

Research Briefing | US

Next FOMC Chair – who is likely and market impact

Economist

Terry Sheehan
Economic Analyst
646 503 3054

Kathy Bostjancic
Head of US Investor
Services
+646 503 3066

Warsh, followed by Fed Gov. Powell, are the leading candidates for next FOMC Chair

- According to President Trump, he will announce his nomination for the next FOMC Chair in the next several weeks. Monetary policy is at critical crossroads as the FOMC considers the pace of interest rate hikes amid balance sheet normalization. Given that the FOMC Chair yields powerful influence over policy decisions, the appointment holds great importance for both markets and the economy.
- Re-nominating Chair Yellen would be our and the markets' preferred choice since she has done an admirable job, is a policy dove, and represents continuity – all things markets typically crave. However, we suspect President Trump wants to put his own “stamp” on the FOMC by choosing a new Chair. Further, we believe that Trump foremost wants a leader at the Fed who would promote his call for a repeal of much of the post-crisis financial regulation, which Yellen does not. We see Kevin Warsh as the leading contender for the position, followed by Fed Governor Powell.

The stage has been set for President Trump to unveil his choice for the next FOMC Chair within the next several weeks, as Yellen's term as Chair ends on February 3, 2018. According to the latest press reports, the short-list of candidates includes Kevin Warsh, Jerome Powell, Janet Yellen, Gary Cohn and John Taylor. Purportedly, President Trump has so far met with all of the contenders, except Taylor. Whether Trump will select from among these names or nominate a dark horse cannot be known for sure until the White House makes the official announcement.

What can be said of the list is that three of the five (Warsh, Powell and Yellen) have experience -- some deeper than others -- as central bankers. The most conventional -- and much preferred by financial markets -- choice would be Yellen, followed by Powell and then Warsh. Taylor would not be wholly an unknown quantity to markets, but this stems from his academic background and his widely-followed Taylor Rule. Of the five, the real unknown view on monetary policy is Cohn's. He has no experience as a central banker and no record as an academic on which to assess his views. As for financial regulation, we surmise Cohn would be in favor of rolling back much of the financial regulations.

Much will depend on if Trump wants to shake up and put his “stamp” on the Federal Reserve, an institution which is almost universally viewed in a negative light by his political base. Given the legal independence of the Federal Reserve and the importance of having the Chair occupied by a trusted leader, the process of Senate confirmation means that it will take a solid nominee to traverse the confirmation process. That argues for someone who can split the difference like Warsh, who has openly criticized the central bank, but has enough gravitas and experience to lead on monetary policy.

Contact: Kathy Bostjancic | Kathybostjancic@oxfordeconomics.com

Yellen is still in the running, but she is against repealing financial regulations and Trump likely wants his own person as Chair

Below, we list the contenders, in order of likelihood, and with associated odds, pros/cons from Trump's perspective and likely market assessment.

- 1. Kevin Warsh is the leading candidate, whom we assign a 40% probability. Markets view Warsh as a monetary policy hawk who is in favour of aggressively repealing post-crisis financial regulations.** Warsh has actively campaigned for the position from the start. He has experience as a central banker with his service as a Fed Governor (2006-2011) that covered much of the financial crisis and the Fed's response to it. While he was a supporter of former Fed Chair Bernanke and helped craft the tools that got the economy and markets through the crisis, he has been critical of the Fed's use of large scale asset purchases -- so-called QE. He also tends to favor a more rules-based approach to monetary that allows the private sector to operate with less fine-tuning by the Federal Reserve. He would be more hawkish on rates and the shrinking of the balance sheet than the current FOMC consensus. He also advocates strongly for repealing large portions of the post-crisis financial regulations. His stance on regulation roll-back endears him to President Trump and Republican Senators. That he would push to raise rates faster than Yellen is a minor negative for Trump, who likely prefers low rates. On the other hand, Trump likely cares and can identify more with taking a strong stance on repealing regulation than wading into the area of monetary policy. Further, Warsh is from a wealthy, politically-connected background that President Trump will probably find personally appealing. Financial markets view Warsh as a monetary policy hawk, i.e. expectations of a faster pace of rate hikes and possibly faster pace of balance sheet normalization. However, it will likely be very hard for Warsh to garner the consensus on the FOMC to speed up the pace of balance sheet reduction.
- 2. Fed Governor Powell is the next likely nominee, whom we assign 25% odds.** Powell joined the Board of Governors in in 2012. He is a later arrival on the field for the next Fed Chair. He was something of a compromise choice for a Governor during the Obama Administration, a moderate Republican to balance the appointment of the Democratic Jeremy Stein. He had government experience during the first Bush Administration. As a governor, he has often focused on issues of market regulation and supervision, and expressed some willingness to ease some of the structures put in place by Dodd-Frank. In general, his approach to monetary policy has aligned with the consensus. Powell has also spoken directly to the President about becoming the Fed Chair. Powell could be a good compromise for Trump regarding his views on regulation and rates and the markets would likely be relieved with a Powell nomination given he represents a steady, experienced policy official who favors the status quo on rate and balance sheet normalization.
- 3. President Trump has run lukewarm on Janet Yellen – we assign 15% odds.** As recently as the September 20 FOMC meeting press briefing, Yellen has said she and the President have not spoken directly about her renomination. That may have changed, according to press reports. The chance she would get a second term as Chair were lowered after her speech at the Jackson Hole Forum on August 25 when she defended the reforms put in place after the financial crisis as necessary and effective. Her support among financial market movers and shakers may outweigh that as many would prefer her steady leadership and reliable presence. However, Trump has said that he likes her demeanor and that she has kept interest rates low (despite harshly criticizing her during the campaign).

4. **Gary Cohn was widely regarded as the odds on favorite until recently – now we assign just a 10% chance.** His public criticism of President Trump's response to the events in Charlottesville, VA have greatly diminished his chances of being nominated. Some press reports indicate he has recused himself from consideration. That does not preclude President Trump from making the nomination since Trump previously spoke very highly of the ex-Goldman Sachs executive. Cohn's views on monetary policy are opaque, although it is presumed he would favor dismantling some or all Dodd-Frank reforms based on his previous role as co-leader of Goldman Sachs. Since Cohn is in Trump's inner circle, it is near certain they have spoken about the possibility of becoming the Chair.
5. **Stanford Professor John Taylor is the long shot at 5%.** Taylor is famous as the architect of the "Taylor Rule" which is often, almost by default, the rule that comes up for discussion in creating a rules-based approach to monetary policy. Given that President Trump seems adverse to bringing forward academics, Taylor may not be an obvious choice. But his name recognition and more conservative approach to monetary policy may appeal to Trump. The Taylor Rule has suggested that interest rates should be meaningfully higher than they currently are, so markets would view Taylor as hawkish on the rate front.
6. **Unknown dark horse – we assign a 5% chance.**

If Warsh is nominated for Chair, it could be that Fed Governor Powell is nominated for Vice Chair. Along with Randy Quarles' Senate confirmation as Fed Governor and Vice Chair of Banking Supervision today, this could place three Fed Governors in key positions to push for the roll back of financial regulations.