Who will be the new Chairperson of the US Fed?

Will US President Joe Biden extend the term of the present Chairperson Jerome Powell, or will he appoint Lael Brainard, a member of the Fed's Board of Governors? This is not simply a choice between two economists, but a political choice between them and their deeper social and political convictions

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At a highly anticipated news conference on November 3, Jerome Powell said the Fed was sticking by its bedrock economic forecast: COVID-19 will eventually fade, which, in turn, will enable supply chain bottlenecks to unsnarl.

Inflation is back at the top of the news charts in the United States with wholesale prices skyrocketing by a whopping 8.6 percent in October 2021 as compared to a year ago. The big question facing US policymakers now is whether inflation can be considered 'transitory' or is it here to stay, at least for a while? Amidst the uncertainty over inflation and the likely monetary policy response to it, there is also the big question over who will be the next Chairperson of the Federal Reserve (Fed). Will US President Joe Biden extend the term of the present Chairperson Jerome Powell, or will he appoint Lael Brainard, a member of the Fed's Board of Governors? This is not simply a choice between two economists; rather, it is a political choice between the two economists and their deeper social and political convictions.

Jerome Powell, a Republican, was nominated as Chair of the Fed by former US President, Donald Trump, replacing Janet Yellen. While Powell was in sync with Yellen on the interest rate front by choosing 'patience' over 'pre-emption', they differed on the regulation front, with Powell favouring greater deregulation in housing markets and liquidity constraints on larger firms as opposed to Yellen's call for a tighter regulatory regime. It was perhaps for this reason that Trump chose Powell, although Yellen's political affiliation to the Democratic Party may have also been a deciding factor.

All through the period between 2009 and 2019, US unemployment rates showed a steady decline from 10 percent to 3.5 percent, and although inflation did seem to pick up briefly, it never deviated too far above the 2 percent target. This led economists to question the validity of the Phillips Curve, in particular the notion of NAIRU (the non-accelerating inflation rate of unemployment), which argued for a buffer stock of unemployment as a pre-emptive step to keep wages and inflation in check. Even Powell had to concede that the Phillips curve relationship between the rate of unemployment and inflation rate had indeed become weak over the years. He was, therefore, more open to a monetary policy stand that was based on 'outcomes' rather than the 'anticipated outlook'.

Although Powell has been accommodative to the massive fiscal expansion on account of the Covid pandemic, it is important to go back to the early period of his tenure when friction developed between Trump and him. For most of Yellen's tenure, as US economic growth accelerated, inflation gradually rose steadily from around 0.1 percent in 2015 to about 2.5 percent in 2018. Yellen responded with steady increases in the benchmark Fed Funds rate, which gradually raised the effective Feds Funds rate from 0.1 percent to about 2 percent. Trump expected a more accommodative stand from the Fed for his tax cut program so that the economy could keep growing while unemployment fell. However, Powell did not oblige. The effective Feds Fund rate rose steadily, much in line with Yellen's policy stand. Moreover, Powell's policy of 'quantitative tightening (QT) on autopilot' by up to $50 billion bond sales also resulted in rising bond yields while equities took a beating. There was increasing pressure for Powell to stop contracting the Fed's balance sheet.

Trump, displeased with Powell's policies, even hurled vicious personal attacks on him. Powell ended the QT program in early 2019 but his hawkish stand on inflation became apparent, a reminder of his aggressive stand on tapering quantitative easing (QE) in 2013. This is something that Biden will be aware of even though Powell has been extremely supportive of Biden's policies in tackling the pandemic crisis.

Recent statements by Powell on inflation seem mixed. In October this year he was categorical that 'the risks are clearly now to longer and more persistent bottlenecks, and thus to higher inflation', while earlier this month he supported the government's stand that inflation was 'transitory'. On the unemployment front, Powell's remarks seem aligned with the Biden government's views. 'While monetary policy does not target any particular group of people...we are attentive to disparities in the labour market, rather than just the headline numbers … [especially of the] many who had struggled for years were finding jobs. Racial disparities in unemployment were narrowing.'

There is a strong contender emerging for the Chair of the Fed, Lael Brainard. Although critics fear her 'progressive' credentials, some dubbing her as the 'MMT [Modern Money Theory] princess' and her possible appointment as 'another Biden disaster', there is no doubt that Brainard's track record on stricter financial sector regulation, her bias towards unemployment issues rather than inflation, and her consistent apprehensions over rising inequalities will make her, politically speaking, the suitable choice for the Biden administration.

Another issue in which Brainard scores over Powell pertains to the Fed's role on the climate agenda. With the growing consensus that climate change could disrupt financial stability, Powell's dismal record of seriously addressing this globally-charged issue, and one in which Biden wants to assert the US's dominant position, will be a factor that may go against him.

There may, however, be a fear that Brainard could adopt a super-easy monetary policy so that unemployment would continue to fall and wages rise, even though she has never explicitly dismissed concerns over inflation. Roiling the markets, the adverse impact of inflation on real wages of the working class, and disrupting a nascent recovery are problems that the Biden administration may not want to contend with at this critical juncture. Here, Powell's experience and supportive monetary policy during the 2020 crisis may work in his favour.

While Biden has a tough decision to make in the days ahead, the positive outcome of this debate is that it starkly reveals the complex trade-offs involved, and more importantly, a recognition of the normative judgments and political priorities intertwined with macroeconomic policymaking.

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Views are personal and do not represent the stand of this publication.

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