Why Trump is wrong on Powell

Fed independence: robust defence needed

by Mark Sobel in Washington

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The US Federal Reserve is on the front page of every newspaper in ways it might not ever have imagined, let alone wanted, and certainly in ways not seen for the past two decades in which executive branch wisdom – quite wisely – was never to speak publicly about monetary policy.

Many prominent and well-respected economists have questioned the latest 25 basis point hike in the fed funds target rate. US President Donald Trump, in casting blame for a falling stock market, has made Fed Chairman Jay Powell and Fed rate increases ground zero in his daily vitriol.

It would be a huge disservice to America, the Fed and its independence if a debate over monetary policy gave succour to Trump's attacks. Now is the time vigorously and robustly to protect Fed independence.

A reasonable debate can be conducted about the Fed hike and its rate trajectory. But those so engaged should recognise that both sides have plausible arguments. A 25 basis point increase – whether right or wrong – is not going to kill the golden goose of the US economy.

The case for not increasing in large measure rests on expectations of a global and US economic slowdown, muted US price pressures and potential yield curve inversion. Price pressures are indeed subdued, and lower oil prices may further depress inflation, strengthening the case for running monetary policy hot. The global fall-out from Trump's trade wars is difficult to predict, and the direct trade impact may not capture negative repercussions for financial markets and business confidence. Fair enough.

But other factors weigh in the opposite direction. Even with waning fiscal stimulus and higher rates impacting construction, most forecasters still see the US economy growing around 2.5% in 2019 on the back of solid consumption gains and remaining above potential for much of the year. Predicting 2020 is difficult at this juncture, beyond assuming growth falling back in line with potential. Global growth is indeed projected to slow modestly. The wild card may be evidence of a sputtering Chinese economy, but Beijing appears to be vigorously addressing the slowdown and sticking to its 6%-plus 2019 forecast. The yield curve is not yet inverted, and special factors may be at play in pushing down the long end.

There are further reasons weighing on the Fed's judgment. The Fed has a dual mandate to promote maximum employment and stable prices. Despite muted price pressures, US labour markets are very strong with unemployment at 3.7%, the lowest level in 50 years and well below Nairu, registering the jobless level below which inflation (despite measurement uncertainty) is deemed likely to rise.

Even prior to the last rate hike and the shift in the Fed's 'dot plot' to signal two rate hikes in 2019, rather than three, the Fed's leadership had communicated a likely pause and slower rate path trajectory. Longer-term Treasury rates fell in reaction. US financial conditions are still accommodative.

The Fed is not inflexible. It has made clear that monetary policy is not on a pre-set path. Rather, it will be data-dependent and adjusted as needed. The rate increase brought the Fed funds rate to what is widely regarded as only the bottom of the neutral range. The Federal Open Market Committee decision was unanimous. The Fed staff is first-rate and has a lot of evidence at its fingertips unavailable to others. Economists hope that the Fed has plenty of ammunition when the next downturn or crisis comes.

While these reasoned debates are taking place, Trump has launched a full-scale assault on the Fed and its independence. His reasoning is spurious. The president – an admitted low interest rate person – had qualms over many of the Fed's past hikes, not just the latest, even though normalisation is the inevitable reflection of US economic strength. A Fed well behind the curve could substantially increase the downside risks to the US and global economy. The latest hike was well discounted in markets.

Behind falling stocks lie other fears. Investors are afraid that attacks on the Fed's independence will undermine US institutions and harm economic performance, and that protectionist US policies may seriously harm economic sentiment and activity. Beyond this, there is an erosion of confidence in the direction of the country, reinforced by the shutdown of the US government and the firing of Jim Mattis as defense secretary.

Reasonable debates about monetary policy and the president's attacks on the Fed should not be conflated. It's time for a more restrained debate, and unity in protecting Fed independence.

Mark Sobel is US Chairman of OMFIF. He is a former Deputy Assistant Secretary for International Monetary and Financial Policy at the US Treasury and until early 2018 was US representative on the board of the International Monetary Fund.