

Fed Research

Powell likely to remain chair and hike twice next year

Key takeaways

- President Joe Biden has a lot of important decisions to make in coming months, which will affect the Federal Reserve.
- We expect President Biden will re-nominate Fed Chair Jerome Powell as Chair.
- We expect governor Lael Brainard will succeed Randy Quarles as Vice Chair for Supervision but Quarles may choose to stay on the board as an ordinary governor.
- We expect Richard Clarida, which term as both governor and vice chair expires soon, to leave the board. This would mean that Biden has another vacant seat to fill (besides the one already vacant) and most likely is searching for a new Vice Chair.
- President Trump nominated Powell on 2 November 2017, which was later than for Bernanke (25 August 2009 and 24 October 2005) and Yellen (9 October 2013). Hence we expect an announcement within two months.
- The Federal Reserve Banks of Boston and Dallas are both looking for a new President amid Fed trading scandal. Biden is not part of these discussions.
- Although it is important to notice in what direction the Fed goes, we do not expect major changes to how the Fed conducts monetary policy overall. The Federal Reserve is usually very consensus-based, also heavily relying on staff. That said, the shift in voting rights among regional Presidents make the FOMC more hawkish, all else equal.
- Looking at recent Fed communication, not much have changed. We still expect the Fed to announce tapering at the next meeting in November and is likely to conclude tapering in Q2 22. We expect the Fed to hike the target range twice in H2 22 (September and December).
- The blackout period ahead of the next FOMC meeting starts on Saturday 23 October.

Fed chair: We expect Biden to re-nominate Jerome Powell

The most important question is whether President Joe Biden will re-nominate current Fed Chair Jerome Powell, whose term as Fed chair expires on 5 February. Not long ago it seemed likely but the Fed trading scandal has definitely hurt Powell's reputation, see e.g. *The Hill*. It is not long ago Senator Elizabeth Warren (left-wing Democrat) called Powell a "*dangerous man*". The left-wing Democrats are not only concerned about the trading scandal but also relaxation of regulation. It is, however, not a big surprise. When Powell was approved in 2017, Warren was the only one (also among Democrats) voting against Powell's nomination in the Senate Banking Committee, see *AP News*.

We stick to our view that Biden will re-nominate Powell (which also seems like the consensus view). It was unprecedented when former President Donald Trump did not re-nominate Janet Yellen as Fed Chair and if Biden chooses someone else, it is difficult to say the central bank is as independent as before. At least all future Presidents can say it is now common practice to replace the incumbent Fed chair. Is Biden really different from Trump if he does exactly the same?

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Also Powell's approval process in the Senate would be relatively smooth, in our view. Powell enjoys support from more than half the Republicans who sit on the Senate Banking Committee (see *Bloomberg*), so Biden can afford losing some left-wing Democrats. Overall, Powell enjoys broad support, it seems.

Also Powell was nominated as Fed governor in 2012 by former president Barack Obama (while Biden was Vice President), which also makes it less controversial for Biden to re-nominate Powell. **According to *PredictIt*, there is an approximately 76% probability that Powell will be re-nominated.**

If we are wrong, the most likely successor is Lael Brainard (19% probability according to *PredictIt*). We do not believe it would change how the Fed conducts monetary policy if Brainard is nominated and approved, as Brainard and Powell have similar views on monetary policy and the economy. **Powell is likely to leave the board in this scenario, in our view, just like Janet Yellen did.**

President Trump nominated Powell on 2 November 2017, which was later than for Bernanke (25 August 2009 and 24 October 2005) and Yellen (9 October 2013). **Hence we should expect an announcement fairly soon.** Powell was approved by the Senate Banking Committee on 5 December 2017 and by the full Senate on 23 January 2018, so the full process may take as long as three months.

Fed Vice Chair: Clarida is unlikely to continue

Fed Vice Chair Richard Clarida's term as Governor expires on 31 January but it seems unlikely that President Biden will re-nominate him for another term. Although Clarida was one of the masterminds behind the Fed's new average inflation targeting regime (which Democrats overall seems satisfied with), he is under heavy fire due to the trading scandal. Apparently, Clarida sold bonds and bought stocks the day before Fed Chair Powell sent a very dovish message to markets, see *Reuters*. Senator Elizabeth Warren has already urged the Securities and Exchange Commission to look into whether Clarida (and two regional Fed presidents) violated any rules, see *CNBC*.

If Clarida is not re-nominated, President Biden has another vacant seat to fill and needs to nominate one as the next Fed Vice Chair. In our view, Clarida is one of the centrist, so we are not sure it would change a lot. On the downside, Clarida is one of the most knowledgeable policymakers at the Fed, so in that sense the "quality" may decline.

Vice Chair for Supervision: A job for Brainard?

We do not believe President Biden will re-nominate Randy Quarles as Vice Chair for Supervision (neutral-to-slightly hawkish) after Quarles term as Vice Chair expired yesterday. The Democratic Party has criticised the loosening of financial regulation under Quarles and that the Federal Reserve is not taking climate risks into account. Instead, **it seems very likely that President Biden will nominate Lael Brainard, which is also our base case (and also seems like consensus).** In this context, it is interesting that Brainard has talked about both *financial stability lessons from the COVID-19 shock (1 March 2021)* and *financial stability implications of climate change (23 March 2021)*. Brainard also discussed climate just recently in her speech "*Building Climate Scenario Analysis on the Foundations of Economic Research*" (7 October 2021).

The question is then whether Quarles will leave the Federal Reserve Board altogether or remain as an ordinary governor? Quarles term as governor expires in 2032, so nothing prevents him from staying. **Our base case is that Quarles would like to stay.** If not, Joe Biden has a new vacant seat to fill.

Fed approval process

The US president nominates Fed governors (and Fed chairs).

The nominations are confirmed by the Senate (simple majority). The first vote is in the Senate Banking Committee and the second vote is in the full Senate

Fed Chair and Vice Chair must already be members of the Board or must be simultaneously appointed to the Board.

Regional Fed Presidents are chosen by the regional reserve bank (subject to the approval of the Board of Governors)

Source:

<https://www.federalreserve.gov/aboutthefed/structure-federal-reserve-board.htm>

Vacant seat to fill

There is already a vacant seat for President Biden to fill. Given Biden's diversity agenda, it seems likely that Biden will look in another direction compared to former Presidents. **According to this *Reuters* story, Biden is considered Lisa Cook** (professor in economics at Michigan State University) who has written a lot about racial disparities. **Another option is William Spriggs** (professor in economics at Howard University and chief economist for the AFL-CIO (largest federation of unions in the US)). **Sarah Bloom Raskin, former Fed governor (2010-2014) and Treasury official, is also mentioned.**

Overall, we expect Biden will nominate dovish-to-neutral policymakers, who would be reluctant to tighten monetary policy too rapidly. That said, the Federal Reserve is usually making consensus-based decisions (also based on staff input), so in reality we do not think the policy reaction would change a lot.

It is important to say that the Fed has a quorum even if there a lot of vacant seats. *Fed's rules* define "a quorum of the Board to be a majority of the Board members currently in office, unless there are five members in office, in which case a quorum would be four members". Also the Fed "decided to amend its definition of a quorum to provide that a quorum of the Board is four members, unless there are three or fewer members in office, in which case a quorum would be all members in office" when the Fed changed the rules in 2003.

Dallas and Boston are looking for new regional Presidents

Both Robert Kaplan and Erik Rosengren (both relatively hawkish FOMC members) have resigned as Fed Regional Presidents basically because of the Fed trading scandal. This means that both Dallas and Boston Fed are looking for new regional Presidents. This process is, however, is internal within the Fed system, so Biden has no say on these nominations. The regional Feds are finding their own preferred choice (subject to approval from the Fed Board of Governors). So also here we have to get used to new faces. The most important one near-term is Boston, as the regional Boston Fed President is a voting FOMC member next year. Dallas is usually leaning in a hawkish direction, so we are not surprised if the next President is as well. Unfortunately, it is more difficult to say in what direction Boston Fed will go.

Both have interim representatives participating in FOMC meetings until the successors are found.

Shift in voting rights makes the Fed more hawkish

Next year, Loretta Mester (Cleveland Fed), Esther George (Kansas City) and James Bullard (St. Louis) are new voting FOMC members (instead of Thomas Barkin (Richmond), Raphael Bostic (Atlanta), Mary Daly (San Francisco) and Charles Evans (Chicago)). Also the next Boston Fed President is a voting FOMC member. Mester, George and Bullard are all considered more hawkish than the median Fed policymaker. **So all else equal, the FOMC becomes more hawkish next year, although we would like to emphasise once again that the Federal Reserve is very consensus-based.**

The Fed gets more hawkish, as Mester, Bullard and George become new voting FOMC members

	Voting 2021	Voting 2022
Fed governors	Powell	Powell
	Clarida	Clarida
	Quarles	Quarles
	Brainard	Brainard
	Waller	Waller
	Bowman	Bowman
	Vacant seat	Vacant seat
Regional Fed presidents	Williams	Williams
	Barkin	Mester
	Bostic	New Boston President...?
	Daly	Bullard
	Evans	George

Sources: Federal Reserve

Overview: Fed Board Changes in coming months (red highlights are important decisions near-term)

	Term start	Term expires
Jerome Powell	2012 (as governor) 2018 (as Chair)	2028 (as governor) 5 February 2022 (as Chair)
Richard Clarida	2018 (as governor and as Chair)	31 January 2022 (as governor) 17 September 2022 (as Vice Chair)
Randy Quarles	2018 (as governor, re-appointed) 2017 (as Vice Chair for Supervision)	2032 (as governor) 13 October 2021 (as Vice Chair for Supervision)
Lael Brainard	2014	2026
Michelle Bowman	2020 (re-appointed)	2034
Chris Waller	2020	2030
Vacant		2024

Note: Red highlights are important decisions near-term

Sources: https://en.wikipedia.org/wiki/Federal_Reserve_Board_of_Governors

No major changes in Fed communication after the FOMC meeting

Nothing suggests the Fed is backtracking on its intention to announce tapering in November. The September jobs report was not as strong as expected but since private payroll was higher than headline (due to a fall in government employment) and there were positive net-revisions, we expect the Fed would say the conditions for starting tapering have been met. The FOMC minutes gave us some more details on the tapering pace, as staff presented policymakers with an “illustrative path” for tapering with a reduction of USD15bn per month (although “several participants” would like a higher tapering pace, so the tapering pace is likely between USD15-20bn per month. We expect actual tapering to start in mid-November, so tapering is likely concluded in Q2 22.

The next big debate is likely when it would be appropriate to hike the Fed funds rate the first time after the FOMC members were evenly divided on whether to signal zero or one rate hike in 2022 (in the dot plot). We have included a summary of FOMC comments in the table below.

The September minutes revealed that FOMC members disagree on how to interpret the labour market development, especially why the labour force is not recovering as much as expected. This is also why there are disagreements on when to hike rates and how much, as some think there are permanent damages while others disagree. On inflation expectations, FOMC members emphasised that longer-term inflation expectations remain well-anchored but some are concerned about the rise in 1-3 year inflation expectations.

Still we have changed our Fed call now expecting two 25bp rate hikes in H2 22 (in September and December). We expect this is the beginning of a regular hiking cycle.

Recent Fed communication

	Tapering	Rate hike	Growth	Labour market	Inflation	Inflation expectations	Risks
Kashkari	"Comfortable" with tapering	Doesn't believe the Fed will need to raise rates until 2024		"It wouldn't surprise me if it takes 6-12M to get people fully back to work"	"We don't want to overreact to short-term price movements"		
Evans	Start by end-2021, finished mid or fall 2022	Zero rate hikes in 2022, one in 2023, "very gent			Inflation down to 2.1%-2.2% by 2023 (coming down when bottlenecks are addressed)	Worried inflation expectations still below 2% target	Supply shrotages finding its way into prices
Daly	Expects bar for tapering to be met by the end of the year	No rate hike in 2022					
Williams	"a moderation in the pace of asset purchases may soon be warranted"		"The recovery continues to show solid momentum", 5.5-6.0% growth this year	"There is still a long way to go before reaching maximum employment"	"I expect inflation to come back down to around 2% next year"	"longer-term inflation expectations have been relatively stable"	Not lifting the debt limit would "create a very negative dynamic"
Brainard	"Employment is still a bit short of [...] what I consider to be substantial further progress"				Expects inflation to decelerate but is "monitoring a few upside risks closely"		Delta variant has been more disruptive than expected?
Clarida	Tapering "may soon be warranted"		Economy continues to strengthen		Inflation risks to the upside but high inflation is transitory		Delta is a headwind
Powell							
Quarles							
Bowman	"it will likely be appropriate for us to begin [tapering] this year"		"remain optimistic about the ongoing expansion"	"very close toward our goal on maximum employment"			
Barkin			Demand very strong		Some of the increase in prices to prove temporary		
Harker	"soon time to begin [...] tapering"	Late 2022 or early 2023	6.5% in 2021, 3.5% in 2022 and 2.5% in 2023		Around 4% by end-21, a bit over 2% in 2022 and 2% in 2023		Persistent supply-chain issues, another COVID-19 wave and the debt limit
Waller	"Go early and go fast"	Calling for rate hike in 2022?					
Mester	"I support [tapering] in November and concluding them over the first half of next year"	End-2022		Sees full employment by the end of 2022	Inflation target has "largely been met", risks to the upside		
George	Appropriate to taper						
Bostic	"Now we can start to normalise our policies"	Liftoff in 2022, three in 2023		Not beyond full employment, still room to run	"Transitory is a dirty word", high inflation lasting longer than expected		Going to be "some uncertainty" due to COVID-19
Bullard	"I think we will go ahead with the taper in November"; end tapering in Q1 22	Two increases in 2022	Economy in great shape despite delta	Unemployment rate may be under 4% next spring	Upside risks		

Note: Green are dovish FOMC members, black are neutral FOMC members and red are hawkish FOMC members

Sources: Bloomberg and various new sources

Our Fed call summarised

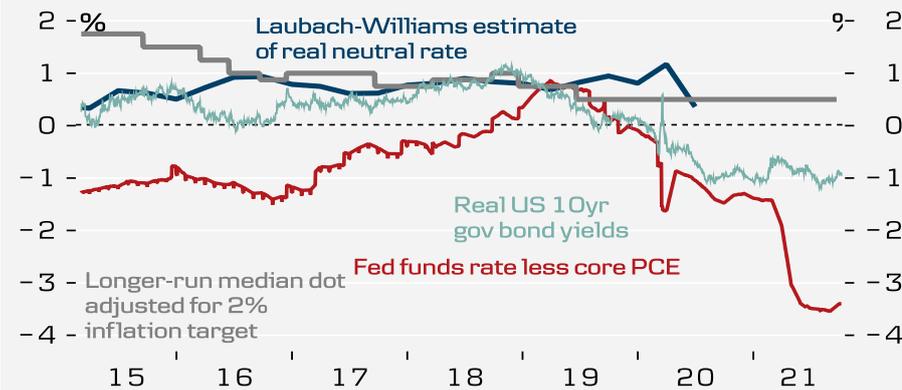
The Fed was more hawkish than anticipated at the September meeting supporting our call that the Fed is about to start a tightening cycle including both tapering and rate hikes.

We expect the Fed to announce tapering at the November meeting and for the Fed to reduce the monthly buying pace of USD15-20bn such that tapering is concluded in Q2 22.

We expect the Fed to hike the Fed funds target range by 25bp both in September and December 2022. We expect this to be the beginning of a regular hiking cycle, implying three-to-four rate hikes in 2023.

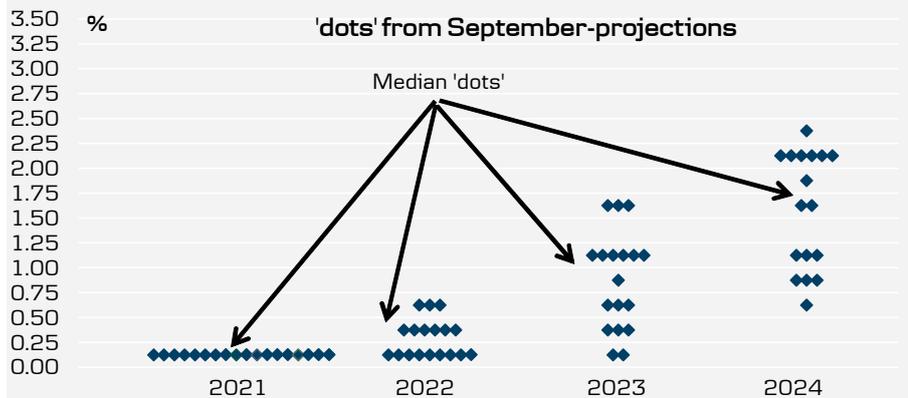
Fed charts

Monetary policy is still accommodative



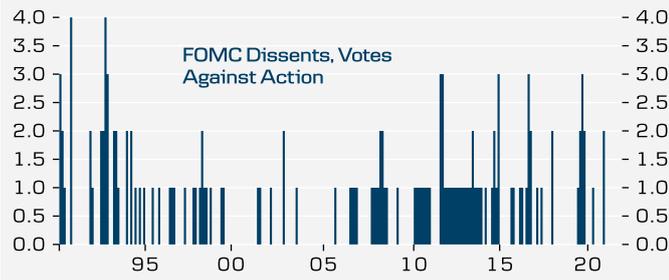
*Note: Past performance is not a reliable indicator of current or future results.
Source: Federal Reserve, Bloomberg, NY Fed, BEA, Macrobond Financial, Danske Bank*

Fed dot plot from September



Sources: Federal Reserve, Danske Bank

The FOMC members usually work by consensus



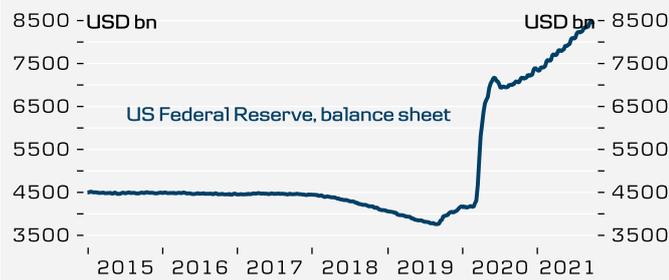
Source: St Louis Fed, Macrobond Financial, Danske Bank

Effective Fed funds rate rose after the IOER rate hike in June



Note: Past performance is not a reliable indicator of current or future results. Source: Federal Reserve, Macrobond Financial, Danske Bank

US balance sheet has been increasing rapidly



Source: Federal Reserve, Macrobond Financial, Danske Bank

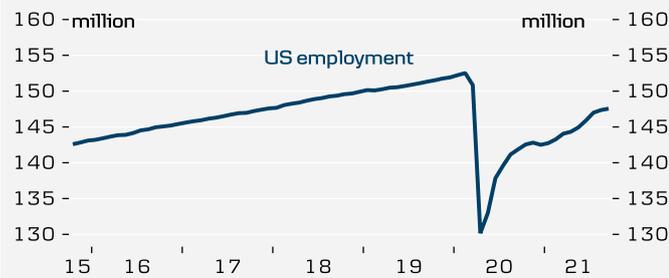
Fed is still buying USD 120bn worth of bonds per month



Sources: Federal Reserve, Macrobond Financial

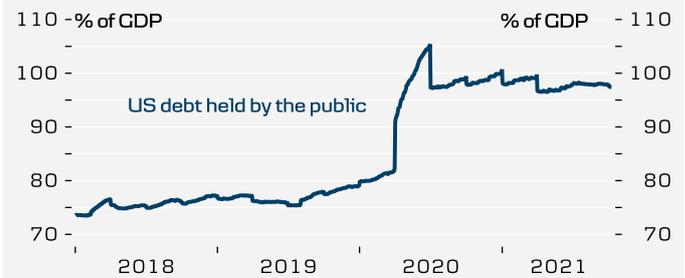
Macro charts

Employment remains significantly below pre-corona levels but jobs indicators are overall strong



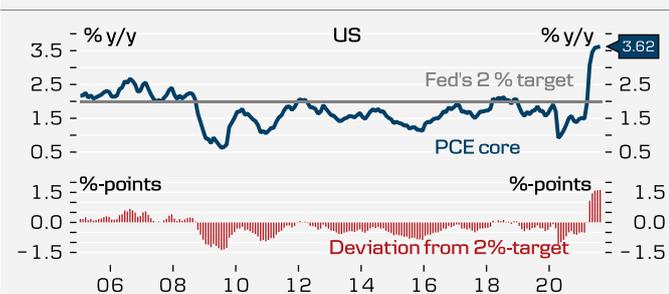
Source: BLS, Macrobond Financial, Danske Bank

US debt has been quite stable since the increase in the early days of the pandemic



Sources: US Treasury, Federal Reserve, Macrobond Financial

Very high PCE inflation



Source: BEA, Macrobond Financial, Danske Bank

Long-term inflation expectations have risen since 2020 but remain well-anchored



Note: Past performance is not a reliable indicator of current or future results. Source: Michigan, Bloomberg, Macrobond Financial, Danske Bank

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