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FED SHADOW

Like It or Not, Trump is Right about the Fed

Friday, July 20, 2018
Donald Luskin

If Powell is just a puppet, doesn't somebody have to pull the strings?

Take your choice among the scandal-mongering headlines:

- Trump Blasts Powell's Rate Hikes, Trespassing on Fed's Independence
- Trump rips Fed for raising interest rates
- Trump Slams Interest Rate Hikes, Ignoring Hands-Off Tradition Toward Fed
- Trump lays into the Federal Reserve, says he's 'not thrilled' about interest rate hikes
- Trump Takes a Rare Presidential Swipe at the Fed

It's a master-class in modern headline-writing: every one puts Trump's name first; every one hallucinates a non-existent failure of temperament; and three out of five suggest an act of impropriety.

In reality – yes, there still is a thing called "reality" – Trump didn't "blast," "rip," "slam," "lay into" or "swipe at." He respectfully expressed an opinion about economic policy. And however he expressed that opinion, we think it is basically right. National Economic Council Director Larry Kudlow and Director of Trade and Industrial Policy Peter Navarro have both said the same thing, and they are right too. *And in his appearances before Congress this week, new Fed Chair Jerome Powell doesn't even particularly seem to disagree with the essence of it.*

Here is our raw transcription of Trump's entire statement:

> *"I put in a very good man at the Fed. I don't necessarily agree with it, if he, because he's raising interest rates. I'm not saying I agree with it. And I don't necessarily agree with it. I must tell you, I don't.*
>
> *"I'm not thrilled because we go up, and every time you go up they want to raise rates again. And I don't really, I'm not happy about, but at the same time, I'm letting them do what they feel is best.*
>
> *"But I don't like all of this work that goes into doing what we're doing. You look at the euro, you look at what's going on with the EU, and they're not doing what we're doing, and we already have*

Update to strategic view

US FED, US BONDS, FX, US MACRO: Trump raised eyebrows by expressing dissatisfaction with Fed rate hikes. Trump is right to urge caution with further hikes. He picked Powell specifically to be non-independent, so it should be no surprise that he is trying to exert influence over his puppet. If Powell wishes to be independent, there is nothing Trump can do about it. In this case Powell's policy views probably don't differ much from Trump's anyway. Policy is just slightly below neutral, and it will take the realization of expected improvement in the economy and in inflation to justify many more hikes. But with inarticulate non-economist Powell it's hard to be sure, especially when he has recently claimed his independence. We don't blame Trump for seeing if his puppet's strings are still attached.

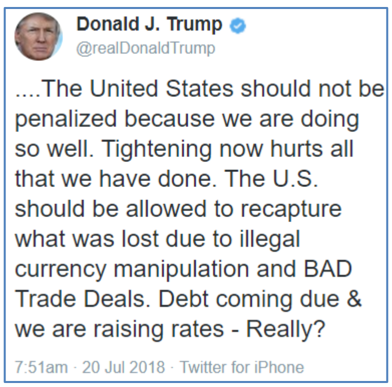
[Strategy dashboard]

somewhat of a disadvantage, although I'm turning that into an advantage.

"You know, last year, and for years, we've been losing a hundred and fifty billion dollars with the EU nations, with the European Union. And they're making money easy, and their currency is falling. And China, their currency is dropping like a rock. And our currency is going up. I have to tell you, it puts us at a disadvantage.

"Now I'm just saying the same thing I would have said as a private citizen. So somebody, what, say, oh, you shouldn't say that as president. I couldn't care less what they say. Because my views haven't changed. I don't like all this work we're putting into the economy and I see rates going up. And I see China where their, I mean look what's happening with their currency. It's dropping like a rock."

This morning – giving his own master-class in political persuasion – Trump unrepentantly doubled down, in a tweet that reiterated most of the same points.


Donald J. Trump
@realDonaldTrump

....The United States should not be penalized because we are doing so well. Tightening now hurts all that we have done. The U.S. should be allowed to recapture what was lost due to illegal currency manipulation and BAD Trade Deals. Debt coming due & we are raising rates - Really?

7:51am · 20 Jul 2018 · Twitter for iPhone

We'll get to the policy question momentarily, but first we want to deal with the issue of the propriety of a president expressing such views.

- These are just Trump's opinions. Powell doesn't have to follow them. There is nothing Trump can do to make Powell do so. It's all bark, no bite. All Trump actually can do is fire Powell, which the law requires be "for cause."
- *Trump is hardly the first president in the modern era of independent central banks to let his policy preferences be known.* He's almost echoing Ronald Reagan in 1984 saying, of Fed chair Paul Volcker's policies, "we are not pleased with the recent increases in interest rates, and, frankly, there is no satisfactory reason for them." At least Trump's doing it cleanly and openly, like Reagan did, rather than favor-currying like Bill Clinton when he seated Alan Greenspan next to Hillary at his first State of the Union address.
- No Fed chair is truly independent, because the president gets to nominate a person with congruent views or who is otherwise politically useful – just as with Supreme Court nominees, or any other presidential appointee. We certainly saw this in action with Barack Obama's nomination of Janet Yellen, bowing to extreme pressure by Senate Democrats to nominate a pro-regulation woman rather than an anti-regulation man (the supposedly misogynistic Larry Summers).
- In the case of Powell, we've said from the get-go that Trump deliberately picked a chair who agreed not to insist on a lot of independence – and deliberately passed over very independent reformers like economist John Taylor or former FRB Governor

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Kevin Warsh (see "Warsh the Reformer, Powell the Plodder" October 3, 2017). Warsh's public statements since Powell's appointment strongly confirm that the interview process was conducted with this in mind.

- *So Trump's policy error is not in trying to influence Powell with public statements, but in having picked a non-independent Fed chair in the first place* (see "Bull Market, Meet Your New Fed" January 29, 2018).
- Since we've been writing about Powell's non-independence, and after Warsh's statements, Powell has tried to rehabilitate his image as an independent in a recent speech in Stockholm, and in an interview on PBS (see "On the Margin: Powell the Non-Independent, Pro-Growth Italeave"). But protesting too much doesn't make it not so.
- There is probably high correlation between people unqualified to be Fed chair, and people willing to be a non-independent Fed chair. The qualified people won't be willing to be anything but independent. Though he has been on the Board of Governors for five years before ascending to the chair, non-economist Powell is not qualified. To be sure, we admit he is getting a little better at talking the talk, but the fact remains that he is not able to deeply or clearly articulate the theoretical underpinnings of his policy positions. He's not an unpolished man, so that is likely a reflection of the fact that he doesn't deeply understand those underpinnings, if he even has any underpinnings (see "On the March FOMC" March 15, 2017). We don't fault him for not thinking like an economist – he's a lawyer by training, and a private equity investor by vocation – but the reality is that he couldn't if he wanted to, at least not without further experience.
- *We don't mean to sound cynical, but once the mistake has been made of picking a Fed chair lacking the necessary economics prerequisites and willing to be a puppet, somebody has to remember to pull the strings.* That's all that Trump yesterday, and Kudlow and Navarro before him, were doing.
- *Say what you will about the long-term damage that does to the sanctity of a supposedly independent central bank. But at the margin, and for markets right now, the question really is whether Trump's policy intervention is a good one or a bad one.*

Trump is right on policy, in this case (whether or not you think he should have said anything, and whether or not all his reasons or examples are correct).

- He's not out of the mainstream in thinking that the recent strength of the US dollar versus euro and RMB is the result of Fed hiking expectations, and indicative that the Fed is being too aggressive. We don't fully agree – we think there are other and deeper explanations (see "USD, Euro and the Risk of Italeave" May 25, 2018, and "Did China Just Run Up the White Flag in the Trade War?" July 10, 2018).
- Trump didn't mention the very flat yield curve, but that is certainly another mainstream piece of evidence that the Fed is on the verge

of being too tight. Powell himself, in response to questions this week in both the Senate and the House, said that the near-flat curve is indicative that the current funds rate is already very close to the long-term neutral rate of interest.

- For that matter, Powell's FOMC has wrestled with finally removing from its statements the claim that the "stance of monetary policy remains accommodative," because it admits it just isn't true anymore – policy is effectively at neutral (see "The Powell Fed Rewrites the Play-book" June 11, 2018).
- This is confirmed by the Fed's own best guess at the neutral rate of interest – the Laubach-Williams model's estimate of "R-star." Based on current inputs, we're only one 25 bp hike from neutral.
- *Trump doesn't want the Fed to go from neutral to tight. Neither do we.*
- *And probably neither does Powell, whether or not Trump appears to be pulling his strings.*
- In his prepared Congressional testimony this week, Powell got Wall Street's attention by saying "*for now* – the best way forward is to keep gradually raising the federal funds rate" [our emphasis]. That can be interpreted as hawkish (someday we have to get more aggressive" or dovish (someday we may have to stop, or even reverse).
- Considering that inflation still isn't even quite at the Fed's 2% target – after years of trying and failing, despite heroic efforts – we can't see any sensible reason why Powell would be giving a hawkish warning. Indeed, he said in his PBS interview, "We're not declaring victory there. We want inflation to be symmetrically around 2 percent, so just kind of reaching up and touching it once doesn't fulfill that goal."
- *More likely "for now" is a reflection that, all else equal, policy is already near-neutral – so unless the economy and inflation improve in ways that move the neutral rate of interest higher, the Fed would have to stop hiking rates. The FOMC's forecast – like ours – is that the economy and inflation will indeed improve, justifying further rate hikes that would keep policy at neutral, not move it into the realm of tightness.*

We suggest that if any clients are especially troubled by Trump's statements about Fed policy, that they transfer those concerns to Trump having picked Powell to begin with. Trump's policy recommendations are sound, not out of the mainstream, and probably not too different than what Powell was thinking anyway. But with Powell one can't be sure, especially after his protestations of independence last week. We can't blame Trump for wanting to pull on the strings and be sure that his puppet is firmly attached.

Bottom line

Trump raised eyebrows by expressing dissatisfaction with Fed rate hikes. Trump is right to urge caution with further hikes. He picked Powell specifically to be non-independent, so it should be no surprise that he is trying to exert influence over his puppet. If Powell wishes to be independent, there is nothing Trump can do about it. In this case Powell's policy views probably don't differ much from Trump's anyway. Policy is just slightly below neutral, and it will take the realization of expected improvement in the economy and in inflation to justify many more hikes. But with inarticulate non-economist Powell it's hard to be sure, especially when he has recently claimed his independence. We don't blame Trump for seeing if his puppet's strings are still attached.