Jerome Powell - You’re hired

President Trump has announced Jerome Powell as the next Fed Chair. Who is he and what are the implications?

Source: Federal Reserve

Under new leadership

In what has sometimes felt like an episode of the Apprentice, Trump has bucked the trend of Presidents reappointing Fed chairs inherited from their predecessors. Instead, he's opted for Jerome “Jay” Powell, giving him a four-year term as Federal Reserve Chair starting February 2018, subject to confirmation.

In a time when there was greater bi-partisanship 64-year-old Powell was nominated to the Fed’s Board of Governors by President Barack Obama, despite being a registered Republican who had worked as Undersecretary of the Treasury for George HW Bush. He took office at the Fed in May 2012, filling an unexpired term. Two years later he was nominated for a full 14 year term.

The new Fed Chair is also a break from convention in that he is not an academic economist. He studied Politics at Princeton and Law at Georgetown and worked as both a lawyer and a banker while also spending time in private equity.

The sames, but different

As for his time at the Fed, Powell appears to be very similar to Yellen in terms of thinking and voting. So from a monetary policy perspective, the directives from the Fed's leadership are unlikely to alter markedly. He has never dissented at the FOMC meetings and is fully on board with the "gradual" increases in the Fed funds rate and the balance sheet shrinkage strategy.

Where he differs from Yellen is on banking regulation. Here he hints at a more relaxed attitude, suggesting in early October that "there is certainly a role for regulation, but regulation should always take into account the impact that it has on markets--a balance that must be constantly weighed. More regulation is not the best answer to every problem". In September he stated that the Fed's role is "one of oversight, not management".

This appears to chime with President Trump's drive to cut regulation. Trump believes that rules such as the Dodd-Frank Act have stifled bank lending while Treasury Secretary Mnuchin had suggested without such constraints sustainable GDP growth could push above 3%. With Randy Quarles, the new Fed vice-chair for financial supervision, seemingly keen to follow through with looser regulation the new management is likely to embrace slightly more aggressive lending practices.

Why not Yellen again?

Yellen's reluctance to support Trump's vision is unlikely to have helped her case for reappointment. She had warned against relaxation of post crisis reforms, arguing in August new rules made the financial system "substantially safer", adding that "material adverse effects of capital regulation on broader measures of lending are not readily apparent".

Janet Yellen already had a tough task of getting re-appointed. During his election campaign, President Trump accused her of keeping interest rates low to benefit outgoing President Obama with Trump stating "she is very political and to a certain extent, I think she should be ashamed of herself".

He subsequently warmed to her, saying she "has done a good job", but the notion that the Federal Reserve was "politicised" fuelled a campaign by some Republican lawmakers for change. One faction favoured the adoption of a "rules-based" system for setting monetary policy – a mechanistic response depending on how far inflation and unemployment are from a desired level.

This would have reined in the power and flexibility of the Fed with John Taylor and to a lesser extent, Kevin Warsh, the candidates favoured by many in this camp. It would also have likely led to a faster rate of interest increases given most Taylor models suggest the current Fed funds rate should be closer to 3% rather than 1% right now. Something that would not go down well with an electorate right ahead of next year's mid-term elections.

What does Powell mean for markets?

Consequently, Powell is seen as the safe choice. He will continue with the Fed's gradual policy tightening and adopt a softer tone to regulation, while also having bi-partisan support. As a result his confirmation hearings are unlikely to be too controversial.

Given the strong economy and jobs market, inflation pressures gradually building and Fed officials broadening out the reasons behind hiking – such as financial conditions, asset valuations and financial stability issues – we are still sticking to our view of a December rate hike. This is more than 90% priced in by financial markets with the main risk coming from the potential for an economically damaging government shutdown in the absence of agreement to raise the debt ceiling.

Under the leadership of Powell we expect two more 25bp Fed rate hikes in 2018 rather than the three the Fed have currently pencilled in. This is mainly down to the Fed's balance sheet reduction strategy doing some of the heavy lifting to tighten financial conditions, reducing the need for hikes at the short-end of the curve.

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