

The Next Federal Reserve Chair: YOU'RE HIRED!!!

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The FOMC is poised to undergo a nontrivial change in leadership and composition with four new regional Fed members rotating into voting roles and with a potential change in leadership. There are also three additional governor's seats—previously four prior to the confirmation of Randy Quarles— and potentially four vacancies —depending if Chair Yellen stays- that President Trump could fill. In terms of timing, the White House has alluded that they will announce their nominee for chair before President Trump leaves for his Asia trip on November 3rd. That said, timing is less valuable than impact, as a misstep from the administration on the selection of the next Fed chair has the potential to disrupt markets and create unnecessary monetary policy uncertainty domestically and globally.

Choosing a candidate that will maintain integrity and independence of the Fed is vital to continuing the stability and prosperity that the U.S. has achieved in recent decades. Although, it predates many Millennials, there was a time in recent history where political pressures influenced the Fed's decision-making, which favored full employment over price stability, leading to increased accommodation despite many signs that the economy was operating at or above capacity. This atypical policy course led to steep increases in inflation in the 1970s and 1980s, which required significant increases in interest rates and were accompanied by economic recessions in later years.

A group of academics, bankers, governors, lawyers and the incumbent have risen to the top of the list of candidates. As it stands, none appears to be candidates that would jeopardize the Fed's goals of price stability and maximum employment, although some of the nominees could bring different preferences and eventually represent a nontrivial shift in policy. In what follows, we describe our view on the backgrounds, policy preferences and styles, and probability of being selected for a handful of candidates. Moreover, even if not selected for the Chair, the vacancies could be filled by some of the remaining "apprentices". In any case, the ultimate bias of a fully refurbished FOMC will depend on who is chosen to fill the vacancies.

The list

Jerome Powell-Waiting in the Wings

Hawk-Dove Rating (1 dove- 5 hawk): 3

Probability of Securing Nominations: 28%

Jerome Powell, who was not considered one of the top candidates for the Chairman's role in early phases of the search, has become one of the favorites to succeed Chair Yellen. In terms of his background, besides being an experienced Fed governor, he also served as Undersecretary of the Treasury under George H. W. Bush after which he joined the private equity firm the Carlyle group. Powell's work as a governor has been behind the scenes for the most part, working to respond to the 2014 Treasury debt flash crash while also leading the effort to reform the London Interbank Offered Rate Benchmark.

Given his affirmative voting history, Powell would likely guide the board in a similar direction to the current and former Chair focusing on a commitment to a symmetric inflation goal, adherence to Phillips Curve albeit with somewhat less orthodoxy, and use of unconventional monetary policy if needed. Powell would also favor a strong risk management approach and clear separation between monetary policy and macroprudential tools. With respect to the political economy and fiscal policy, he would likely have a slightly higher tolerance than the current chair, but would not sacrifice price stability for short-term growth objectives. In addition, Powell would also be inclined to find opportunities for modest financial deregulation.

Given Governor Powell's background and experience, ties to the Republican Party and centrist attitude there is a chance the administration opts for continuity and certainty with respect to monetary policy. However, this would be a break from a number of the President's appointments thus far, that have favored individuals considered "outsiders".

John Taylor- Maxim-us

Hawk-Dove Rating (1 dove- 5 hawk): 5

Probability of Securing Nominations: 24%

The architect of the aptly named "Taylor-rule" is a favorite among GOP lawmakers who have at times proposed auditing the Fed and reverting to a gold standard in attempts to limit the discretionary powers of the independent body. In this sense, the appointment of Taylor would be vindication for the excessive intervention that they derided during the crisis. Regardless of the political motivations of the GOP, his experience and reputation are noteworthy; he served as undersecretary of the Treasury during the George W. Bush administration and is listed as a citation laureate suggesting he may be possible future candidates for Nobel Prize.

Taylor's approach would be highly conventional, nondiscretionary rules-based, nonreactive interest rate policy-setting with limited or no forward guidance, and scaled down macroprudential and financial stabilization tools. His stance would be a departure from recent Fed Chairs, with the potential to enhance transparency and accountability, while reducing the risk-management approach and potentially validating some proposals that call for more scrutiny of the FOMC.

The fact that he is a GOP favorite and that any chair will face Senate confirmation suggests that he remains a strong candidate. However, his rules-based approach could dampen any major expansionary fiscal policy if the fiscal stimulus ends up building inflationary pressures and thus requiring an abrupt tightening cycle. Moreover, his rules-based approach would not coalesce with any potential demand for loyalty. That said, his credentialed past makes him hard to discount.

Janet Yellen- Old Faithful**Hawk-Dove Rating (1 dove- 5 hawk): 2****Probability of Securing Nominations: 20%**

The current chair, Janet Yellen, is as safe a pick for the position as it gets. Aside from her current experience as Chair, Yellen was CEO of the San Francisco Fed, Vice Chairwoman of the Board of Governors from 2010-2014, and the Chair of the Council of Economic Advisors —She is also married to Nobel Prize winner George Akerlof. Some extreme factions of the economic community feel that she has done too much or too little in terms of removing accommodation. However, the fact remains that she has overseen the normalization of highly unconventional monetary policy and an industrial recession without any major slowdown in growth or surge in financial volatility or inflation.

How Trump views the current chair is unclear. During the campaign he criticized her, saying she should be ashamed of the near-zero interest rate policy whereas recently he has said that he “respects” her and that he was pleased with how well the stock market is doing.

From a policy perspective, her current views of low equilibrium real interest rate levels and lower long-term unemployment rates imply a less aggressive tightening path than would be for a rules-based advocate. However, her appetite for expansionary fiscal policy and politics seems small given her views on the limited remaining excess capacity in the economy and the risks that a poorly designed expansionary fiscal policy could pose to the inflation outlook. Moreover, it is unlikely that Chair Yellen would agree with the White House on financial deregulation and other policies that could impact potential output and long-term unemployment.

The previous three Chairmans served at least two terms (Volker 8 years, Greenspan 19 years and Bernanke 8 years), so not reappointing Chair Yellen would be a major departure and represent the shortest tenure as Fed Chair since W. Miller in 1978-1979.

Neel Kashkari- The Hail Mary**Hawk-Dove Rating (1 dove- 5 hawk): 1****Probability of Securing Nominations: 10%**

The Minneapolis Fed President Neel Kashkari’s monetary bias is clearly tilted towards the doves, which tend to be more associated with the Democratic Party. However, Kashkari is a registered Republican who ran for governor of California as a GOP candidate in 2014. In addition, he worked in the private sector as an investment banker at Goldman Sachs, and was Assistant Secretary of the Treasury for Financial Stability, and International Economic and Development under George W. Bush. Although he has had a short-tenure as president of the Minneapolis Fed, he has gained attention for his outspoken stances on bank’s balance sheets and capital requirements and notable dissensions to the recent policy actions of the Fed.

As chair, he would likely adhere to the current policy-setting framework of discretionary based policymaking, based on empirical or statistical evidence. In practice, this would likely translate into a slower pace on normalization than the

median forecasts of the FOMC, with a broader lens to view monetary policy in a low inflation environment, possibly expanding the toolset of the Fed beyond the standard measures used today. This shift would likely add more weight to data dependency and less to forward guidance and anticipatory action.

With respect to the political economy and fiscal expansion, he may be willing to accept slightly hotter economy given concerns about persistently low inflation and weakness in the labor market. However, his data drive nature would suggest that he would not accept inflation rates that jeopardize the Fed's symmetric policy goal of 2%.

The fact that he is a member of the GOP and graduated from Trump's Alma Matter (Wharton Business School) will help his, albeit slim, chances. That said, he will likely remain a long shot, but, with Trump, nothing is out of the realm of possibilities and his marketability may be too tempting for the author of "Think Big and Kick Ass."

Kevin Warsh- The Manchurian Candidate

Hawk-Dove Rating (1 dove- 5 hawk): 4

Probability of Securing Nominations: 10%

Kevin Warsh, a former Fed governor with both private sector and academic experience, is one of, if not, the leading candidate for Federal Reserve Chair. As a former lawyer, Kevin Warsh would be a break from recent Fed Chairs Bernanke and Yellen who were experienced economists with extensive monetary policy experience.

In terms of his bias, his views on monetary policy have been mixed. After leaving the Fed he has advocated for a rules-based approach and chastised the Fed for its use of unconventional monetary. However, during his term at the Board of Governors he voted consistently with then Chairman Bernanke who was promoting highly unconventional monetary policy with QE1, QE2 QE3 and Operation Twist. Speeches from period are also a mixed bag in terms of policy, advocating at times for less intervention prior to the financial crisis and additional support for financial institutions during the crisis, probably reflecting a high level of uncertainty on what the data was telling about the state of the economy.

Bernanke has praised his work as a de facto liaison to the private sector, suggesting his political skills could be invaluable in a period for which financial vulnerabilities are likely to remain low. His mercurial communication and policy positions have the potential to be seen as an asset for the President who himself is prone to nontrivial swings in policy. Warsh would probably lean more in favor of a policy rule amid less emphasis on the symmetric 2% inflation target, the Phillips Curve and the equilibrium real interest rate. In addition, Warsh would also be more sensitive to political economy and react more softly to fiscal stimulus. Warsh would also favor additional steps on financial deregulation and try to change FOMC communication.

Gary Cohn-The Fallen Angel

Hawk-Dove Rating (1 dove- 5 hawk): 3

Probability of Securing Nominations: 5%

Former Goldman Sachs executive, Gary Cohn, gained considerable standing in Trump's White House as the Director of the National Economic Council. In fact, he was selected to head the White House's major tax initiative with Secretary of

the Treasury, Steven Mnuchin. Although there are no tangible successes in terms of tax policy, his communication strategy appears to be consistent with the president's objectives on tax reform.

While Cohn has no formal economic or monetary experience, he has been a part of the financial sector for 25 years and at times has advocated for and against monetary policy action. In terms of his approach to monetary policy, he would likely favor reducing macroprudential intervention and regulation for the financial sector. In terms of interest rate policy, given his background in banking, his rate bias would likely lean towards higher rates and less intervention in capital markets. Communication and forward guidance could decline under his leadership given that he believes it has the potential to generate uncertainty for markets. However, in terms of his approach to managing the political economy, the fact that he has been an advocate of tax reform suggests that he would likely promote be less aggressive in staving off any potential inflationary pressures prematurely.

In terms of his likelihood of becoming the next Chair, indications are that his chances have declined considerably since he criticized the President's handling of the Charlottesville riots. That said, he has remained in the cabinet in spite of these frictions and thus must have not fallen completely out of favor with the president. While a successful passage of the current tax proposal could boost his chances, it is likely that the decision on the Fed will occur before the tax cuts and the President might want him to follow through this major reform.

Glenn Hubbard- The Godfather

Hawk-Dove Rating (1 dove- 5 hawk): 4

Probability of Securing Nominations: 3%

Glenn Hubbard's experience as George Bush's tax-architect and his expertise in fiscal policy would be a perfect monetary policy complement to the President's fiscal agenda. In addition, he favors less interventionist monetary policy and rules-based policy setting. In terms of background, he served as chief economist for George W. Bush from 2001 to 2003, and is currently the dean of the Columbia University Graduate School of Business.

Hubbard's tenure, like John Taylor, would be based on a conventional, nondiscretionary rules-based, nonreactive interest rate policy-setting framework. In addition, given his advocacy for lower taxation and fiscal stimulus it is almost certain to avoid counteracting expansionary fiscal policy with abrupt monetary policy tightening. In addition, Hubbard is on record as saying that the 3% target growth rate set out by President Trump is attainable.

His background and expertise appear to be a perfect fit for administration, but his ties to George W. Bush and Mitt Romney both of whom have contentious relationships with the President likely lowers his chances. To get the job, Hubbard may have to lean on his private sector contacts to get his foot in the door.

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