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Warsh's views and Fed monetary policy; US-Iran relations following signing of memorandum

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On 22 May, under close scrutiny from the global financial community, Kevin Warsh assumed his new position as the latest chair of the Federal Reserve Board. Markets were closely watching this appointment because they want to know how Warsh—who previously served as a Fed governor and holds strong views of his own regarding the US central bank—would respond to President Trump's constant calls on the institution to cut rates.

The first Federal Open Market Committee (FOMC) meeting under Chair Warsh was held on 16–17 June. While the policy rate was left on hold, the content of the post-meeting press conference was markedly different from those of previous Fed chairs.

Chair Warsh stated that the Fed would establish five new task forces to conduct a fundamental review of the Fed, which meant he would be unable to provide many answers at the present time.

The type of explanation that had become customary—namely, that this data supports one interpretation while that data supports another, and that the Fed arrived at its decision after comprehensively weighing all such information—was almost entirely absent from this press briefing.

Fed faces renewed inflation risk due to Iran war

Putting aside for now the question of how Mr. Warsh intends to reshape the Fed through these task forces, I would like to consider what can be concluded at this point by examining the Fed's present situation in light of the arguments made by Mr. Warsh over the past 15 years.

In terms of the current state of the US economy, employment growth, which fell sharply in 2H 2025, has recently been recovering, while inflation, which was already high, has risen further, partly as a result of the surge in energy prices triggered by President Trump's war on Iran.

In this context, inflation caused by higher energy prices is attributable to the external factor of war. The generally accepted view is that central bank monetary policy should not be swayed by such external factors as long as they are temporary.

However, this war was initiated by the US itself, and it will naturally have an impact on the US economy if it is protracted. Indeed, a considerable amount of ammunition and missiles were expended in the US attacks on Iran, and production will need to be urgently expanded to replenish them.

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Supply chain turmoil led to strong inflationary pressures in 2022

Past examples suggest that even if the initial cause of inflation is external in nature, once it penetrates and becomes entrenched in the domestic economy, new inflationary factors can emerge. That outcome is especially likely when labor market conditions are solid, as has been the case recently.

For example, Mr. Warsh himself blamed the delayed policy response of former Fed Chair Jerome Powell for the sharp acceleration in US inflation from 2022 onward. This surge in prices was also initially triggered by external supply-side factors and arose precisely because it took time for supply chains to normalize as the pandemic wound down.

At the time, the Fed hesitated to raise rates based on the view that inflation caused by supply chain turmoil would be temporary and would resolve itself within a few months. Contrary to the Fed's assumptions, however, those disruptions continued for more than a year, and the resulting supply shortages drove the inflation rate sharply higher.

For example, the Port of Los Angeles and the Port of Long Beach on the US West Coast were unable to keep up with loading and unloading work immediately after the pandemic, leaving ships unable to unload their cargos and creating lines hundreds of vessels long. Some automakers could no longer obtain necessary parts, resulting in disruptions to production, and for a time used cars actually became more expensive than the new cars that were unavailable.

In an article published in the *Wall Street Journal* on 16 November last year,[1] Mr. Warsh criticized the Fed's response for allowing inflation to take hold. If the same logic were applied to today's situation, he would probably argue that the Fed should raise rates early and avoid repeating the mistake of former Chair Powell, who was late to tighten policy.

Inflationary pressures in US may persist depending on crude oil prices following memorandum

When we look at past examples in Japan, the Bank of Japan hesitated to raise rates during the first oil shock, in 1974, on the grounds that this was an external factor. As a result, the Japanese economy entered a period of high inflation that was dubbed "maddening prices."

Having learned from that bitter experience, the BOJ responded quickly to the second oil shock at the end of the 1970s and was able to avoid a sharp acceleration of prices.

With not only the ECB but also the BOJ now in rate-hiking mode, the Fed may also be forced to adopt a tightening stance unless oil prices drop sharply in response to the US-Iran memorandum.

Warsh opposes use of QE except in liquidity crises

Such short-term monetary policy conduct is important, but markets should be more concerned about Mr. Warsh's views on the long-term conduct of policy.

As a starting point, the Fed chair himself has said that—like former Fed Chair Ben Bernanke—he was strongly influenced by Professor Milton Friedman. He has also stated that the first round of quantitative easing (QE), in which the Fed injected funds into the market in response to the Lehman shock when he was serving as a Fed governor in 2008, was an appropriate response.

However, his views on the second and third rounds of QE, as well as the massive doses of QE administered by former Fed Chair Powell during the pandemic, differ considerably from the consensus within the Fed at the time, which included Mr. Bernanke.

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[1] Kevin Warsh, "The Federal Reserve's Broken Leadership," *The Wall Street Journal*, 16 November 2025.

The Fed chair believes that while central banks may need to provide short-term liquidity in an emergency, such measures should be strictly emergency responses and should not be left in place after the crisis has passed.

According to one report, Mr. Warsh resigned as a Fed governor in 2011 because he could not acquiesce in the growing acceptance of QE within the Fed as a standard tool of monetary policy.

Mr. Warsh opposes the established use of QE as central bank policy for two reasons: (1) the monetarist view, which comes from Milton Friedman, that excessive supply of funds by a central bank ultimately stokes inflation; and (2) the view that by purchasing or holding large amounts of government bonds under QE, central banks undermine government fiscal discipline and ultimately impede the healthy growth of the private economy.

QE effective when lender-side problems exist

To properly assess Mr. Warsh's stance, we need to look at the process by which QE, initially referred to as "unconventional monetary policy," came to be used so widely.

Milton Friedman, who could be described as their intellectual guru, long argued that the Great Depression of the 1930s could have been prevented if the Federal Reserve Bank of New York had supplied sufficient funds—i.e., if it had implemented QE.

This argument is what led to the Fed's rapid rate cuts and massive liquidity injections in response to the Lehman shock in September 2008. Mr. Bernanke, who was Fed chair at the time, viewed the crisis as an opportunity to prove Mr. Friedman's hypothesis that even the Great Depression could have been avoided through the use of QE.

At the start of the Lehman shock, the real economy entered a borrower-side problem in the form of a balance sheet recession following the collapse of a debt-financed housing bubble. There was also a severe lender-side problem in the form of a financial crisis as most US banks were burdened by massive nonperforming loans related to subprime loans, and the resulting mutual distrust among banks effectively froze the interbank market.

When these sorts of lender-side problems exist, the financial system will collapse unless the central bank supplies funds as "lender of last resort." The economy will also collapse without a functioning payment system. In that sense, the first round of QE implemented by then-Fed Chair Bernanke and Governor Warsh was precisely the right response.

Second and subsequent rounds of QE did not prompt recovery in growth or inflation

The issue was the second round of QE, which then-Chair Bernanke decided to introduce in November 2010. This was intended not as a response to the financial crisis but instead as an economic stimulus for the US economy, and it was here that differences of opinion emerged between Mr. Warsh and the other members of the FOMC.

Mr. Warsh argued that while such policy might be permissible and needed in the short term in the midst of a financial crisis, the funds released into the market would, over the long term, trigger the problems described above in (1) and (2) and should therefore be promptly withdrawn. However, other FOMC members at the time, including then-Chair Bernanke, argued that no actual harm had been observed following the second (and subsequently the third) round of QE while the Fed's 2% inflation target still had not been achieved, so there was no need to quickly withdraw the funds injected via QE.

Mr. Warsh himself left the Fed in 2011, while the second round of QE was underway, but in September 2012 the Fed decided to launch a third round of QE. This took base money supplied by the Fed up to about 4.5 times its level in August 2008, just before the

Lehman crisis erupted. However, US inflation not only did not rise to the levels warned of by Mr. Warsh but also failed to reach the Fed's 2% inflation target.

As a result, both Mr. Warsh and those who remained with the Fed turned out to have been wrong. The common reason, as I have pointed out previously in this report, was that the US was then in a balance sheet recession, a borrower-side problem where the private sector as a whole was seeking to minimize debt following the bursting of a debt-financed bubble.

When that happened, the liquidity supplied by the Fed could only go as far as the private sector banks. It could not go beyond and enter the real economy because the private sector had stopped borrowing money in spite of zero interest rates.

Leaving QE in place can spark inflation

Both Mr. Warsh's warnings about QE and the Fed's expectations proved to be wrong. However, because no actual harm had been done, the Fed left the funds supplied via QE in the market until Chair Janet Yellen began the process of quantitative tightening (QT) in autumn 2017.

The Fed then revived QE during the crisis caused by the pandemic in 2020, and at present the monetary base is 6.13 times what it was immediately before the Lehman crisis.

Under Mr. Friedman's monetarist way of thinking, this 6.13 multiple means it would not be surprising if inflation eventually climbed to 613%. According to Mr. Warsh, this is the biggest problem facing the Fed, and it is something that he has warned repeatedly about.

Chair Warsh is conservative mainstream monetarist

While still a Fed governor, Mr. Warsh was asked in a 2011 interview for his views on the second round of QE.[2] He said his assessment would vary significantly depending on how the funds provided under the policy were withdrawn, and that the ultimate risks and returns of this policy could not be properly assessed until that process had been completed.

Seen in this way, it can be said that many economists—including Mr. Bernanke—broadly interpreted Mr. Friedman's hypothesis that the Great Depression could have been avoided through bold monetary accommodation and gave their blessing to quantitative easing, which exemplifies such "bold monetary policy," as a standard monetary policy tool. By contrast, Mr. Warsh did not broadly interpret this argument and has instead argued that tools like QE must not be used outside of emergencies such as the Great Depression.

In other words, Mr. Warsh is close to the original version of monetarism, while those currently at the Fed, ECB, and Bank of Japan—who implemented QE and have not been proactive in withdrawing the funds released under it—adopted a broad interpretation of Mr. Friedman's hypothesis.

My impression is that Mr. Warsh's sense of foreboding over leaving QE in place has not changed at all over the subsequent 15 years, and if anything has grown even stronger.

In the earlier article from 16 November 2025, he argued that the recent inflation has resulted because the Fed left QE in place, leaving the market awash in liquidity.

Monetarist policy does not function during balance sheet recessions

Mr. Warsh's stance appears to stem from the direct application of Mr. Friedman's argument that throwing money around leads to inflation. However, Japan's balance

[2] Bernanke's right hand: exit interview with Federal Reserve Governor Kevin Warsh," *The International Economy Spring 2011*, pp. 8–13 and p. 62.

sheet recession from 1990 onward and the similar recessions that Europe and the US experienced starting in 2008 have painfully taught us that there are times when no amount of liquidity provision will cause inflation.

The lesson these balance sheet recessions left for economists was that the monetarist world described by Mr. Friedman exists when private-sector balance sheets are sound and the private sector is seeking to maximize profit. However, when the collapse of an asset bubble has severely impaired private-sector balance sheets and the private sector is trying to minimize debt to nurse its balance sheet back to health, there are effectively no borrowers, and monetarist policy does not function at all. In such a phase, as John Maynard Keynes argued, the government needs to return the excess savings of the private sector to the income cycle of the economy in the form of fiscal stimulus in order to stabilize the economy.

The central banks of the US, Europe, and Japan were unable to achieve even their 2% inflation targets for a long time despite zero or negative interest rates and massive doses of QE because the private sectors in these countries were focused above all else on repairing their balance sheets and therefore had stopped borrowing money.

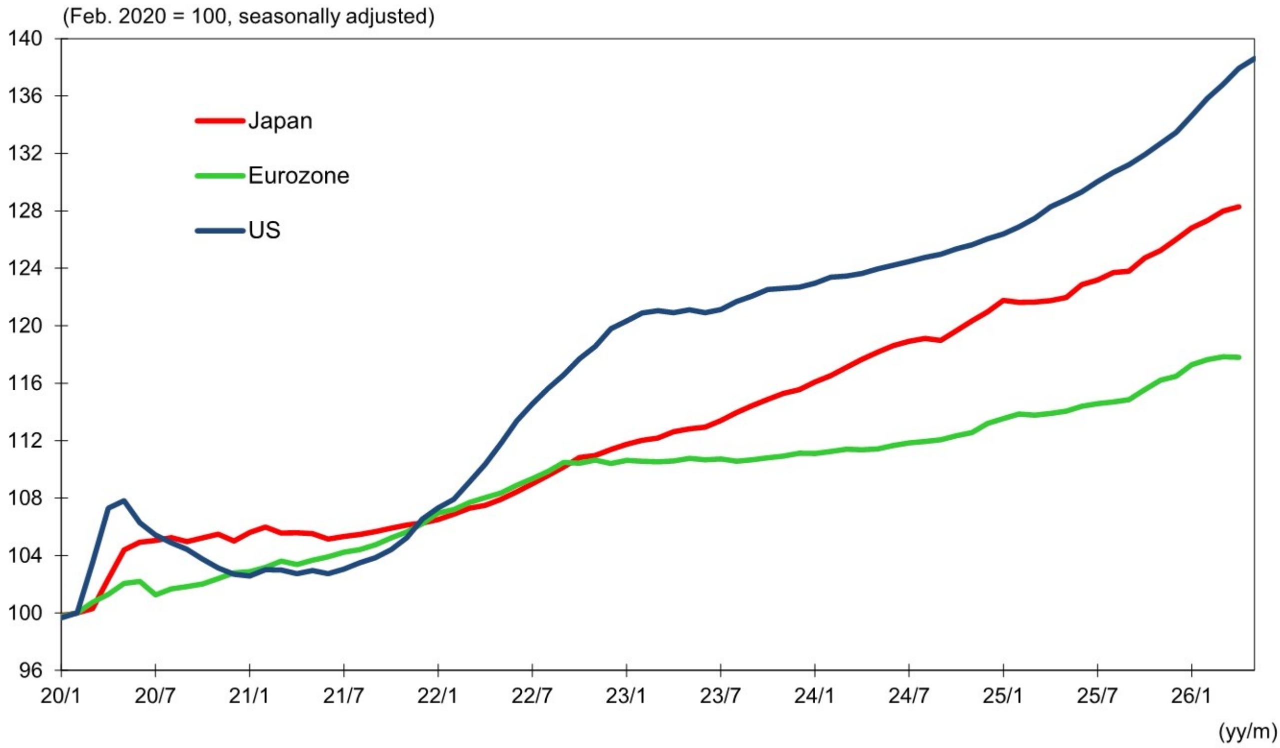
Bank lending growth in Japan, US, and Europe has picked up since pandemic
This means that Mr. Warsh's claim that recent inflation is due to the Fed leaving QE in place for too long is based on the assumption that the US private sector has shifted back from debt minimization to the more normal maximization of profit.

A look at private-sector funds demand shows that bank lending over the 10-year period starting just before the Lehman crisis grew at an annualized rate of only +3.1% in the US, while growth was even lower in the eurozone, at +0.4%, and Japan, at +1.9%. This was despite near-zero interest rates in each of these economies.

Even a monetarist would not expect to see inflation if the amount of money flowing out from private-sector banks was growing by only this much each year, and ultimately these countries did not experience inflation in the 2010s.

As Figure 1 shows, however, annual lending growth at US banks was running at 7.6% YoY in May this year and stood at +3.4% in the eurozone and +5.4% in Japan (both as of April), which means conditions are very different from the 2010s.

Fig. 1: Bank lending in Japan, US, and Europe since pandemic



Note: Bank lending in Japan seasonally adjusted by NRI.

Source: Nomura Research Institute, based on BOJ, FRB, ECB, and BOE data

This change means that even if the current inflation has been triggered by an external factor, there is a real possibility that it will be amplified by domestic factors. In that sense, Mr. Warsh's argument that the Fed should proceed with QT seems reasonable enough.

Of course, the Fed chair also understands that rapid implementation of QT could cause a bond market crash, and he has argued that the pace of the process should be decided carefully.

Why Trump nominated Warsh as Fed chair

Incidentally, Mr. Warsh's argument that QE must be unwound early on may have been one reason why President Trump nominated him to serve as Fed chair.

Mr. Trump wants a lower policy rate, and it is said that Mr. Warsh may have told the president that he wants to proceed with QT to contain future inflation, but if he succeeds in reducing inflation risks by mopping up the excess reserves that are fueling inflation, it may be possible for the Fed to cut rates.

This requires the appropriate use of the two policy tools available to central banks: adjustments to the policy rate (i.e., the price of money), and adjustments to the amount of liquidity provided (i.e., the quantity of money). Although the two are not completely independent of each other, at present, only one of these is available to the central banks of Japan, the US, and Europe because they implemented QE.

This is because monetary tightening policies that curb the supply of liquidity are effective only if the liquidity supplied to the market by the central bank serves as a constraint on lending by private financial institutions. However, because of the QE implemented in

Japan, the US, and Europe over more than a decade, the supply of liquidity does not in any way constrain the actions of private financial institutions in these countries.

Central banks in Japan, US, and Europe can no longer use liquidity to tighten monetary policy

To understand this point, it is useful to compare today's situation with that of October 1979, nearly 30 years before QE was implemented, when then-Fed Chair Volcker moved to combat inflation.

This historic fight against inflation began when Mr. Volcker chose one of the two policy levers available to a central bank and decided to restrict the supply of liquidity.

At the time, US banks held almost no excess reserves, which generated no income. Funds needed temporarily for day-to-day banking operations, as well as those needed to meet reserve requirements, were borrowed in the interbank market.

After the Fed restricted the supply of bank reserves, private banks were forced into intense competition for funds in the interbank market to meet those needs. The federal funds rate, the cost of borrowing in the interbank market, rose as high as 22%. This put a sharp brake on the then-overheated US economy and ultimately brought inflation under control.

By contrast, the use of QE by central banks around the world in response to the Lehman crisis in 2008 dramatically increased the amount of excess reserves (i.e., reserves in excess of the statutory minimum) held by banks. Most recently, excess reserves stood at 1,450 times their level just before the Lehman shock in the US, 2,219 times in Europe, and 1,701 times in Japan.

At present, therefore, the supply of bank reserves is not acting as a constraint on lending by private banks in any way. For today's central banks, this has eliminated the option of tightening financial conditions by restricting the supply of reserves.

QT helps curb inflation by pushing long-term yields higher

On the other hand, quantitative tightening to absorb these excess reserves entails selling Treasury securities and mortgage-backed securities (MBS) held by the Fed. That will slow the real economy via the mechanism of higher long-term bond yields, which in turn will help curb inflation.

Mr. Volcker tackled inflation using short-term interest rates (a 22% federal funds rate), as central banks normally do, but Chair Warsh is trying to achieve the same objective using long-term rates.

He apparently made the case to President Trump that the inflation-suppressing effect of QT would give the Fed room to lower the policy rate. However, this can be seen as something of a gamble for him, since it is equivalent to arguing that the Fed will be able to lower short-term rates because QT will raise long-term rates.

President Trump comes from the real estate industry, and what matters most for the US real estate market, and particularly the housing industry, is long-term rates, not the Fed's (short-term) policy rate.

Hence it is possible that at some point President Trump will claim he was tricked by Mr. Warsh. Even if the new Fed chair lowers rates, the all-important long-term rates may not fall and could even rise due to QT.

US is steepening yield curve; Japan is flattening it

On the other hand, Mr. Warsh himself appears to believe that his mission is to normalize Fed monetary policy through QT. When he was previously approached by the Trump administration about becoming Treasury secretary, he replied that there was something he needed to do at the Fed.

I suspect the new Fed chair is urgently concerned that the need for QT, which he began advocating in 2011, is still not recognized 15 years later.

Seen in this way, I think Mr. Warsh is trying to steer monetary policy in the direction of a steeper yield curve by lowering short-term rates while keeping long-term rates elevated via QT.

This runs exactly counter to recent actions by the BOJ, which wants to flatten the curve by raising short-term rates while halting reductions in its purchases of JGBs. We need to keep a close eye on how these differences affect the yen-dollar exchange rate going forward.

How Trump managed to get the memorandum signed

Shifting from Chair Warsh's views on monetary policy to developments in the Middle East, which the Fed is also watching, the US and Iran on 17 June signed a memorandum aimed at ending the war, and crude oil prices fell on expectations that the blockade of the Strait of Hormuz would begin to resolve itself.

Whether this memorandum actually leads to a final agreement will depend on subsequent negotiations, and the scale and complexity of the issues involved means there is absolutely no room for complacency. But at the same time, it is worth noting that a major change appears to have taken place within the Trump administration over the past several weeks.

As I noted in my last report, the starting position of the US for the current negotiations were extremely poor compared with those for the previous negotiations with Iran, led by President Obama in 2015.

Figure 2 compares the initial conditions then and now.

There are three particularly serious issues. First, while moderates outnumbered hardliners in Iran in 2015, hardliners are now fully in control ((4) in Figure 2). Second, while Iran viewed the US as a trustworthy counterpart in 2015, the relationship of trust between the two countries has now disappeared ((5) in Figure 2). Third, while hardline Israeli Prime Minister Benjamin Netanyahu was not involved in the negotiations between the two countries in 2015, this time Israel is a direct participant with the US in the war against Iran ((6) in Figure 2). Simply holding meaningful negotiations between the US and Iran will be difficult unless these three obstacles can be overcome.

Fig. 2: Contrasting conditions for US-Iran negotiations in 2015 and 2026

	Obama (2015)	Trump (2026)
(1) US allies on board	Yes	No
(2) United Nations (IAEA) on board	Yes	No
(3) China & Russia on board	Yes	No
(4) Iranian moderates outnumber hard-liners	Yes	No
(5) US is considered credible counterparty for negotiation	Yes	No
(6) Israel's Netanyahu on board	No	?

Source: Nomura Research Institute, based on BOJ, FRB, ECB, and BOE data

Trump ended up negotiating with formidable opponent of his own making

Regarding (4) in particular, in 2015 there were still many moderates within Iran who wanted to establish good relations with Western and other countries. With a parliamentary vote of 161 to 59, they succeeded in holding back the hardliners represented by the Revolutionary Guard, who argued that Iran should pursue an independent path with nuclear arms, and thus made it possible to reach an agreement with the US.

President Trump not only unilaterally scrapped this agreement in 2018 but also imposed even tougher sanctions on Iran than those that had been in place in 2015. As a result, moderates within Iran who had supported the agreement with President Obama lost their standing, while the influence of the hardliners increased sharply.

In effect, President Trump now has to negotiate with an Iranian regime dominated by hardliners that came into power because of his own actions in 2018.

Extreme distrust of US in Iran is compounded by Israeli relationship

With respect to (5), from Iran's perspective, President Trump not only casually scrapped an agreement that had taken the country 20 months to forge with the rest of the world, including President Obama, but was also responsible for carrying out a surprise military attack on 28 February this year, while the US and Iran were in the midst of negotiations, that killed a large number of senior regime officials, including Ali Khamenei, then Iran's supreme leader. Iranian hardliners and moderates alike understandably place little trust in such a person.

In an interview with CNN on 5 June,[3] Mohsen Rezaei, military adviser to new Supreme Leader Mojtaba Khamenei, said that the US should release some of Iran's frozen assets and demonstrate goodwill toward the negotiations as a way to ease Iran's extremely strong distrust of President Trump. He was concerned that the negotiations themselves

[3] Frederik Pleitgen and Claudia Otto, "Exclusive: Iran supreme leader's adviser says talks deadlocked over $24 billion and warns of wider war," CNN, first published on 5 June 2026.

would not move forward unless the deep distrust felt toward President Trump could be dispelled.

Iran and Israel both under control of hardliners
As for (6), Israeli Prime Minister Netanyahu is himself an extreme right hawk within his country who played a key role in President Trump's 2018 decision to scrap the 2015 agreement. Indeed, the two were so close that it would hardly be surprising if the Iranians thought President Trump was simply doing Mr. Netanyahu's bidding.

And unless Mr. Trump can reach an agreement that is far tougher on Iran than the one forged by President Obama in 2015, neither man can justify Trump's 2018 decision to abandon the agreement at the request of Prime Minister Netanyahu.

With both Iran and Israel under the control of hardliners, and with the Iranian people's trust in President Trump, who is extremely close to Israel, having disappeared, it looked almost impossible for Mr. Trump to conclude peace negotiations with better terms than those of the agreement reached by President Obama.

Trump policy shift broke the deadlock
What broke this seemingly intractable stalemate was a sudden shift by President Trump, who has made several key policy changes over the past three weeks.

One was that Mr. Trump himself said he wanted to meet Mojtaba Khamenei, Iran's supreme leader. The fact that he made such a statement probably had the effect of improving the Iranian side's impression of him, even if there was little likelihood of such a meeting actually taking place.

Moreover, the US president has held three meetings with General Secretary Kim Jong Un, the leader of North Korea, a country that is so dogged by numerous human rights issues that all pre-Trump US presidents refused to meet its leaders one-on-one. In other words, Mr. Trump's offer to meet Mr. Khamenei is backed by a credible track record.

He decided to make public his worsening relationship with Netanyahu
US news site Axios reported that President Trump had berated Israeli Prime Minister Netanyahu over his expansion of military operations in Lebanon, going so far as to use profane language, saying "You are f**king crazy." Moreover, the president is reported to have said something to the effect of, "You'd be in prison if it weren't for me. I'm saving your ass. Everybody hates you now. Everybody hates Israel because of this."

The reference to prison is believed to refer to the International Criminal Court, or ICC, in The Hague, Netherlands, issuing arrest warrants for Prime Minister Netanyahu and former Defense Minister Yoav Gallant over their responsibility for inhumane actions by the Israeli military in Gaza.

In response, the Trump administration imposed sanctions normally used against terrorists on the ICC prosecutors and judges involved in this matter, disabled their bank accounts outside the Netherlands (including those in their home countries) and their credit cards, and also banned them from entering the US, effectively incapacitating the court.

The fact that President Trump made these remarks to Prime Minister Netanyahu, whom he had previously protected with such forceful measures, and moreover made them public, likely reflects his need to demonstrate to the Iranians that he is not at Israel's beck and call.

Trump lined up conditions that were difficult for Iran to reject
President Trump's use of profane language in reprimanding the Israeli prime minister appears to have had a considerable impact on the Iranian side. Moreover, the president's proposal for a $300bn private-sector fund to rebuild the Iranian economy, as

well as his pledge not to interfere in the country's domestic affairs, appears to have enabled the conclusion of a memorandum that initially seemed (to myself as well as others) almost impossible. (According to some reports, however, the president also declared the US government would not contribute anything to the fund when he signed the memorandum on 17 June, saying "We're not investing. We're not putting up 10 cents.")

In other words, President Trump addressed all of the unfavorable initial conditions noted above—(4), (5), and (6)—and all of the answers he provided were difficult for even hardliners on the Iranian side to reject.

Current memorandum close to unconditional surrender for Israel, but...
President Trump's major course shift led to the signing of a memorandum that may lead to the reopening of the Strait of Hormuz. From an Israeli perspective, however, this document could be described as nothing less than an unconditional surrender by the US and Israel. Based on the wording of the current memorandum, even if the two sides manage to reach a final agreement within 60 days, it is unlikely that it will be tougher on Iran than the deal forged by President Obama in 2015.

That will create some backlash against President Trump from Israel and those referred to as neoconservatives within the US. According to reports on 20 June local time, Israel already violated the terms of the memorandum by continuing to conduct airstrikes on Lebanon, and in response Iran has declared that it is reinstating its blockade of the Strait of Hormuz.

In that sense, there is no guarantee that future developments will move in the direction envisaged by the memorandum, and the situation remains highly unpredictable.

That said, future developments should be closely monitored since President Trump has previously shown a tendency never to forgive anyone who has opposed him even once.

Moreover, if Israel continues its attacks on Lebanon and seeks to hollow out the memorandum, it could turn the entire world against itself, including all the G7 members who welcomed the agreement.

Why Trump rushed to sign agreement at Versailles
Regarding the timing of the G7 summit and the announcement of the agreement with Iran, the Trump administration appears to have rushed the latter process. Iranian President Masoud Pezeshkian went so far as to say that the US was "desperate" this time. President Trump signed the memorandum in front of television cameras at the Palace of Versailles in France, with President Macron at his side, two days before the originally scheduled date of 19 June.

This was likely because he was determined to secure the support of allies for the memorandum, which corresponds to (1) in Figure 2. In other words, by presenting the content of the agreement at the G7 summit and securing support not only from the other G7 participants but also from Indian Prime Minister Modi, who had been invited to the summit, he wanted to signal both domestically and internationally that the agreement was receiving global recognition.

President Trump most likely proceeded in the following sequence: (A) to reopen the Strait of Hormuz, he had to accept most of the demands of Iran, which is controlled by hardliners; (B) but doing so would invite a fierce backlash from neocons in the US as well as the Israeli lobby; and (C) to deflect that backlash, he needed to create a setting in which the international community, including the G7, welcomed the agreement.

President Trump announced his participation in the current Evian summit at an unusually early date for him, and this calculation appears to have been behind that decision.

Being criticized for surrendering deemed less damaging than other options
In the end, President Trump was forced to seek an exit strategy after the initial military operation against Iran failed to achieve its objectives. In doing so, he appears to have judged that accepting what was effectively a full US surrender and swallowing most of the demands imposed by hardliners on the Iranian side would result in smaller overall losses for the US than other options, which would entail a sustained military conflict and blockade of the Strait of Hormuz.

To begin with, it was made clear in last year's debate over Ukraine that President Trump's definition of "peace" includes the complete surrender of a country that has few cards to play in negotiations. At that time, Ukraine and Europe pushed back strongly, and the US was not a direct party to the conflict, so that did not happen.

This time, however, the US is directly involved, and to use Mr. Trump's language it holds an extremely weak hand, as shown by (4), (5), and (6) in Figure 2.

Having realized this, I suspect President Trump concluded that the memorandum would minimize overall losses for himself and the US compared with the other options, even if it is criticized by Israel and domestic neocons as amounting to a full US surrender.

At the very least, Mr. Trump was able to demonstrate with this decision that he is the president of the United States and not the president of Israel.

What will Trump administration do next to divert public attention from its missteps?
What we need to focus on now is what President Trump will do next, after this major defeat in the Iran war.

The war began just one week after the US Supreme Court rejected the "reciprocal tariffs" that the president had focused all his energies on since taking office. The war successfully shifted the attention of people and the media from the tariff policy failure to events in the Middle East, enabling the president to avoid answering the questions over the collapse of his tariff initiative.

I think it is highly likely that the Trump administration will seek to recover ground lost in the Iranian defeat by quickly unveiling some new policy that comes as a major surprise to the public.

Appendix A-1

Any Authors named on this report are Research Analysts unless otherwise indicated

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