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Musings

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Randal Quarles: Pragmatic on Bank Supervision, Republican Orthodox on Monetary Policy

It was clear that the first Trump nominee to the Federal Reserve Board would be for Vice Chair of Supervision. Randal Quarles now appears to be the likely nominee, and it appears to be a mixed blessing for the Fed. He is eminently qualified to provide leadership on regulatory policy within the Board, and we expect that as Vice Chair of Supervision he will be a pragmatist—someone who wants to reform regulation, but not someone pushing to "repeal and not replace." His views on monetary policy, perhaps not surprisingly, lean toward today's Republican orthodoxy. Most notably, in the past he has advocated that the FOMC follow a simple policy rule, and he has criticized the FOMC's conduct of monetary policy as "no way to run a railroad." We don't know what his views on monetary policy are today, but it seems likely that, once on the Board, he will temper his critical views about the conduct of monetary policy.

Quite A Resume

We naturally start with his resume, which tells us a lot about his qualifications, if not his views. And quite a resume it is. He is an expert on banking law, having headed that practice as a partner at Davis Polk. That is certainly a good background for a Vice Chair of Supervision. At Treasury, he was Assistant Secretary for International Affairs and then Under Secretary for Domestic Finance during the George W. Bush administration. He also represented the U.S. at the IMF as U.S. Executive Director. And he was reported to be a likely pick for Treasury Secretary had Romney been elected President. His private sector experience is undoubtedly valued by the Trump administration. In addition to practicing law, he was a partner at Carlyle Group and is currently founder and head of a private equity firm, the Cynosure Group. To top it off, there is wide agreement that he is a team player.

Why Quarles?

In some respects, Quarles appointment seems consistent with the reported ascendency of the moderates among Trump advisers. In any case, Gary Cohn, along with Steve Mnuchin, are likely to be the principal influences on Trump's decisions for appointments to the Board. They picked someone who is extraordinarily well prepared for the role of Vice Chair of Supervision. On supervisory matters, he seems sensible and pragmatic, and certainly not an ideologue. His views on monetary policy may not have factored much into his selection, but here he appears to hew to the Republican orthodoxy.

What Are His Views on Bank Regulation?

He was an advocate during his time at Treasury of fundamental reform of the financial regulatory system, including more-uniform federal regulation of investment banks and insurance companies. We do not have a clear view of his current position on many specific regulatory policies, but he seems closer to the "reform and improve" camp than to the "repeal and don't replace" camp. He has said that some parts of Dodd-Frank are "too ambitious" while other parts "are not ambitious enough." We expect his views will not be a radical

Larry Meyer	**202-794-7358**	**larry@lhmeyer.com**
Kevin Burgett	**202-794-7352**	**kevin@lhmeyer.com**
Derek Tang	**202-794-7356**	**derek@lhmeyer.com**

departure from the views of Tarullo, but he is likely to favor a lighter regulatory touch than Tarullo and one that is more industry friendly. In addition, he is a supporter of more international cooperation with respect to financial regulation and represented the U.S. at the Financial Stability Forum. This runs against the grain of current Republican orthodoxy, including the President's skepticism of international forums. If confirmed, he will certainly resume that role as the representative of the Board.

On the evolution of Dodd-Frank under a Republican administration, he observed, perhaps ambiguously: "Probably a Dodd-Frank repeal is politically very difficult at this point, but I think you can see significant changes to Dodd-Frank. There are many aspects of Dodd-Frank...I think that in some ways Dodd-Frank was not ambitious enough. And in other ways, it was overly ambitious. I think there are lots of ways refine Dodd-Frank and other forms of regulatory policy in ways that would be beneficial to the economy." He also spoke about that in May 2015: "You could have responded to those pressures with a more aggressive restructuring of the financial-regulatory structure of the country without some of the particular provisions that aren't well designed and were included for political rather than financial-regulatory reasons."

It is not entirely clear from our reading of his past comments whether or not Quarles favors reinstating Glass-Steagall, which forced the separation of investment banking from commercial banking activities. It was repealed in 1999 during the Clinton Administration. He is sure to be quizzed about his views during the confirmation hearing.

Likely Adheres to Republican Orthodoxy on Monetary Policy

Quarles' views on monetary policy to lean decidedly toward current Republican views, specifically those of the House Republicans. He has, like those Republicans, mostly offered critiques on Fed policy, and has previously shown himself to be outside the consensus view on the FOMC today about how to conduct monetary policy. Indeed, at one point, he supported policies that are anathema to the FOMC and seen by the Chair, in particular, as a threat to Fed independence. Specifically, he has advocated that the FOMC should set policy using a rule, a position generally championed by Republicans in the House in years past. And, referring the FOMC's current monetary policy, he said that it was "no way to run a railroad." But it is different being on the inside as a pragmatic member of the Board than it is being an outside commentator.

Before the December 2015 rate hike, Quarles gave a wide-ranging interview with Bloomberg on monetary policy and other matters. He saw the "Kremlinology" surrounding "the way that the Fed has been telegraphing its [rate-hike] decision" as problematic. He noted that the Fed had attempted to become more transparent in the past decade, much like other central banks, as a means of reducing uncertainty in financial markets, but observed: "And yet, [the Fed's] transparency has increased uncertainty." While he agreed with the general concept of transparency, he argued that a rule-based policy is a prerequisite to effective transparency: "what [the Fed] has wrong is that it continues to believe it shouldn't be following a rule. If you're going to be transparent, in an activity like the Fed's, you have to be much more rule-based in what you're doing...The transparency has to involve: This is the rule that we will follow, so that the markets can say, alright, we now understand what it is that the Fed is going to do, we can see what its inputs are, and as we see those inputs develop we'll know how to react." He contrasted this setup with the current framework: "But if, the decision-making process is, 'we'll decide what is best,'...well, what are they going to decide? Your decision is not: What is the economy doing, and we know how the Fed will react to that, it's 'What do these people think?'" He cited an example: "So recently, I saw a list of members of the [FOMC] ranked by what people thought their influence would be on the ultimate decision. That's a perfectly rational thing to do in the current environment, but it's a crazy way to run a railroad for the Federal Reserve."

Quarles cited this problem as one argument for a rules-based decision-making process: "I don't think [the question is] so much, 'Where is the discretionary decision-making authority, is it in one man or is it in a group'—although it does complicate the analysis if it's in a group—I think the issue is: Is that decision going to be a discretionary decision based on the individual assessment[s] of people who are at the Federal Reserve at a particular moment or is it going to be, is the Federal Reserve's monetary policy going to be more rules-based? Is the Federal Reserve's job going to be: 'We will determine what the rule is, and the markets can then assess what that rule is, and from time to time we may change the rule. But while that rule is in effect, there will be certainty in the markets as to what the consequences of it will be.'" Rather, he saw the current environment as: "whether it's one man's decisions or a team's decision, it is nonetheless a [discretionary] decision, and the market uncertainty is driven by the fact that that decision will not be knowable in advance."

When pressed on whether a rule would increase political pressure on the Fed, he countered: "I actually think that it increases the politicization of monetary policy to have it driven by these discretionary decisions, I think if you have...a more rules-based policy, you've increased certainty in the markets, I think that makes the whole process of monetary policy less political rather than more." Turning to whether a rules-based policy would even be enacted, he commented: "Now here is where politics really does come into play...Quite likely if there's a Republican President. One of the principal differences in economic policy, in particular monetary policy, between the two parties currently...that an important element of Republican thinking about monetary policy currently is that it ought to be more rules-based."

Consistent with the Republican orthodoxy at that time, he floated the idea of John Taylor as Chair: "And so if there's a Republican President, I think there will be a new Chairman of the Fed, maybe somebody like John Taylor at Stanford, who stands for rules-based monetary policy...the Taylor Rule. And I think you'd see a significant change at the Federal Reserve in that respect."

Keep in mind that Quarles expressed these views in November 2015, when the Republican nomination was still in flux, although Trump was already the leading primary candidate. The most interesting comment from Quarles concerned the ideological flexibility of his views on monetary policy, suggesting that these views are not set in stone: "[Republican thinking on monetary policy] could've developed the other way, there's nothing necessarily that says this is a Republican rather than a Democratic policy, but it has developed this way."

While his views on the conduct of monetary policy are noteworthy, it is very, very unlikely that they will carry the day at the FOMC, specifically with respect to following a simple policy rule. On the other hand, while we have not seen comments that indicate where he fits on a dove-hawk spectrum, we expect that he conforms to typical Republican appointees to the Board, to the moderately hawkish side, more focused on price stability, less on activist use of monetary policy with respect to promoting full employment. It may seem like a stretch to classify someone who wants to follow a simple rule as a hawk or a dove. But some rules are more hawkish than others! The one he favors—the Taylor rule—prescribes a much less aggressive response to deviations from full employment than rules that today seem to inform monetary policy decisions, and specifically less aggressive than rules than those Yellen has written down.

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Larry Meyer
202-794-7358
larry@lhmeyer.com

Jacqueline Dolson
202-794-7357
jacqueline@lhmeyer.com

Matt Peterson
703-965-6568
matt@lhmeyer.com

lhmeyer.com

LHMeyer Macro Team

Larry Meyer
David Stockton
Kevin Burgett
Derek Tang

Senior Advisers
Jonathan Wright
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