelton. He nominated both to the Board of Governors in his first

term (as it happened, neither could get through the Senate). And both are every bit as constitutionally hawkish as Warsh.

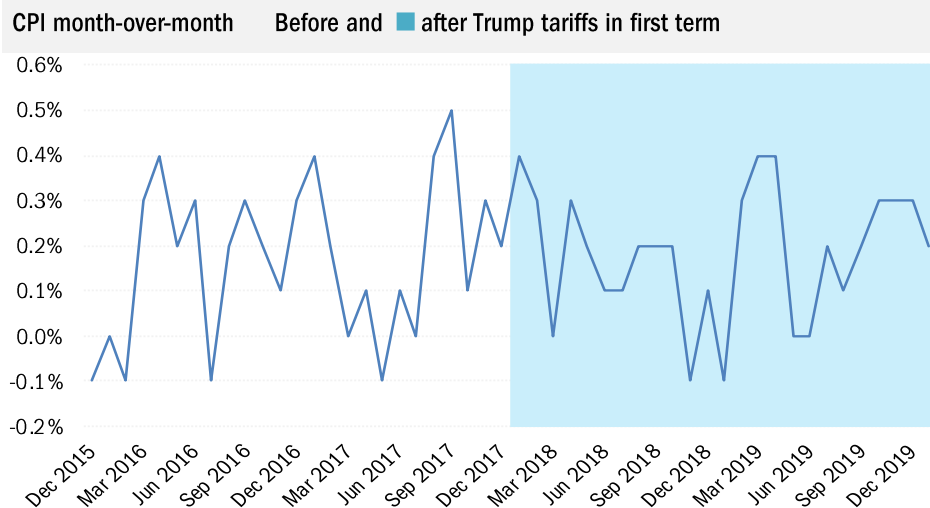
- We acknowledge Timiraos' s extraordinary track record as a deeply sourced Fed forecaster. But the idea that Trump is favoring Warsh to replace Powell has nothing to do with his Fed sources – *Powell* may leak to Timiraos, but why think that *Trump* does? Timiraos is the second of two names on the byline. We're not buying it.

SO IF NOT WARSH, WHO? Well, we really hate to say this. But of the last four Fed chairs over almost forty years, three (Greenspan, Bernanke and Yellen) had first been chair of the White House Council of Economic Advisors. *Today that person is... wait for it... Stephen Miran.*

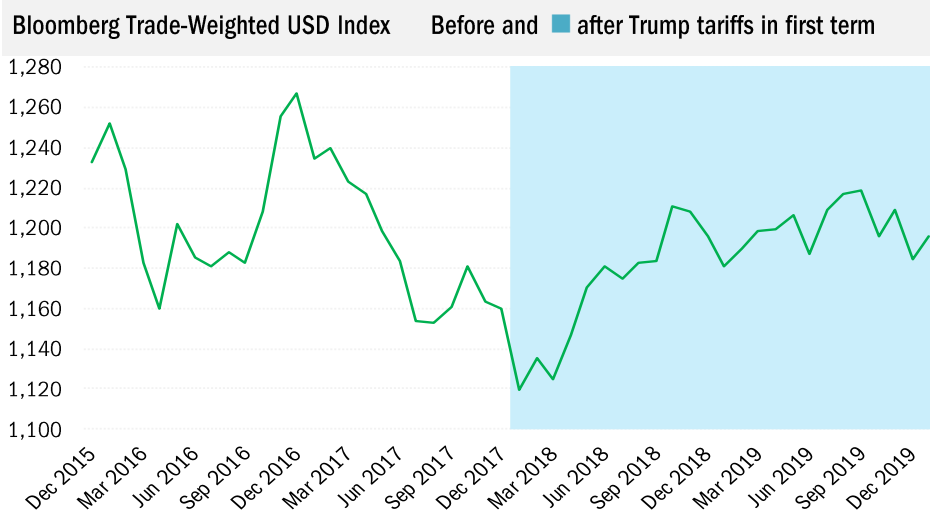
- Unlike Warsh, Miran is a Trump loyalist whose [November manifesto](#) on “restructuring the global trading system” is [what he himself calls](#) a “cookbook” of America-first policy ideas including surrendering the US dollar as the world’s reserve currency, weakening the dollar by selling all the gold in Fort Knox and carrying out a selective default on foreign holders of Treasury securities posing as a “Mar-a-Lago Accord” (see, among many discussing Miran, [“Is There a New US Risk Premium?”](#) April 14, 2025).
- Let’s say Trump makes good on [his threat](#) from Miran’s “cookbook” to extend the tariff war with China by terminating [the 1984 United States-The People’s Republic of China Income Tax Convention](#), effectively slapping a 30% tax on coupon income from Treasury securities held by China. Let’s say China, in retaliation, dumps the \$760 billion in Treasury securities it holds – a black swan nightmare economic-warfare scenario that has been feared for many years. *It would be nice for Trump to have a compliant Fed that could somehow come up with a way to internalize all that on its balance sheet. Miran would try to find a way.*
- Don’t just dismiss this risk. Miran is an intimate of Bessent, who will have a voice in the decision. Even if Powell is *not* removed, he surely won’t be renominated as chair next year. Miran may be.

ALL THAT SAID, POWELL IS SOMEWHERE BETWEEN CONFUSED AND WRONG ABOUT ALL THIS It *seems* beyond question that tariffs will cause inflation. But *tariffs didn’t cause inflation last time Trump imposed them in 2018 and 2019 – not even temporarily* (please see the chart on the following page, and [“Will the Trump Tariffs Be Inflationary?”](#) April 9, 2025).

- Higher after-tariff costs are not necessarily pushed downstream by importing firms to their consumers. They may wish to internalize them in the form of reduced margins. And if they *are* pushed downstream, the prices of tariffed goods will rise – forcing budget-constrained consumers to buy fewer units of *all* goods. The overall price level needn’t rise – although consuming fewer units would cut against growth. *It’s more a growth thing than an inflation thing.*



- But upstream of the importer, exporting firms may cut their prices to accommodate the tariffs, or exporting nations may cheapen their currencies. The latter appears to have happened in the 2018-2019 episode (please see the chart below, and again, [“Will the Trump Tariffs Be Inflationary?”](#)).



- For what it's worth, [Powell admitted at the March FOMC press conference that he knows all this](#) about the 2018-2019 experience.

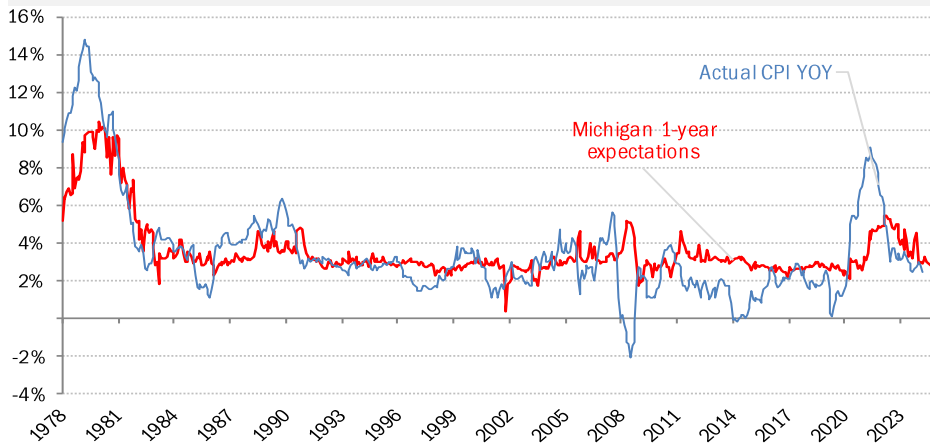
Powell is also wrong about inflation expectations.

- His case, in a nutshell, is that inflation is caused by inflation expectations. He anticipates the risk that if tariffs *do* cause inflation this time, that will inflame expectations, which will in turn cause a vicious cycle of more inflation and more expectations, and so on. He believes that a way of reining in those expectations is to assure

the public that the Fed will move first and foremost to prevent inflation, whatever the costs.

- First, *inflation is not caused by inflation expectations*. When we take the entire history of the University of Michigan survey of inflation expectations all the way back to the beginning in 1978, we discover that the correlation of expectations to future inflation outcomes is only marginally better than the reverse – in other words, *expectations don't predict inflation any better than inflation predicts expectations, which makes it pretty hard to argue that expectations cause inflation* (please see the chart below).

Inflation expectations versus actual, 1 year lag



Source: University of Michigan, BLS, TrendMacro calculations

- To be sure, the [March Michigan survey](#) 1-year inflation expectation of 6.7% is terrifying. We didn't see a level like that even at the height of the post-pandemic inflation in 2022. For that matter, we haven't seen it since 1981.
- That said, we need to look inside the number. It turns out that of the 900 to 1,000 persons surveyed, *Democrats have even higher expectations – 7.9%. Independents have somewhat lower, but still high, expectations – 6.2%. Republicans have sharply lower expectations – 0.9%.* Weighting these expectations by the [actual share of American voters](#) in each affiliation (33% Democrat, 32% Republican, 35% independent), we get a weighted average of 4.99%. That's still a big number, but inquiring minds want to know how the University of Michigan came up with 6.7% (we can infer they think only 9% of voters are Republican and 56% are Democratic). Be that as it may, the expectations are anything but homogeneous and anything but objective.
- The New York Fed conducts a consumer survey, too, with a somewhat larger population of 1,300 persons. *Its March survey shows 1-year inflation expectations at a slightly elevated – but far from jaw-dropping – 3.6%.*
- This survey does not report political affiliation, but it does offer other useful demographic divisions. It turns out that *inflation expectations are only notably high among the lowest income, least educated and least “numerate” among the respondents.*

- Oh – and the 1-year TIPS inflation breakeven is lower still, at 3.2%. Indeed, it has fallen over the last couple of months even as larger-than-expected tariffs have been announced. And last time we checked, TIPS don't know whether Democrats or Republicans are buying them.
- So what exactly is Powell so worried about – except as a hypothetical? If the tariffs deliver a blow to growth as they well may (see [“Video: What you're not hearing about how tariffs are taxes -- and big new tariffs are big tax hikes”](#) April 8, 2025), how much unemployment is it worth to pre-empt an inflation that may not come (it didn't last time) or expectations that have no predictive or causative record?
- That's not to say he should be fired, or that it would do any good if he were. But it would be a better world if he weren't wrong about so much. Then again, it would be an even better world if we weren't facing tax hikes in the form of tariffs.

Bottom line

The Supreme Court order preventing deportations under the Alien Enemies Act is a template for overturning Trump's use of the International Emergency Economic Powers Act to impose tariffs. Powell has drawn new criticism for the same old statements about the effect of tariffs on inflation and growth. Said to be hawkish, futures-based rate expectations have only gotten more dovish. And the suspension of QT means easing has already begun. There is no gain for Trump to fire Powell, and we don't think he will. He would have to fire the entire Board of Governors. Warsh, a fundamentally hawkish conservative, would be no improvement for Trump. His ideal pick would be Miran with his radical trade, debt and currency agenda, making him the fourth of the last five Fed chairs to have chaired the CEA first. Powell is wrong to assume tariffs will be inflationary (they weren't last time). He is wrong to emphasize inflation expectations that are highly biased and have no predictive record. ▶