View from the Beltway

Will Donald Trump Meet Wile E. Coyote?

By Owen Ullmann

Rubin's Rule meets Trump tweets.

President Donald J. Trump has shown no compunction about attacking independent institutions. Targets of his Twitter rage include Congress, the FBI, the Justice Department, the intelligence community, the Federal judiciary, and the news media.

So it was hardly a surprise when he took on one of the most powerful independent agencies in the U.S. government on July 20: the Federal Reserve. In doing so, he broke with a twenty-five-year-old rule observed by Democratic and Republican presidents alike to avoid public comments about Fed policy. And for good measure, Trump tweeted his displeasure with the Fed in case it didn't get the message. Senior Fed officials have been bracing for quite some time for a Trump attack; their only question was when. That's because the central bank has embarked on a path of steady interest rate increases to keep a hyper-stimulated economy from overheating and causing an outbreak of inflation. At its August 1 meeting, the Fed signaled its intent to keep raising rates.

For Trump, the Fed's policy course is looking increasingly perilous in 2020, when he would be up for reelection. Today, he is benefitting from a Goldilocks economy that is about as good as it can get. Growth is moderate, unemployment is extraordinarily low, and inflation is tame.

That virtuous cycle is unlikely to last much longer, according to most economic forecasts. The Fed is likely to accelerate the pace of its hikes to offset the stimulative effect of the $1.5 trillion tax cut and $300 billion spending increase Congress passed last fall. Meanwhile, the yield curve has been flattening and is close to inverting, a strong indicator of a coming recession.

Ben Bernanke: "In 2020, Wile E. Coyote is going to go off the cliff."

All that fiscal injection "is going to hit the economy in a big way this year and next year," former Fed Chairman Ben Bernanke observed during a policy discussion in June, just weeks before the government reported that GDP rose 4.1 percent in the second quarter, the fastest growth since 2014. "And then in 2020, Wile E. Coyote is going to go off the cliff," he said, referring to the Road Runner's nemesis in the cartoon series.

As predicted, Trump seized the opportunity to bash the Fed when asked in an interview with CNBC about interest rate policy. He began by praising Chairman Jerome "Jay" Powell, whom Trump appointed to succeed Janet Yellen, as "a very good man." Then he blasted the Fed's rate increases. "I'm not thrilled because we go up and every time you go up, they want to raise rates again … I'm not happy about it." He singled out for concern the strengthening of the dollar, which hurts his push to expand U.S. exports and reduce the U.S. trade deficit. He ignored the fact that the dollar has been rising because the American economy is so strong.

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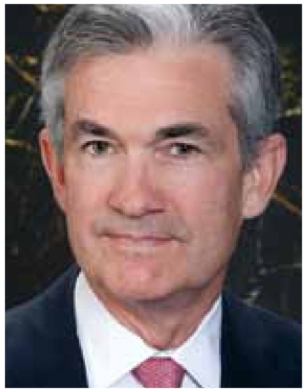
The pressure is on Fed Chairman **Jerome Powell** *to try his hand at a soft landing to keep the current expansion going without letting inflation get out of hand. If successful through mid-2019, Powell would oversee the longest continuous period of growth in U.S. history, surpassing the Greenspan expansion of the 1990s.*



Trump acknowledged in the interview that he was breaking with established policy in criticizing the Fed but, true to form, was unapologetic: "Now I'm just saying the same thing that I would have said as a private citizen. So somebody would say, 'Oh, maybe you shouldn't say that as a President.' I couldn't care less what they say because my views haven't changed." And in typical Trump aggrandizement, he said that despite his unhappiness with the Fed's rate moves, "I'm letting them do what they feel is best," ignoring the fact that he has no authority over what the central bank does.

Numerous current and past Fed officials had predicted just such comments from a man who has described himself as a "low interest rate" advocate and always speaks his mind, damn the consequences. None would dare comment on the record for fear of sparking his fury, but they all see a growing collision coming, as interest rates rise, a stronger dollar slows export growth, and financial markets react nervously to his willingness to stoke a global trade war.

"It doesn't take a huge imagination. This is a President who would go after his own attorney general, individual companies, the prime minister of one of our closest allies, so why would the Federal Reserve think it would be exempt?" confessed one source close to top Fed officials.

Many presidents have challenged the Fed's independence in past decades with mixed success. In late 1965, Fed Chairman William McChesney Martin Jr. had pushed through a hike in the discount rate to keep inflation from breaking out because of all the fiscal stimulus from increased spending on the Vietnam War, Johnson's "Great Society" domestic agenda, and a tax cut passed the year before. An enraged President Lyndon Johnson summoned Martin to his Texas ranch, where he was recovering from gallbladder surgery, and publicly chastised the Fed chairman for taking advantage of him while he was ill. Despite the intimidation, Martin stood his ground.

Martin's successor, Arthur F. Burns, proved to have less backbone. The Nixon tapes reveal that the president pressured Burns to goose the economy in advance of Nixon's 1972 re-election campaign by keeping rates low even though inflation was posing a growing threat. Nixon, who had appointed Burns, bullied him by leaking false stories that Burns was seeking a big pay increase and that Nixon planned to expand the size of the Board of Governors so Burns wouldn't be able to control it. Burns caved and later tried to blame the subsequent outbreak of inflation on Nixon's loose fiscal policy.

In more recent times, presidents have been more respectful of the Fed's independence. Ronald Reagan backed Paul Volcker's assault on double-digit inflation in 1981 even though the result was a deep recession. The harmony didn't last. In 1986, Volcker clashed with four Reagan appointees on the Board of Governors who wanted to cut the discount rate over his objections. Volcker prevailed, but the dispute contributed to his decision to step down at the end of his second term in 1987, and Reagan made no effort to dissuade him.

Volcker's successor, Alan Greenspan, clashed repeatedly with officials from George H. W. Bush's administration, particularly Treasury Secretary Nicholas F. Brady, who complained openly that the Fed's monetary policy was too restrictive. Bush also sent Greenspan a message of presidential displeasure by delaying Greenspan's reappointment to a second term. Bush later blamed Greenspan's aggressive rate actions for his re-election loss to Bill Clinton in 1992 because of a weak economic recovery.

When Clinton took office, his director of the National Economic Council, former Goldman Sachs Co-Chairman Robert E. Rubin, insisted that all members of the administration respect the independence of the Fed and refrain from any public comments on its conduct of monetary policy.

That policy became known as Rubin's Rule, which he continued to enforce when he became Clinton's Treasury Secretary. It has been followed with nary an exception ever since, including by George W. Bush's and Barack Obama's administrations.

Until the CNBC interview, Trump and his appointees abided by Rubin's Rule. Trump's first director of the National Economic Council, Gary Cohn, made a point of avoiding any criticism of the Fed, but his successor, Larry Kudlow,

GAGE SKIDMORE

National Economic Council Director **Larry Kudlow** *shares Trump's low-interest-rate views. "Just let it [the economy] rip, for heaven's sake," Kudlow said in an interview on CNBC in March, a few weeks before officially assuming his White House post. "The market's going to take care of itself. The whole story's going to take care of itself. The Fed's going to do what it has to do, but I hope they don't overdo it."*

feels differently and shares Trump's low-interest-rate views. "Just let it [the economy] rip, for heaven's sake," Kudlow said in an interview on CNBC in March, a few weeks before officially assuming his White House post. "The market's going to take care of itself. The whole story's going to take care of itself. The Fed's going to do what it has to do, but I hope they don't overdo it."

Kudlow has a point. The Fed is hardly infallible in its forecasts or conduct of monetary policy. "Fed forecasts are filled with a lot of mistakes," conceded a former senior Fed official. "We didn't see the depth of the crash in 2007, the recovery was slower and shallower than we expected, leading to several rounds of QE [quantitative easing]. Until recently, the Fed was wrong about growth and the slowdown in productivity. Its forecasting record is pretty crappy—but no worse than anyone else's."

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Achieving the proverbial economic "soft landing" also is elusive for the Fed, which more often than not has kept rates too low for too long and then overreacted with too many rate hikes. Critics blame both the 2000 dot.com bubble bursting and the 2007 financial crash on the Fed for running an overly accommodative monetary policy. And in retrospect, Greenspan probably was too restrictive in fighting inflation during the elder Bush's presidency.

Now the pressure is on Powell to try his hand at a soft landing to keep the current expansion going without letting inflation get out of hand. If successful through mid-2019, Powell would oversee the longest continuous period of growth in U.S. history, surpassing the Greenspan expansion of the 1990s.

Powell, who has a long record of distinction and integrity in government service, pledged at his Senate confirmation hearing last November to maintain the Fed's independence as it tightens policy in advance of the crucial 2018 midterm elections and the presidential election two years later.

"I'm strongly committed to an independent Federal Reserve, and I would add nothing in my conversations with anyone in the administration has given me any concern on that front," he declared. "I just would plan, if confirmed, to follow in the footsteps of distinguished prior chairs and of our long tradition, really, to assure that we do conduct monetary policy and financial regulatory policy, by the way, without a view to political outcomes but with a view solely to the right answers."

In a prescient interview a week before Trump's outburst, Powell reaffirmed the Fed's independence. "We have a long tradition here of conducting policy in a particular way, and that way is independent of all political concerns," he told *Marketplace* host Kai Ryssdal. "We do our work in a strictly nonpolitical way, based on detailed analysis, which we put on the record transparently."

Indeed, pressure from Trump is sure to be futile because the Federal Open Market Committee that sets monetary policy would refuse to change course for political reasons now that it is more open than in the past about its forecast for rate increases. In fact, Trump tirades may only stiffen Fed resolve to act independently.

Trump's criticism "risks undermining public confidence and makes the Fed's job harder," predicted one Fed insider. "We would take the high road and the public punches. But we won't change course."

Pressure from Trump is sure to be futile.

That is why other recent administrations decided to avoid second-guessing the Fed: Jawboning would only hurt them by roiling markets without achieving any policy change.

Such reasoning is unlikely to persuade Trump to keep silent. He defied his economic advisers in siding with his political base over the markets by imposing tariffs on top trading partners and risking a trade war and the loss of U.S. factory jobs. Bashing the Fed would also be popular with Trump's supporters who view the central bank as part of the Washington establishment they despise.

So with two more Fed rate increases scheduled for 2018 and another four likely in 2019, count on a torrent of Trump invective against Powell and Co. over the next two years. It's only going to get uglier. ◆