Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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The profound differences between the Trump and Biden Administrations obscure a still more fundamental shift in the power balance: many Democrats have abandoned the centrist – some would say corporatist – policies of the Clinton and Obama Administrations. No one epitomizes this transformation better than Senate Banking Chairman Brown and thus no institution is under more political pressure than the Federal Reserve. Sen. Brown has a five-point mandate for the U.S. central bank, one that would redesign not just central banking, but also financial regulation. A divided Senate means he can't enact it, but Sen. Brown's powerful position still means he can insist on it.

In his opening statement at the February 23 hearing, the Senate Banking chairman laid out five missions for the Federal Reserve: ensuring that "the biggest banks" use their capital for community investment and worker protection, making sure that the Fed's responses to crises don't just help "Wall Street," requiring financial institutions to take climate risk into account, helping everyone have access to funds and a bank account, and undoing systemic racism and making workers the central focus of the U.S. economy.

This is a radical rewrite of the dual mandate, comprising as it does a set of standards to which Sen. Brown and other progressives will now hold the Federal Reserve accountable not just in occasional rhetoric, but in day-to-day decisions. Taking each one of Sen. Brown's commandments in turn shows how these demands will force action.

First, the injunction that banks use their capital for the public good echoes many recent demands not just from Congress, but also from shareholders. Mr. Brown's edict espouses a version of stakeholder capitalism, one many banks adhere to in broad scope but fall short of when measured against what stakeholder-capitalism advocates actually expect. In JPMorgan's case, nothing short of corporate conversion into a public benefit corporation will do.

It's most unlikely that privately-held banks will recast their charters solely for the public good, but Sen. Brown's mission statement puts considerably more pressure on banks to demonstrate their equality and equity benefits. Boilerplate discussion about economic growth and community service clearly won't cut it – the chairman wants tough policy from the Fed and hard facts from the banking system, and he wants all of this now. Expect the next round of quarterly earnings and capital-distribution announcements to trigger not just tirades, but also to-dos. Equality Banks along lines I've outlined before could well be part of the answer.

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Even more potent is Sen. Brown's second mission statement: crisis rescues for the real economy, not the financial system. Here, I stand with the chairman, detailing in my new book how repeated Fed interventions to safeguard financial markets have done little but exacerbate U.S. wealth inequality. The Fed wants far broader authority to use its 13(3) emergency-liquidity authority; expect any future facilities to face sharp questioning about who really benefits.

Democrats don't like these interventions because they favor markets and Republicans such as Senate Banking's Ranking Member, Patrick Toomey, don't like them for very similar reasons. An alliance between progressives and conservatives is a potent political force.

The climate-risk point is of course all the rage. Mr. Powell told both Senate Banking and House Financial Services that data are insufficient for effective risk disclosures, let alone for anything beyond tentative scenario analyses. We expect the SEC to push the climate-risk point hard, giving the Fed an out for at least a while as it works on scenario analyses. Don't, though, expect pressure to let up on big banks with a hankering for fossil-fuel borrowers. The Fed's advance notice of proposed rulemaking we forecast late last year will soon be upon us.

The point about bank accounts and the Fed's role is clearly about the legislation Sen. Brown introduced in the last Congress creating "FedAccounts." Mr. Powell was cautious about central bank digital currency (CBDC), let alone anything as ambitious as FedAccounts. The central bank's payment-system outage shows the operational risks inherent in single-point infrastructure and even strong CBDC advocates may thus give the Fed some breathing room. However, it won't be much and it won't be for long, especially if FedNow limps along the way to implementation sometime, somehow.

And, finally, the fifth mandate: racial equity and worker opportunity. This is a double-barreled demand for the Fed to do more than just show it cares – it's doing that apace all of a sudden with new talk about distributional unemployment data. Nor is this all about the lack of diversity within the ranks of Fed officials, about which Mr. Powell was suitably chastened. Instead, this is a demand for an activist Fed that sets policy with an eye not just to data about distributional impact, but also with the goal of doing something to fix it.

As Mr. Powell reiterated earlier this week, the Fed has long said that monetary policy may be distributional, but none of this is its fault and fiscal policy must clean up any debris the central bank leaves behind. In fact, the Fed has policy tools readily at hand that would equalize policy without undue market disruption. Senator Brown is not the only official putting the Fed on notice, but he's one with a bully pulpit and a very large gavel. Democrats are willing to give the Fed a break because they respect the central bank and like Mr. Powell. But that's all they'll give the Fed – a short break to show it does more than care before Mr. Brown's five mandates turn into five demands not just of the Fed, but also of the financial industry.