LH|M MONETARY POLICY ANALYTICS

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Good News: Powell Moving Up in Race for Fed Chair

While we are not counting out Yellen, Powell has jumped to the top of our list. Why? Because Powell is a Republican; is highly respected inside the Federal Reserve System; is known in the global central banking world and knows the players; has Fed and market experience; looks (perhaps important to Trump) and talks like a Fed Chair (important for press conference, testimonies, and market confidence); has had a role in virtually every aspect of Fed responsibilities, especially on the regulatory side; and is a safe pick, perhaps the safest among those apparently being considered. No controversy, no drama, quick confirmation, everyone is happy! And, despite not being a Ph.D. economist, he is up for the job and would be trusted to build a consensus, though he would have less ability to shape decisions relative to Bernanke, Yellen and, of course, Greenspan. But his credibility inside and outside the Committee with respect to monetary policy judgments would grow over time. He is a card-carrying centrist, sometimes to the slightly hawkish side of the Committee, sometimes slightly to the dovish side. That's a good place to be! And, most importantly, Powell being Chair would not give rise to any strain on our FOMC calls.

As you know, Governor Powell has been moving up our list of potential candidates for Fed Chair. Now he has raced to the front of the line. It is very promising that he met with Trump. What's not to like? Mnuchin is said to back him. Enough said. So he at least deserves the spotlight today.

Powell as Chair would be a change in the model of leadership—specifically the amount of power a Chair has to shape policy decisions, but that model has been changing over time. Dominated by the Chair over the tenures of Volcker and Greenspan; more consensus-oriented under Bernanke and Yellen, though they were seen as more than one "one among equals"—not because they were Ph.D. economists but because they were respected as among the top economists in their respective fields and had previous experience on the FOMC. Because of that, their judgment got extra weight, so they had a special ability to persuade and, hence, to shape as well as build the consensus. Powell would, like Yellen and Bernanke, work tirelessly to build and communicate the consensus, but with less ability to shape the consensus, at least initially. But in a close call, the Chair will generally get his or her way. Powell would initially be cautious in this regard, but be more willing to push in one direction or another other time.

These are my views of where he stands with respect to policy. He has been a centrist—which, on this Committee, might be dovish from a historical perspective. But, to his credit, he has sometimes appeared to be to the slightly hawkish side of center and at other times to the slightly dovish side. Admirable. He would be a source of continuity in policy: gradual increases in rates toward neutral, and a gradual and well-advertised pace of runoff. He favors retaining the current operating framework and, hence, a relatively large steady-state level of reserves and securities portfolio.

Powell would be inclined to pause when he sees risk management as called for. He is comfortable with QE, and has participated in important discussions inside the Fed about the challenges for policymakers near the zero bound, including discussions of new strategies to enhance the power of monetary policy in that case.

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As for the possibility of expanding the balance sheet in the future, should economic conditions warrant, he described it was a policy tool "only in extraordinary circumstances." He has already been immersed in staff research. While all Chairs tend to rely heavily on staff research, Powell would have to lean a bit more. OK, that means he respects experts. Good for him.

We have said that the primary principle for Trump in selecting a Fed Chair would be: "Don't rain on my parade." And, in this regard, we have said that Yellen would be the best choice for Trump among the list of candidates. She favors remaining accommodative, supporting above-trend growth even as the unemployment rate falls further below the NAIRU. But Powell would be a good second choice! The second principle is "no academics need apply." Enough said. Powell has private sector experience in a high position at a prominent firm.

And he would be an appealing face for the Fed in terms of communication to the public. He would be a star at press conferences and in testimonies. He doesn't speak on monetary policy issues often, but he is careful and thoughtful when he does. He would get used to moving the markets even when he didn't intend to, although it's clear that he already understands the implications of his choice of words when he speaks.

In His Own Words

Here are some quotes from Powell that let him tell his own story about his views on monetary policy.

In June, he saw "many indicators suggest[ing] that the economy is close to full employment." Later on, he noted that "inflation is a little bit below target and it's kind of a mystery…You would [have] expected, given that we're getting tighter labor markets, you'd have a little higher inflation. I think what that gives us is the ability to be patient…I think it's too soon to make decisions about particular meetings and whether to raise rates, but I think we have the ability, if we keep getting strong growth and strong labor markets, we have the ability to be a little bit patient and that's not a bad thing."

On financial conditions and monetary policy: "What matters is not the level of the federal funds rate, it's the level of financial conditions generally…so if [a longer-term disconnect] exists, then I think it's something you need to take into account." His assessment back in June was that financial markets were not "at very toppy levels" and he didn't "see credit growth above its longer-run trend."

On the operational framework and size of the normalized balance sheet (See **Powell Updates Guidance on Balance Sheet Plans**.): "This approach, sometimes referred to as a 'floor system,' is simple to operate and has provided good control over the federal funds rate…[The] 'corridor' framework remains a feasible option, although, in my view, it may be less robust over time than a floor system." In concrete terms, he said it was hard for him "to see the balance sheet getting lower than 2.5 to 3 trillion." Indeed, "if you're going to have a floor system, reserves have to be abundant. They have to be well above the demand for reserves." On asymmetric risks when near the zero-lower-bound asymmetric risk: "When you're near the zero lower bound, you are not in a symmetric world. I think you have to be more risk averse because you've got, really you don't have the tools to deal with the downside case. So you've got to do more to push away from the zero lower bound. Once you're well away, the reaction function becomes more symmetric."

Bottom Line

All in all, Powell would be an inspired pick, actually obvious when you think about it. But that's today. Who knows what tomorrow will bring!

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FOMC Statement Comment and Projections: Dots Point to December Hike
FOMC Briefing: Lower Underlying Inflation Making December Close Call; Still Assuming No Hike
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