

Rates Spark: The Lisa Cook affair and the curve

The thing about the Lisa Cook affair is it's laced with legal grey. We make the simple apolitical assumption, from a market's perspective, that Ms Cook will be replaced. Tough to undo what's been done, and an extrapolation of these circumstances result in a steeper curve from both ends. The front end does not care. The back end cares a lot (or at least should)



Embattled Fed
Governor Lisa Cook

It's not looking good for Lisa (sorry Lisa), as tough to undo what's been done

We're not legal experts, but our basic assumption from a market's perspective is she has been fired, for cause, and will be replaced by a new governor of President Trump's choice.

The courts can of course debate whether there is "enough" cause. The falsifying of mortgage documents is possibly enough, even though it occurred before she was appointed governor. And, she is entitled to due process and a hearing, as she has a 14-year term in a government job.

In the private sector, if an "employer" does not want an "employee" it's tough for the courts to

force the issue, even if the employer is in the wrong. Here, Lisa Cook is employed by the Federal Reserve, but does not “report” to Chair Powell, so he technically can't stop this, albeit a grey area. And if he did, *he* risks getting fired, for cause.

Again, we don't know what's going to happen here. If it's deemed to be a stuck process, it could even go to the Supreme Court, and if it did, we'd have to acknowledge that that court does tend to swing right. We're still left with the basic assumption that a Cook replacement is more likely than a Cook continuation.

A steeper curve from both ends is the prognosis ahead

The reason markets are not getting too upset about this is there is a reasonable element of plausible truth to the falsifying of documents allegation, unless negated

So even if this whole affair is premised off a political agenda to make changes at the Fed, if there is an element of truth to the falsifying of documents accusation, markets can only judge based off that. But if Chair Powell were to get involved as an obstacle, say for attempting to protect Cook, and gets fired, that would be a whole different dimension. Take us there, and the market would react in a more dramatic fashion. The back end would have to discount a whole lot of uncertainty as to what it means for long-term inflation.

The front end does not care about longer term risks, as it is slavish to where the fund rate goes. By definition it has no capability to think beyond two years. But the back end is a deeper thinker, and can worry about second- and third-round effects, and especially on medium-term risks potentially being taken on inflation should the interference with the Fed be seen to be swinging policy too dovish. Part of this call reflects the potential hit to the Fed's independence, and specifically centred on the risk that the Fed might cut by too much. This is fine for the front end (2yr), but for the longer tenors the risks being taken with inflation means there is less protection for longer holdings.

A steeper curve, from both ends, is shaping up as the likely prognosis ahead. The 2/10yr curve (now 60bp) stretching to the 75-100bp zone is perfectly conceivable, and the same for the 10/30yr spread (now 65bp). That could conservatively comprise the 2yr at around 3.5%, the 10yr at 4.5% and the 30yr at 5.25%, give or take 25bp, and all over the coming few months. And it risks being even more dramatic, on both ends of the curve.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.