Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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Much recent coverage assumes that the Federal Reserve is a vestal virgin when it comes to presidential elections. In fact, history teaches us that the Fed is far from virginal even though it always slaps the hand of anyone trying to pet it in public. This peek-a-boo strategy works only as long as policy-makers and the public accept this spotless image. Increasingly, they don't and not without cause. The 2024 election will thus test the credibility of Fed "independence" and threaten it as never before.

How political is the Federal Reserve? First, all Fed chairs are political because they would not be Fed chairs if they were not also adroitly able to advance themselves and, when it suits, also their institutions. The best-skilled among them play politics with gusto since doing so behind the wizard's curtain brings considerable reward even as a pristine image keeps unwelcome suitors at bay. When this works as it often does, Fed chairs execute the monetary policy they prefer and drop wise words in receptive ears even as they demurely disavow any political thoughts on awkward fiscal- or national-policy questions when queried in the public's eye.

This nimble strategy was widely adopted After the Fed chair in the early 1970s, Arthur Burns, delayed anti-inflation measures to keep interest rates low enough to boost Richard Nixon's prospects. These decisions were transparent and brought out virulent Democratic opponents of the Fed even before Mr. Burns' diary confirmed his political bent, damaging Fed credibility.

The "Maestro" Alan Greenspan assiduously built on Paul Volcker's studied political indifference, closely guarding his thinking. Still, George H. W. Bush believed Mr. Greenspan's tight monetary policy cost him his second term. Whether Mr. Bush was collateral damage or was actually Mr. Greenspan's target is unknown, but Mr. Bush was still a casualty. During Mr. Bush's son's term as president, Mr. Greenspan was far more careful to suggest – but never quite say – that he stood with George W. Bush, thus ensuring reappointment until Mr. Greenspan decided to step aside.

Assertions about Fed political ambitions also swirled in the 2008 race, with Chair Bernanke's policy suspect because it took the central bank so long to realize how dire the great financial crisis would become and lower rates. My own view here is that Mr. Bernanke was demure not because he was apolitical, but because he knew that whatever the Fed did if it did more than a little would be deemed political, not dispassionate economics. Still, failing to act due to political risk to the Fed is as political as acting to advance a candidate. All it is is harder to discern.

Now, Fed avowals of its wholly apolitical nature – implausible at the best of times – are running into a buzzsaw. Donald Trump is not exactly a fan of the political restraint necessary to keep the Federal Reserve out of the political fray. He uses what comes in handy and it was handy for him in 2016 to attack the Fed for keeping rates too low and then in 2018 for starting to raise them. Joe

Biden has carefully modulated his economic comments to make it clear that he respects Fed independence even though Fed policy might cost him the election. Will he stay within the boundaries set for him by Fed alumnae Yellen and Brainard? We shall see, but I doubt it.

Even if both presidential candidates hold back, it's more than clear that Fed policy isn't making the U.S. economy a comfy place for an incumbent. As I've written elsewhere and the *Washington Post* catalogued last Sunday, Americans aren't focused on the statistics that make Mr. Biden and his team happy, they are focused on high prices and how hard it remains for most of them to get by.

There is thus simply no way for the Fed to hunker down in its 20th Street fortress and wait the election out – Mr. Trump will surely make it a target and Mr. Biden may be forced to do the same. The Fed is in fact a sitting duck because it won't take much to rouse voters -- American populists and progressives have long deeply distrusted the central bank. The more Mr. Trump can tie Joe Biden to an edifice many believe to be Wall Street's second headquarters, the better for Donald Trump.

What does this mean for 2024 monetary policy? Duck and cover – the Fed will do anything it does gently and even over-cautiously if meaningful rate reductions are planned after the middle of next year. Rate hikes seem unlikely, but the Fed will be especially averse to them if inflation spikes after mid-year to stay out of the political bulls-eye. Similarly, lower rates will come slowly after mid-year to preserve the ever-virginal façade. The mid-year equivalent of a blackout zone results from the fact that most Americans won't pay much attention to the election until summer at the soonest.

What about regulation? Here, the Fed, FDIC, and OCC will not hold back. The central bank's political vulnerability derives from monetary policy and its macroeconomic impact no matter how much Members of Congress talk about capital or other rules. Quite simply, neither candidate will win because the Fed changed its stand on operational-risk scaling factors or even credit risk weightings for mortgages and small-business loans.

But even tough new rules could become a political target if Mr. Trump fires on them. Last week, Mr. Trump called the economy during his watch "the greatest economy in history." As with so much else, that's not exactly true, but that doesn't matter to Mr. Trump. He will surely say this over and over again to draw a sharp contrast between increasingly rosy memories of his slow-growth era and the far more acute financial insecurity most American households now experience. If the banking agency rules catch his fancy, Mr. Trump might also level accusations that the White House and its Fed hench-people are favoring Wall Street at the expense of average households. That's not exactly what the agencies or most bankers think the rules do, but what does that matter in this viral era?