Politics and The Fed

The Federal Reserve and in particular its monetary policy setting Federal Open Market Committee have long been considered apolitical. Being relatively free from political pressures allows the Fed to focus on their congressional mandates of full employment and stable prices, pursuing the course they believe will be best for the economy at large. Historically, most presidents have kept a respectable distance. President Trump has not followed that path and has been very public with his criticism of the Fed and its chair, believing the Fed has kept interest rates too high. Last Friday, he went so far as to suggest that Fed Chair Powell is an enemy of the state. The president apparently feels it is the Fed’s duty to support his trade war with China by providing the ammunition of lower interest rates.

Up to now, the Fed has not publicly responded to the president’s criticisms or his demands. But in an opinion piece for Bloomberg News that was published Tuesday morning, one former Fed official has fired a shot across the president’s bow. Bill Dudley, who served as president of the New York Fed and Vice Chair of the FOMC until 2018, referred to “Trump’s trade war” as a “disaster-in-the-making” and questioned whether the Fed should “mitigate the damage by providing offsetting stimulus, or refuse to play along?” As Dudley noted, conventional wisdom says the Fed should react to the economic reality, cutting interest rates if the trade war hurts the outlook for the economy. “But what if the Fed’s accommodation encourages the president to escalate the trade war further, increasing the risk of recession?” Dudley asks. His argument escalates even further, suggesting the Fed “could state explicitly that the central bank won’t bail out an administration that keeps making bad choices on trade policy, making it abundantly clear that Trump will own the consequences of his actions.”

Dudley didn’t stop there. He went on to say, “Trump’s reelection arguably presents a threat to the U.S. and global economy, to the Fed’s independence and its ability to achieve its employment and inflation objectives.” He closed with this doozy, “If the goal of monetary policy is to achieve the best long-term economic outcome, then Fed officials should consider how their decisions will affect the political outcome in 2020.”

Suggesting the Fed could use their policy tools in an effort to impact the results of a presidential election is an extraordinary statement, particularly when it comes from the highly regarded and recently departed president of the New York Fed. While we can understand Dudley’s concerns, his statements will likely only make the situation worse. Some have suggested that President Trump has been setting the stage to blame the Fed for any economic consequences of the trade war. If the Fed doesn’t cut rates, his argument will be bolstered. If the Fed does cut rates, they’ll be criticized for kowtowing to the president. Either way, their independence and their credibility are damaged.

You can read Bill Dudley’s comments in their entirety here. You can read some of the reaction here.

Please see disclosure on page 2.
Market Indications as of 4:00 P.M. Central Time

DOW          Down 120 to 25,778
NASDAQ       Down 27 to 7,827
S&P 500       Down 9 to 2,869
1-Yr T-bill  current yield 1.75%; opening yield 1.75%
2-Yr T-note  current yield 1.52%; opening yield 1.54%
5-Yr T-note  current yield 1.38%; opening yield 1.42%
10-Yr T-note current yield 1.47%; opening yield 1.54%
30-Yr T-bond current yield 1.95%(An all-time low); opening yield 2.04%