

FED SHADOW

Did Powell Just Cut a Deal?

Sunday, December 23, 2018

Donald Luskin

From firing threat Friday to denials Saturday, Trump may have solved his Powell problem.

We said Thursday of Fed Chair Jerome Powell, *“one way or another, he’s got to go”* (see [“It’s Not ‘Quantitative Tightening’ – It’s Powell”](#) December 20, 2018). Then after markets closed on Friday, a [Bloomberg](#) story reported:

“President Donald Trump has discussed firing Federal Reserve Chairman Jerome Powell as his frustration with the central bank chief intensified following this week’s interest-rate hike and months of stock-market losses, according to four people familiar with the matter... Trump’s frustration with Powell has greatly intensified in recent days, said two of the people.”

At that point on Friday, what did we really know? Way at the bottom of the list is whether or not it’s true. We know with 100% confidence only that [three Bloomberg reporters](#) chose to claim these things in print. With less than 100% confidence we might also believe that there were actually one to four sources – “administration sources”? “White House sources”? ...nothing even that specific – who wanted it reported for some reason. From there, it would just be a guess as to their reasons, as to whether Trump knew they would talk to reporters, or wished them to, or why.

- We don’t *know* – but we firmly *believe* – that removing Powell would eliminate a huge risk. He has lost the market’s confidence, lost the “Mandate of Heaven.” Doom-and-gloom scenarios in the media notwithstanding, we think his sacking would trigger a very substantial risk-on rally in markets, with US stocks now at cheap valuations not seen since before the 2016 elections. In fact, the S&P 500 equity risk premium is just basis points away from its highest levels since the end of the Global Financial Crisis.
- The risk isn’t that Powell is too hawkish. It’s that [Wednesday’s post-FOMC press conference](#) was a tipping point about him for markets (see [“On the December FOMC”](#) December 19, 2018). [Drenched in flop sweat](#), stammering phony-breezy non-answers in response to deep policy questions, Powell got what he deserved: the markets’ verdict that this Fed chair doesn’t have their back. It’s not quite that there’s no “Powell put,” or that we so desperately need him to exercise it now. It’s that he’s too obtuse to be relied upon to exercise it in time, should the need ever arise.

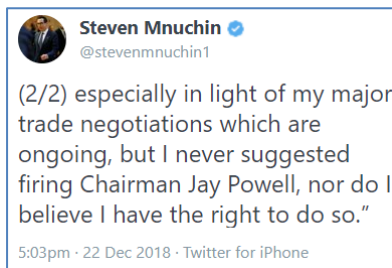
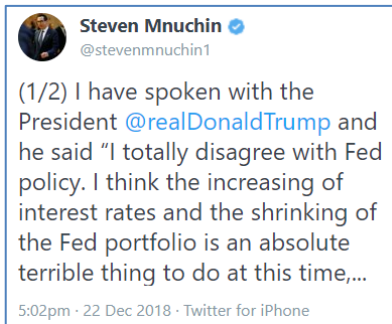
Update to strategic view

US FED, US STOCKS:

Bloomberg reported Friday that Trump is considering firing Powell. Mnuchin denied it Saturday, quoting Trump – but Trump himself has been silent. The pattern of events suggests to us that Mnuchin has worked out a deal with Powell between Friday and Saturday, to change policy course and/or to resign with dignity. Either one – or even an outright firing – would trigger a substantial risk-on rally, with stocks at cheap valuations not seen since before the 2016 election, indeed, the equity risk premium is within basis points of the highest seen since the end of the Global Financial Crisis. Powell has lost the markets’ confidence that there is a “Powell put,” and Trump can restore confidence by dealing with him one way or the other. If fired, Clarida would step in temporarily and could make a better permanent chair if nominated and confirmed. Kudlow and Hasset are excellent internal White House candidates, both with proven good relationships with Trump, and both with a strong pro-growth orientation.

[\[Strategy dashboard\]](#)

- More than that, failing to remove Powell – or deal with him some other way – starts to raise question about whether Trump has the markets' back.



But 18 hours later, on Saturday, Treasury Secretary Steven Mnuchin denied the Friday Bloomberg story in [two tweets](#) quoting President Donald Trump – seemingly in a highly definitive way and concluding with Trump saying “nor do I believe I have the right” to fire Powell.

Now what do we really know? So far, all we know with 100% certainty is that Mnuchin – who has [reportedly faced Trump's scorn](#) for having recommended Powell in the first place – has moved to take Powell's firing off the table. We do not know whether Trump said the things he is quoted as saying. Even if we did, we wouldn't know whether Trump believes them, will stick with them, or whether they are true. Remember, Trump is certainly capable of tweeting his own view on

this himself, or otherwise letting the world know where he stands. He doesn't need Mnuchin to tweet for him. Nor does he need Chief of Staff-designate Mick Mulvaney appearing on the Sunday talk shows, actually saying only that he heard from Mnuchin about the matter, but [getting reported](#) as having affirmed Trump's position.

We are especially skeptical of claims [in Bloomberg's follow-up reporting today](#) that “Mnuchin moved to reassure financial markets.” We doubt very much that the story's trio of [three different reporters](#) acquired mind-reading capabilities as to Mnuchin's motives simply from having observed the same two tweets the rest of the world saw. Whatever Mnuchin actually thinks, if markets need reassurance at this point, it's that Powell is on the way out.

Whether or not Trump said it or believes it, we are very skeptical that a president cannot fire a Fed chair – despite a lot of [knee-jerk Trump-bashing](#) that suggests a president can't fire the chair of an “independent agency.” The best we can tell is that Trump can indeed fire Powell.

- [Federal Reserve Act Section 10.2](#) says any member of the Fed Board of Governors can be “removed for cause by the President.” There is no definition of “cause” in the statute, and it is silent as to whether the president can revoke a member's position of chair (a special position with a 4-year term), even if he does not remove him as a member of the Board (a 14-year term).
- [Lyndon Johnson was advised](#) by the Department of Justice in 1965 that he could not fire Fed chair William McChesney Martin. But modern jurisprudence seems to indicate this was wrong. The [2010 Supreme Court decision](#) against the Public Company Accounting

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[\[About us\]](#)

Oversight Board, and the [2018 US District Court decision](#) against the Consumer Financial Protection Bureau both held that an agency's independence doesn't insulate it from the president's duty under [Article 2, Section 3, Clause 5 of the US Constitution](#) that he "shall take Care that the Laws be faithfully executed."

Based on the sequence of events, and on our belief about the president's powers (no matter what he is quoted as saying about them), *we think there is a decent chance that between Friday afternoon (the Bloomberg story) and Saturday afternoon (the Mnuchin tweets), Mnuchin and Powell have agreed on a plan under which Powell will change his policy views in exchange for Trump's silence – and/or a plan under which Powell can gracefully leave the Fed on favorable terms. Mnuchin's tweeting Trump's admission that he lacks the power to fire Powell might have been a flourish demanded by the Fed chair to preserve his dignity in the situation.*



- *This is pure conjecture – but again, we're trying to learn from the sequence of events – Mnuchin's seemingly contextless tweet Sunday afternoon, announcing he had talked to six to bank executives to assure systemic soundness, was in part to let the banks know about the deal with Powell, and in part a concession to Powell in which Mnuchin and the whole banking system exonerate Powell of having done any harm.*

Two historical precedents come to mind.

- *Fed chairs can be indirectly, but nevertheless effectively, fired.* Prior to this, the only failed Fed chairmanship was that of G. William Miller (to whom we have compared Powell from the beginning; see ["On the March FOMC"](#) March 21, 2018), the shortest-serving post-Depression chair. He was fired by Jimmy Carter – the same

president who nominated him – less than 17 months after assuming the chair. Officially, he wasn't *fired* – he was kicked upstairs to Treasury secretary, where he could do less harm. That position doesn't seem to be open right now in the Trump administration, but surely there's some plummy ambassadorship Powell would enjoy, after having voluntarily stepped down "to spend more time with his family."

- *Independent agencies can be strongly influenced by presidents.* Another precedent is President Franklin D. Roosevelt's 1937 threat to "pack" the Supreme Court in his second term, having had many of his New Deal programs declared unconstitutional in the first term. FDR's [Judicial Procedures Reform Bill of 1937](#) – which effectively would have let him add as many as six friendly justices – ultimately failed in the Congress. But merely the threat of it did the trick. Starting with a single 1937 5-to-4 decision that became known as ["the switch in time that saved nine,"](#) the Court began regularly

upholding New Deal legislation.

If Powell goes, who would replace him?

- *If it's sudden, until a new chair could be nominated by the president and confirmed by the Senate, under the Federal Reserve Act the vice chairman "shall serve in the absence of the Chairman."* That's *Richard Clarida* – a sensible economist whom we had already marked as "adult supervision" for Powell (see ["Chinese Tariff Torture"](#) October 29, 2018). In fact right when he was nominated, we said, "As far as we're concerned, *vice chair nominee Richard Clarida* can't get to Washington soon enough – we need an intervention" (see ["The Powell Fed Rewrites the Play-book"](#) June 11, 2018).
- *We could do worse than letting Clarida accede to the chair* – we suppose it would send some kind of comforting message of continuity (although under the circumstances, a little discontinuity might be better).
- *But we could do better.* Our friends Larry Kudlow and Kevin Hassett are both already in the White House (as chair of the Council of Economic advisors, Hassett has the same job Ben Bernanke had just before he was nominated to Fed chair). Both enjoy a mutually respectful relationship with Trump. *And both Kudlow and Hassett have exactly the right orientation to be a successful Fed chair: both of them hold economic growth to be the highest good.*

Just to be clear, we don't think Fed policy – anything the Fed is actually doing or not doing with interest rates or its balance sheet – is the biggest problem faced by volatile markets. *We continue to think that the global systemic risk implied by a possible disorderly recession in China – under the pressure of the US/China trade war – is the real problem* (see ["Death by China on the Way to Yes"](#) December 17, 2018). Beyond the systemic risk and the risk premium it commands, already slowing growth in China is contributing to an oil glut which, in turn, is largely responsible for the last two months' rollover in S&P 500 forward earnings (see ["Recession Risk at Last?"](#) November 20, 2018). Without those risks, we think markets would be able to whistle past the Powell graveyard.

- But obviously Mr. Market has now decided Powell is a problem. That makes him a problem.
- And Trump can solve it – either by forcing better performance under threat of sacking, or by actual sacking.
- Either way, Trump can catalyze a restoration of confidence in the Fed and in himself, which will be very useful as the US goes into the showdown with China [when negotiations begin in earnest](#) in the New Year.
- We'll be looking for signals from Powell, perhaps encoded in the minutes of the December meeting due January 9. It shouldn't really be all that hard at this point. Presidential pressure aside, he must surely know he blew it badly on Wednesday. If not, others on the

FOMC do, having [already begun the rounds](#) to make up for Powell's failure to be clear that the Fed stands ready to change its normalization policies if the economy falters.

Bottom line

Bloomberg reported Friday that Trump is considering firing Powell. Mnuchin denied it Saturday, quoting Trump – but Trump himself has been silent. The pattern of events suggests to us that Mnuchin has worked out a deal with Powell between Friday and Saturday, to change policy course and/or to resign with dignity. Either one – or even an outright firing – would trigger a substantial risk-on rally, with stocks at cheap valuations not seen since before the 2016 election, indeed, the equity risk premium is within basis points of the highest seen since the end of the Global Financial Crisis. Powell has lost the markets' confidence that there is a "Powell put," and Trump can restore confidence by dealing with him one way or the other. If fired, Clarida would step in temporarily and could make a better permanent chair if nominated and confirmed. Kudlow and Hassett are excellent internal White House candidates, both with proven good relationships with Trump, and both with a strong pro-growth orientation. ▶