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Policy Focus

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Trump's Fed Nominees: What Does He Want, What Will He Get?

The Federal Reserve Board will soon evolve from one that consists of governors appointed by President Obama to one that will shortly be dominated by appointees of President Trump. We outline our views on what kind of FOMC Trump likely wants, look at what kind of Committee he might get, and speculate on who he might appoint.

Changing of the Guard

The change in composition will happen quickly. (See "Changes to the FOMC Under Trump.") There are currently two vacancies on the Board of Governors, and there will be another when Governor Tarullo leaves in April. Moreover, Yellen's term as Chair ends in February 2018 and Fischer's as Vice Chairman ends in June 2018. By mid-2018, the President will have had the opportunity to nominate at least five of the seven governors. And depending on how long Governors Powell and Brainard decide to stick around, Trump may be able to put in place all seven Board members in relatively short order, even though terms have been staggered since the Board's inception, with the intent to limit the prospect of such a quick turnover.

Don't Rain on My Parade

Trump is going to appoint people who will be most helpful in advancing his agenda. To be fair, all presidents are looking for this to some degree. The question becomes how presidents view the role of the Fed in supporting their objectives. Most presidents probably realize deep down (or are told by their economic advisers) that the Fed can contribute most to the success of the country—and thus to the president—by creating a stable macro environment in the pursuit of the dual mandate. But how that objective gets translated into the characteristics of potential nominees is not straightforward, and perhaps especially for Trump. He will want nominees that support his campaign promises:

First, he wants monetary policy to support his campaign promise to "Make America Great Again." With respect to monetary policy, that means support for continued above-trend growth, bringing a further decline in the unemployment rate and a continued strong advance in employment. All presidents want a Fed that will support growth and employment, but it is an absolute imperative for Trump.

Second, he likely wants monetary policymakers who will be open to the view, even if they are not outright strong advocates, that the growth potential of the economy is already greater than the 1¾-to-2% rate currently estimated by most FOMC members, or is at least poised to increase meaningfully and quickly above that pace under his policies.

Republican vs. Democratic Appointments

There are some clear differences in the views about the conduct of monetary policy by Board members nominated by Republican presidents and those by Democratic presidents. A common, if crude, rule of thumb is that Republicans tend to lean to the hawkish side and Democrats tend to lean dovish. In other words, Republicans tend to prioritize keeping inflation low over boosting employment, while the opposite

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tends to be true for Democrats. Republicans today, as a result, see Democratic policymakers as too focused on the short term, too data dependent, and not focused enough on the objective of price stability in the medium term, a task that central banks actually have the ability to achieve. Taken at face value, this view suggests that Republican nominees therefore would likely be inclined toward both a steadier and faster pace of rate hikes going forward, given that monetary policy remains accommodative even with the economy near or at full employment, growth above trend, and inflation headed toward 2%. In addition, Democratic presidents are also more likely to appoint academics or at least economists as governors, while Republicans are more likely to appoint business executives. On the other hand, Republican presidents have been inclined to nominate highly regarded academic economists as chairs—for example, Alan Greenspan and Ben Bernanke. The same, of course, goes for Democrats, as in the cases of Janet Yellen and the renomination of Greenspan and Bernanke.

But Trump is a Different Kind of Republican!

Like other Republican presidents, Trump will be more inclined to favor business executives over economists for governors. And that may, and we expect it likely will, apply even to the Chair. Indeed, with respect to Trump, it's fair to say: "Academics need not apply." That reflects his general disdain for academics. He respects the judgment of successful business executives and their real-world experience more. A cautionary note: We cannot count out the possibility that perhaps one of his nominees will be someone with strong views about monetary policy and central banking that are outside the mainstream.

But what we suspect Trump wants is for his nominees to support his agenda and promote stronger growth, even with the economy essentially at full employment and headed to 2% inflation, and that isn't exactly what more typical Republican presidents look for. Indeed, we suspect his ideal candidate might have more in common with the more dovish governors appointed by Democratic presidents than the more hawkish inclinations of Republican-appointed ones! While Trump gave conflicting views about his monetary policy inclinations during the campaign, we suspect Trump, deep down, is likely more of a low-interest-rate guy, more focused on the prospect that lower rates will promote faster growth and stronger advances in employment, than someone who is more concerned about overshooting the 2% inflation objective or limiting the possibility of asset bubbles. He is likely to steer clear of very hawkish nominees who might be more likely to rain on his parade.

Someone who would be consistent with Trump's ingrained inclination for low rates would be a nominee with "developer DNA." But Trump will encounter some constraints in the nomination process and may have difficulty nominating someone who leans heavily in favor of low rates in the interest of borrowers and who would seem so out of touch with the traditional mission of a central banker. Still, he might be able to get one governor with "developer DNA," but probably not more.

Trump likely also wants nominees who believe that the economy can grow faster than 2% without unacceptable inflationary consequences, and he certainly wants people who are more focused on the supply-side benefits of his fiscal program and less focused on its demand-side implications. Republicans in general seem less persuaded that fiscal policy has material demand-side effects; a Board member holding this point of view would be less inclined to try to offset the effects of looser fiscal policy with faster rate hikes. Someone who fits the bill for Trump would be a "supply sider" who believes strongly that Trump's pro-growth policy agenda could substantially raise growth—indeed even immediately—and that monetary policy should accommodate this faster growth.

The Prominent Business Executive

Trump's nominees for the Board are most likely to be from a group of prominent and successful (i.e., wealthy) business executives. With respect to his economics team, he has appointed executives with experience with financial markets, specifically Steven Mnuchin and Gary Cohn, and that may well be the case for nominees for Chair and Vice Chair. This group would likely be very smart, but appreciate contributions from experts, that is, in this case, economists; be pragmatists rather than ideologues; hopefully understand how to build a consensus; and, importantly, not likely be swayed by what Trump wants once he or she joins the Board. Possible candidates might have little in the way of paper trails for their monetary policy views, making it more challenging to read their perspectives on monetary policy. They may indeed come without very sharp views. But we suspect the group would be neither very hawkish nor very dovish.

However, appointing a business or financial executive as Fed chair may reduce the prospect that the Chair would be a strong intellectual leader in the vein of Greenspan, Bernanke, and Yellen. Even though the Chair has to devote more energy to consensus building today, we believe the Committee appreciates the leadership of a strong chair, one whose judgment is especially respected. In addition, not coming from academia nor having served as a professional economist or in a similar role could make him or her more dependent on the Fed staff for forecasting, scenario and other macro analysis,and topics related to monetary policy.

Who Else Has A Say on Trump's Fed Choices?

Who Trump chooses will also depend on:

1. The degree to which his economic team influences his choices could provide some restraint. For example, Gary Cohn, chief economic advisor to the President and Director of the U.S. National Economic Council, would likely have a moderating influence on any extremist economic views and counsel the President to make sound choices.
2. The markets: They will voice their opinions on his nominees.
3. Maybe even the Senate. As a whole, Republicans have not pushed back much on Trump's nominees. But they may show less deference in the case of Fed Board appointees, and especially for the positions of Chair and Vice Chair, who are intended to function independently of the Administration.

In terms of the monetary policy that Trump will get, don't forget the regional Fed presidents! They are the guardians of Fed independence and a source of continuity in policy and in the decision making process inside the Committee.

Contenders

We consider separately candidates for Chair or Vice Chair; candidates for Vice Chair of Supervision; and candidates for other openings on the Board. In general, conspicuously absent from our lists are prominent (or any other) Republican economists—specifically, John Taylor and Glenn Hubbard. We believe that, as academics and experts, they may be disqualified.

Chair/Vice Chair

Kevin Warsh	The most obvious contender. Although he is currently at Stanford, he is not an academic and, in any event, he is with the conservative Hoover Institute. He has been critical of the FOMC's policy, and his critique jibes well with the Republican perspective. He has a financial industry background and was a Fed governor, so he knows the system well. Might be more hawkish than Trump would prefer.
Governor Powell	Makes a lot of sense. Resume, experience inside the Fed, Republican, private sector experience focused on financial markets, and well versed on the regulatory side. He is well respected inside the system. He would clearly be a consensus builder.
Prominent financial market executive	Just playing the odds here! Another current or former Goldman Sachs executive? Not likely, unless already a member of his administration. Can't go to that well too often! In any case, such a person would most likely be competent, not ideological, and a centrist, by the standard of the current FOMC. Cohn already has Trump's stamp of approval and could be groomed for the job during a year as Director of the NEC. In any case, he may have the greatest influence on Trump's nominees.
Hedge fund manager	A big donor would have an edge! Note, however, that some hedge fund managers have views way out of the mainstream. But that might actually make them more attractive to Trump! Unlikely to be a consensus builder.
Janet Yellen	A dark horse, to be sure! Still, picking her would be a way of nominating a Chair who is very highly respected, though less so by Republicans in Congress, with dovish leanings. Don't count her out just yet. Still, as Fed Chair, would often be called upon by the oversight committees to comment on other aspects of Trump policies—and her assessments might not be favorable. In any case, also don't rule out the possibility that she might even remain as a governor after her term as Chair is if she believes doing so would better ensure that the Fed's independence is maintained in practice as well as in principle and that policy is conducted in a disciplined way. In that case, the Reserve Bank presidents and remaining current governors would dominate the FOMC. While unlikely, it may depend on the direction of Trump appointees.
Kevin Hassett	At the last minute, we had to add an additional possibility, Kevin Hassett, currently director of economic studies at the AEI and reportedly soon to be nominated as Chair of the CEA. That position has been a springboard for nomination to be Chair of the Fed: Greenspan, Bernanke, and Yellen. While an economist and former academic, he would fit the supply-sider mold we talked about. But, like traditional Republican nominees, he would likely be more hawkish than Trump would prefer. He also served as an economist at the Board, an advantage, at least from my perspective.

Vice Chair for Supervision

The nominee for Vice Chair of Supervision will be chosen based on his or her qualifications with respect to this position and less for his or her views on monetary policy, though those views will likely be consistent with the Republican ideals.

David Nason (see our analysis)	Widely seen as a candidate for Vice Chair for Supervision. Free market type, fitting the Republican wishlist. Treasury experience, having led a study on regulatory reform. Well suited for the job. Not much paper trail on monetary policy, but we suspect most likely a centrist by today's standards.
John Allison	Also seen as a candidate for Vice Chair for Supervision. He revealed that he has been in discussions with the Trump Administration on a Fed position. He was with the conservative Cato Institute for a few years, and advocates a simpler regulatory regime. He said that he would "kind of change the game, in the sense of requiring banks to have a high level of capital, and then essentially end most of the regulations."On interest rate policy, he said that, "In a certain sense, the Federal Reserve, particularly in regards to monetary policy, has an impossible job. Think about this: We know that price setting doesn't work... Acting like you know what the right price of money is really a form of arrogance."
Tom Hoenig	Head of the FDIC and former Reserve Bank president. He would immediately be one of the most hawkish members of the Board and the FOMC. Talk about raining on Trump's parade. He could nevertheless be a contender for Vice Chair for Supervision because of his regulatory experience, but his views on appropriate regulation are likely more onerous for banks than what Trump and Republicans prefer.

Other Governors

A community banker	Dodd Frank requires that one member of the Board be someone with community banking experience. One who has been talked about as being on the short list is Cynthia Blankenship, Vice Chairman and CFO of Bank of the West. She chaired the Independent Community Bankers of America for a year. Would guarantee a woman on the Board after Yellen's tenure as chair is over.
Not-so-prominent business executive or financial market executive	The prototypical Republican nominee
Buddy	This is, after all, Trump, and he has many friends among business executives.

Bottom Line

We are likely to see some combination of financial market executives and practical business people. As a group, they may not be especially hawkish, indeed we would expect them to be more in line with the centrists among FOMC participants today.

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