Can Trump Directly Influence The Fed?

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The USD on a DXY basis depreciated by about ½% and USDCAD fell by about one-third of a cent immediately following US President Trump's remark that "I am not happy about" rising rates and "I don't like all of this work that we're putting into the economy and then I see rates going up." The DXY has since recovered a part of this and in my view there should be little follow through.

The crux of the issue that is embroiled in matters of tradition and sacrilege concerning the divisions of authorities and taboos surrounding comments by top administration officials is the degree of Trump's direct and indirect power over the Fed Chair and the overall FOMC. There is mild cause for concern, but only mild at this point. What is below reviews the President's powers in order of rising uncertainty. More fundamentally, it highlights a long held contention since the November 2016 election that the Trump administration would come to be increasingly concerned about the sterilization of its stimulus efforts by the markets including through the USD and the Fed. This concern will likely only escalate within the administration with time.

1. Powell Is In The Seat Until At Least 2022

For one thing, the Fed Chair is appointed to a four year term that in this case stretches to early 2022 and hence after the next Presidential election. Under normal circumstances, the next Fed Chair appointment depends upon what you think will happen in the 2020 election and then into the following mid-terms. It's not like the November 2016 election when Yellen's term was up a little over a year later. So this is not the issue this time around and we can obviously set that aside.

2. Trump Can't Touch The Regional Presidents

On stacking remaining appointments, Trump has no direct influence over regional Fed vacancies that now only include the one that remains at the San Fran Fed. The process for selecting a regional President is led by the Class B and C Directors of the district bank (ie: excluding class A directors who are bankers for perhaps obvious reasons). These directors establish a search committee and hire an outside search firm. Candidates are interviewed and the top choices are forwarded to the Board of Governors. The top choices are interviewed by each individual member of the BoG (presently only three with three more stuck in the works and more on that in a moment). The regional bank's B and C directors then make a recommendation subject to approval by the BoG. Throughout this process, there is no need for Presidential or Congressional approval.

3. Most BoG Vacancies Are Already Being Addressed — But Confirmation Risks May Have Gone Up

The President has also mostly exhausted his ability to influence the Board of Governors through nominations. Randal Quarles was just confirmed by the Senate. Richard Clarida's nomination as the Fed's #2 to replace Stanley Fischer after he quit is pending confirmation by the Senate. So is Michelle Bowman's nomination and Marvin Goodfriend's. There were generally few to no concerns about patronage appointments of unqualified people in any of these cases in the eyes of seasoned Fed watchers but politics has held up the confirmations. It is unclear whether Trump's remarks today will make the Senate even more guarded on the topic of Fed independence and how that may influence the confirmation process from here.

Trump could, however, attempt to influence the composition of the Board through the remaining appointment to what should be a seven member BoG but that's just one more vote on a twelve member FOMC that also includes the NY Fed President and four annually rotating regional Presidents that are drawn from the eleven Presidents. With mid-terms fast approaching, the timing of any Senate confirmations—let alone the last possible nomination—remains highly uncertain. Beyond the President's influence, there is obvious precedent in terms of the ability of the Senate to reject nominations either on partisan grounds or out of concerns over the process surrounding the nomination or the qualifications of the individual. This is an important check on this third Presidential option. There have been eight times in the history of the Fed that the Senate has rejected Governor nominees. The last time was Peter Diamond in 2010 who won a Nobel Prize in Economics just ahead of the Senate vote but the Senate then rejected him as 'unqualified' in the words of Republican Senator Richard Shelby who chaired the Senate Banking Committee at the time. To repeat, the more pressing issue is whether Trump's perceived interference with the Fed may further politicize the existing confirmation processes facing Clarida, Goodfriend and Bowman as mid-terms draw nearer and that may be unfortunate despite the White House's recent pleas to expedite the confirmations.

4. The Issue Of "For Cause"

The biggest issue to dredge up again—and that was the main issue after the election when speculation over Yellen was swirling—is the Federal Reserve Act's stipulation that the term is the term "unless sooner removed for cause by the President." This is a complex and uncertain legal matter but the law is one consideration among several.

Before turning to it, note the irony in today's attacks relative to Trump's pointed criticisms of Yellen in September 2016 when he said she should be "ashamed" of what she is doing to the US while stating that the Fed was a politically motivated central bank and simply serving the Obama administration. He positioned this criticism of low rates at the time as follows: "Any increase at all will be a very, very small increase because they want to keep the market up so Obama goes out and let the new guy ... raise interest rates ... and watch what happens in the stock market." Investors can cheerily note that since the Fed first began raising borrowing costs in December 2015, the S&P500 has rallied by about 35%. Trump's questioning of the Fed's independence when it was at lower rates is being followed by further questioning of its independence well into a hiking cycle.

What exactly is meant by 'cause' was the sticking point but there was general agreement that there is a high bar to the ability of the President to fire a Fed Chair on the basis of 'cause'. That said, 'cause' is not well defined. The one time a President (Roosevelt in 1935) tried to fire a senior bureaucrat, the bureaucrat fought back all the way to the Supreme Court and, unfortunately, died before it got to them! If that's not a statement on the efficiency of the legal process then what is. The Court ruled posthumously (Humphrey's Executor vs. United States) by setting limits to the President's powers over firings but only in terms of relatively less senior members of the administration. It remains somewhat of a grey area what powers the President has over a role like the Fed Chair and it may be implied that such more direct executive roles involve more latitude.

I would think that when it comes to a Fed chair versus a lower profile government official, markets would vote in a very destabilizing period long before it could potentially go all the way to the Court again and with Congress inserted in the middle. Along the way would be the risk of a united FOMC stridently seeking to preserve or restore independence and rallying around the Chair. Because of the legal uncertainty, the FOMC's role in guarding its independence, the fact that markets may become significantly destabilized and the availability of other options such as the one existing vacancy, I don't think markets should be treating today's errant remarks very seriously.

On balance, this is more the stuff of headline-induced market volatility going into the dog days of August. It is also more the stuff of a relatively unsophisticated administration that appears to be unschooled or uncaring toward the reasons for why things have tended to evolve the way they have over time. Adding to fairly benign concerns at this stage is that Trump dialed back his misstep by at least speaking highly of Powell as a "very good man" and "But at the same time I'm letting them do what they feel is best."

In my opinion, the issue is less about what Trump can 'let' the Fed Chair do and more about how *little* he can do about it in any practical direct sense especially within near- to medium-term horizons. He already has a Fed Chair who is tactfully avoiding more open criticism of the administration's trade and fiscal policies when he could easily be more pointed. He already has a Fed Chair that partly got the job because he was more open to modest regulatory relief. Along the way toward realizing this may be the need for the US administration to figure out its narrative on whether it prefers a strong dollar policy that Treasury has historically tended to advocate. On top of volatility that was induced earlier in the year in remarks by the President and his Treasury Secretary Steve Mnuchin, it appears that the administration is still feeling its way on the matter. That, on its own, may raise apprehension toward USD denominated assets just as we witnessed today.