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Hello, and welcome to this week's Dividend Cafe. I am your host, David Bahnsen. I am recording from just outside the Reagan Museum and Library here in beautiful Southern California. It has been a whirlwind of a week. I am about to give my fifth speech in five days in four states, is that right? Here at the Reagan Foundation Economic Forum, and I'll share more about some of that next week, but this really is today a very, very important topic, and it's one I extremely enjoyed writing, and I really want everyone who doesn't care about monetary policy, who doesn't care about the Fed, to still listen, in the sense that I think what we're talking about has become a very important topic in terms of ongoing Aspirational economic health and stability in the midst of what's become a very politicized issue, and I'm hoping to bring some clarity to the subject.

The catalyst to this debate, discussion about Fed independence is political, as I will make clear in a moment, and the ability to have a sensible and grown-up conversation about it requires nuance, and nuance is the enemy of, well, everybody and everything these days. But it's not gonna stop me. I am very excited for our new Fed chair, Kevin Warsh, for now.

I made a comment to a client who asked the question in Dallas this week, you know, "Are you, are you excited about Kevin Warsh coming?" And I said, "I very much am." But of course, my excitements

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have led to disappointments many times in areas of public policy over my adult life. So I always brace for disappointment.

But one of the big controversies about Kevin Warsh coming in, he was confirmed into this role a week ago. President Trump was there, and then I heard media people say like, "Oh, they shook hands and they were smiling," and, "Are we really gonna get an independent Fed?" And that question came up a lot throughout the not only confirmation process, but as President Trump himself was vetting different candidates, is he just gonna appoint someone who does his bidding?

And I think markets were reasonably pleased at the choice.

Prudentially, Kevin Warsh is highly unlikely to be anybody's lapdog. He's a man of tremendous intellect and independent thought. The reality is we don't know exactly how this will play out, but my thought is that President Trump selected Kevin Warsh because he believes he would be the right guy, and Kevin Warsh is very likely to prove to be the right guy in what is a job that I don't know very many people, very many sane people who would want right now.

Now, where does this come from? What is the reason people are so worried about Fed independence? What does it even mean? I wanna tackle all of this, and I wanna do it in the most de-politicized way possible, because I think a lot of it is that President Trump used pretty aggressive tactics to try to signal to Jerome Powell, Jay Powell was the Fed chair up until a week ago, and there's many people, myself included, who do not agree with the way the president handled that.

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And yet I believe it's entirely possible to believe that the president didn't handle it in the right way and at the same time that Jay Powell made some significant mistakes in affecting monetary policy. I think that it is also possible to believe that President Trump's manner of doing it may have been wrong, but the notion that the Fed is supposed to be out on an island away from either executive branch or legislative branch connectivity is completely unfounded.

And so we're gonna, we're gonna discuss this. More, more realistically, the reason people are all of a sudden interested in Fed independence is not an ideological commitment to the sacrosanct autonomy of central bank decision-making separated from political consideration, but rather either a disapproval of the way in which President Trump did it or just the idea that now all of a sudden we wanna pay attention to it because of who is the president or what have you.

So history is not gonna be a great argument for those that say we've always had this perfect Fed independence. History will be a good argument that we've never had it go down the way it had gone down, this DOJ investigation, some of the tweets, some of the things done and said, and I think kind of public humiliation.

I can't defend it because I don't. But I do believe, as is the case with everything I wanna be doing in this current moment about economic commentary, financial commentary that overlaps with political, it's just not that hard to call the balls and strikes of what was done wrong, what was done right, what is within bounds, what is not in bounds, and have all these thoughts at the same time.

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That's what we're gonna do here right now. Uh, let me read you word for word what President Trump said at the confirmation hearing about Kevin Warsh and the issue of independence. "I want Kevin to be totally independent. I want him to be independent and just do a great job. Don't look at me. Don't look at anybody.

Just do your own thing and do a great job." Okay, so again, perhaps those are just words. Perhaps he very much desires a particular outcome and there will be a dynamic there that makes him uncomfortable. It would be a problem for credibility in markets. All of that can be true. But what is exactly the Fed's role, its structure?

When we talk about being independent, where does it exist? It isn't found in the Constitution. It was created legally in nineteen thirteen by an act of Congress Congress had the power to create the Fed because why? Because Article 1, Section 8 of the United States Constitution gives the jurisdiction over the value of money and the creation of money to the Congress.

And they, in their wisdom, delegated some element of this to the Fed, which inherently puts it under their jurisdiction. They could amend that tomorrow to get rid of the Fed or to modify the powers they've given to the Fed to expand or to contract. And in fact, they've done additional legislation, including in the 1978 Humphrey-Hawkins Act, that further clarified the mandate of the Fed being price stability and maximum employment.

There are procedural connections, but whenever a agency or a department or some quasi-entity is created, it then is under the

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authority of the executive branch, and the fact of the matter is that the president appoints the governors, the Senate confirms them. The Fed, and this is a byproduct of the '78 Humphrey-Hawkins Act, has to go report to Congress twice a year as to what's going on.

They, but then they cannot be fired. The Fed governors have 14-year staggered terms, which is meant to make it more apolitical, akin to judges. And the fact of the matter is that not being able to be fired without cause puts it in an independent zone. But it isn't an agency. This is what is very tricky, and I wanna get you the exact language here.

It is not an executive branch like a Department of Treasury, Department of Commerce, Department of Education. We have a lot of departments that I think we shouldn't have. We have some departments I think we should have, but they were created lawfully by Congress. It is not a private institution, and it's not a congressional agency.

It sits in a zone that doesn't exist in our form of government, and so you have a sort of ambiguity that I think needs to be addressed structurally. Now, let's be very clear. There is no world in which what the Fed does is actually apolitical. Their explicit mandate is price stability and maximum employment.

Therefore, they are talking about things that have political repercussions. They have monetary policy tools that affect the cost of money. Who is the biggest borrower of money in the world? It's certainly in the United States economy. It's not private equity, it's not mom and dad's car wash, it's not individual mortgages.

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All of these people are borrowers affected by cost of capital consideration, but the United States government is the biggest borrower. So you have this quasi-agency that has a function that is very political when you're talking about employment and prices that affect every citizen who votes in the country.

They're legally under a purview of Congress, but removed from certain unitary authorities of the executive branch. There is a legal nebulous structure that is problematic, but in no way independent. Now, by the way, I don't have to make this argument ideologically or feigning to be a constitutional scholar.

There is absolutely nobody who disagrees with this. The connectivity of the Federal Reserve to the political arms of government is celebrated. There's a link in Dividend Cafe in which the accord between then Fed Chair Alan Greenspan and then Treasury Secretary Bob Rubin, and then National Economic Council director, who's appointed and sits under at the pleasure of the president, Larry Summers, in the Clinton administration in the 1990s, was referred to in Time Magazine, very famously, very high profile, as the committee to save the world.

And their connectivity was celebrated in the context of a Mexican peso crisis, a Russian ruble crisis, an Asian financial crisis, a US hedge funds implosion, the long-term capital management, which I've written about in the past at Dividend Cafe. Look, there's been moments in which Richard Nixon had browbeat Arthur Burns, and the tapes of some of these conversations are almost kind of humorous, but not great.

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And we know that Vice President Al Gore was famously quite livid with Alan Greenspan in 1994 for hiking rates. Obviously, we've already discussed these issues with President Trump and his relationship with the chair of the Fed. I'm talking about the idea of actual policy coordination that is openly celebrated, that is made to be a media meme, if you will. What could be more famous than the 2008 moment?

Hank Paulson, Treasury Secretary, Ben Bernanke, Fed chair, co-creating the TARP legislation. Now, that was passed by Congress, but the AIG bailout, the particulars of the Bear Stearns package, the alphabet soup of credit facilities that were created to help backstop illiquidity in commercial paper, in asset-backed security markets.

This was explicit integration of Fed and Treasury function to go affect policy. More recently, in 2020, the CARES Act legislation passed by Congress, but then heavy implementation with Secretary Steven Mnuchin and then Fed Chair Jerome Powell. Now, by the way, they were literally creating Treasury Fed joint operations.

They branded it as such, and it was funded as such to go provide emergency backstops during that moment. If this were just a matter of it being crisis coordination, I think many people would say, "Yeah, yeah, it's okay. We don't really like it, but it's okay during crisis." But then during routine implementation of monetary policy, it's a bad idea.

But what if routine implementation of monetary policy is a factor in some of the crises that come up? Many people certainly believe that. I happen to be one of them. But my point being, where is the line

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drawn? It isn't statutory. There is an automatic political nature to the implementation of monetary policy.

There is no legal or constitutional structure by which the Fed is purely independent. There is a legal structure by which the Fed is not fully independent. So I guess my question is: do we want an independent Fed? And if so, how do we go about getting there? My answer is that prudentially, I think it is good for credibility to not have the executive branch desire to use monetary policy to create short-term sugar highs.

Now let me point something out. If right now the big concern voters have is affordability, and if theoretically people believe that low, artificially low interest rates drives inflation, that isn't always true, but it certainly can be true at times, then why would it be politically favorable for the president to go have the Fed temporarily create inflation?

Now I guess the answer some would say is it gives a sugar high and inflation comes later. There could be truth to it, but my point being it could also be very counterproductive politically. But no, I would be in full agreement as a matter of what facilitates economic stability and wisdom in, in that there is something imprudential about the executive branch's interventions being, shall we say, short-term focused and devoid of the right process and structure.

However, I want to just remember that Congress created the Fed. Congress sets its mandate. The governors in the Fed are appointed by the president, they're confirmed by the Senate, and the policy administration always has and always will require coordination with the

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Treasury Department, which sits under the executive branch purview, which of course is the president of the United States.

We should not let some of the ways that politicians might have handled some of their interventions obfuscate the fact that the Fed does exist as a non-independent entity, period. How could we make this better? How could we provide better clarity? Well, let me give you a crazy suggestion. Maybe Congress could do its job Congress created the Fed using powers delegated to it by the Constitution.

Maybe Congress could fine-tune the legislation to provide pure structural clarity about where the Fed sits in the org chart of the United States as opposed to creating a space that doesn't exist for it. Perhaps Congress could do more in having it answer to the public. The Fed governors are unelected.

They're unaccountable to the public. Congress is accountable to the public. The things the Fed are doing affect the public. Congress is the bridge for that accountability to the public, and Congress is refusing to do that. Having a token conference with one committee once or twice a year is not what I'm referring to.

PhDs in the conference rooms of the Fed that have the footprint in the US economy they have, they did not take it by force, and I just wanna make clear they didn't take it by charm either, I assure you. They were given it by the Congress, and they were more specifically given it by Congress's own dereliction of duty.

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What we need is a fine-tuned Federal Reserve Act that provides more structural and legal clarity. But then we need not only the rules defined by Congress, but the oversight that is expected of public policymakers being accountable to the public. Let's end this by bringing it back to Kevin Warsh. I do expect Kevin to function with the right modicum of independence as long as independence is properly defined in a prudential but not legal or ahistorical way.

I believe that he is now actually outside the purview of the president in the sense that the president got to nominate him, Senate got to confirm him, but he now cannot be fired without cause. I hope that he will have conversations with the president. He may make bad decisions, he may make good ones, but I do believe he will make them in what he genuinely believes to be the right decision-making process and result.

But what I guess I would like to suggest is that lowering rates to help a politician win an election is wrong and stupid. But so is raising rates to try to curtail growth because you believe growth to be inflationary when it is not. See, that's wrong and stupid. And yet the Phillips curve driving Fed policy is just as big a problem and, and over history in matters of actual policy implementation, far bigger problem than anything we've seen from political bullying.

What I would like is a Federal Reserve that's independent in practice of political pressure, not independent of political reality or consequence. But I would like a Fed that is independent of the Phillips curve, of the belief that growth itself is a problem because it is not. Growth is not for the Fed to accelerate or decelerate, and the sooner we understand this very natural principle of economics, the sooner we can get the Fed out

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of the business of setting the cost of capital and letting markets set the cost of capital.

The sooner we have a better clarity on the jurisdiction and structure of the Fed, the sooner we don't have to worry as much about presidential behavior, misbehavior, and by the way, the debate about Fed independence and the myth of the whole thing. What I think we can do is get to a place where we have it right-sized and reduced their footprint and intervention and distortion.

Maybe I'm dreaming a little, but maybe some others wanna dream with me. Maybe this group of us who wanna dream, maybe we can be the committee to save the world. Thanks for listening. Thanks for watching. Thank you for viewing The Dividend Cafe. I look forward to being with you next week as we now go into the month of June.

Have a wonderful weekend