The What Keeps Me Up Department:
Trump II and Global Systemic Risk

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Remarks Prepared for the
Annual ACTUS Conference
Washington, D.C.

May 15, 2024

- Markets demand certainty, but Donald Trump engenders volatility and often seems even to enjoy it. This might not end well.
- No one now is talking about what a Trump Presidency could do to systemic stability. They should – it's a lot.
- The Fed is uniquely vulnerable to significant loss of independence, with sure and certain personnel changes adding monetary-policy volatility and regulatory rollbacks to the systemic cauldron.
- The Fed and FDIC's ability to provide systemic backstops could be sharply curtailed. So many backstops have increased so much moral hazard that sudden loss of emergency liquidity or systemic resolutions could have grievous consequence.
- Universal trade tariffs are likely to fragment global finance, ring-fencing capital and liquidity flows and putting vulnerable nations at greater risk. Sovereign risk has clear systemic consequence from which the U.S. is not immune.
- Pulling the U.S. out of the global construct of multilateral financial institutions and standard-setters puts still more stress on U.S. systemic buffers, many of which could be eroded or eliminated over the next four years.

Thanks, Allan, for inviting me to talk today about the systemic risks that keep me up. There are more than a few, but most are the focus of a good deal of attention so I thought it might be helpful instead to highlight a risk that, to my knowledge, has attracted no public attention but warrants a lot of thought ahead of November 2024: how another Trump term would affect the foundational premises on which global finance rests. I know we made it through Mr. Trump's first term without incident related to his policies, but I'm not so sure that will be the case this time around.

But, before I say why I fear possible disruption, let me make it as clear as I can that I am not saying that Donald Trump will attack systemic stability or that money will run for the hills should he again win the White House. Like you, I've my own views on who should lead the nation, but I've tried to the greatest extent I can to leave them out of this talk. What I'll do is look at what is known about Mr. Trump's plans for decisions that have far-reaching financial-market impact, laying out what these plans are, what they might do to whom, and how external macroeconomic or geopolitical circumstances could affect the outcome of these policies – it may be America First, but there are an awful lot of runners-up with a good deal of clout.

I need also to point out that many consequential actions the Trump Administration may take to rollback current rules or Biden policies could have significant national and even strategic impact on U.S. financial institutions but no systemic impact. For example, rewriting the Community Reinvestment Act or even repealing it if Congress turns red has significant community-development impact, but little systemic consequence. Similarly unsystemic are banning a CBDC or repealing a raft of Biden ESG and racial-equity initiatives or consumer protections. I personally think we'll miss them, but that's a different matter.

And let's not forget that personnel is policy. If Mr. Trump relies on more established advisers as he mostly did the last time around, then proposals now under active campaign debate could retreat to the ideological sidelines. If not, not and watch out.

Taking all this into account, what might Mr. Trump do with near-term systemic consequence? Here's a quick run-down of some of the most immediate risks based on some of the most recent comments from Mr. Trump and his advisers.

Bedeviling the Fed

Press reports indicate that Mr. Trump's advisers are considering ways to reduce or even eliminate the Fed's independence.[1] This has the ring of more-than plausibility to it given how furious Mr. Trump was when his own choice to head the Fed, Jay Powell, raised interest rates even a little bit for a very short, but politically-inconvenient, period of time. The President has few levers to pull to squash Fed independence, but he does get to name names that a GOP-controlled Senate will be far more eager to confirm. Jay Powell's term as Chair ends in 2026, Vice Chair for Supervision Barr's term as such also ends in 2026, and Vice Chair Jefferson's term in the position ends in 2027. All can stay longer on the Board of Governors, but any resignations give more seats for Mr. Trump to fill as well as to find a governor to his liking from those remaining. Most now on the board are inflation hawks and politically-independent enough to stay that way, but what of others?

And, at the least, Fed supervisory policy would undergo a radical rewrite. There are numerous areas where I think this beneficial, but go too far and we've gone over the edge. See 2008 for a reminder.

A red Congress could also go considerably farther, handing the White House new tools with which to control the Fed. In my view, the Fed is now uniquely vulnerable to renewed attack because its monetary-policy record is spotty and its new "data-driven" methodology smacks more of uncertainty than any underlying methodology. Indeed, even the Federal Reserve knows it needs a new model for crafting monetary policy.[2] Congress might save it the trouble, mandating a "Taylor Rule" or similar hard wires. Would these work under stress? I hope we don't have to find out the hard way.

Where's the systemic risk? Monetary-policy uncertainty or, worse, misfires have significant systemic impact unless volatility remains within manageable guardrails. This is harder and harder to ensure as fixed-income markets grow ever more illiquid. Throw in an even bigger U.S. deficit and this gets even scarier.

Systemic-Crisis Intervention

What's more, it's important to remember that the Federal Reserve now needs Treasury approval before dispensing emergency liquidity other than through the discount window or certain other bank-specific facilities. Would a Trump Treasury Secretary concur? It depends.

Congress could also be considerably more inclined to curb the Fed's emergency-liquidity powers. This is a perennial target for both conservative Republicans and progressive Democrats.[3] I am no fan of the way the Fed has used its emergency-liquidity powers – these are all too often reflex-action bailouts that exacerbate moral hazard, but there are times the Fed should step in and Congress may forget to ensure this if it redesigns the Fed's 13(3) powers.

And what might happen if a systemic entity faltered? The Dodd-Frank Act created an orderly liquidation authority (OLA) for these scenarios, authority it hoped to temper by requiring the FDIC to be sure it has agreement from Treasury in consultation with the President and the FRB. Would Donald Trump concur? In my view, he's the ultimate pragmatist and knows a systemic meltdown isn't good for his image, but then again, these interventions are decried by free-market advocates, many of whom are likely to surround him. And, if markets worry about Mr. Trump's thinking, they'll run as fast as they can no matter what he chooses to do.

Global Market Fragmentation

Press reports also indicate that Trump advisers are considering a new "universal tariff" that would end the most-favored-nation status and generally resurrect something akin to the Smoot-Hawley isolationist trade policy some believe helped precipitate the Great Depression.[4] I will leave for others the discussion of whether the U.S. supply chain is robust enough to handle universal tariffs without severe macroeconomic disruption, but I can assure you it would lead to significant financial-system strain even if the new tariffs do not officially extend to trade in services.

The reason is that nations facing trade-in-goods barriers will quickly roll up the welcome mat for cross-border finance, doing so not only by forcing subsidiarization of host-country financial activities, but also increasing the barriers to the transborder payment and information flows essential to smooth market function. Ring-fencing of financial-company activities creates barriers to cross-border capital and liquidity flows that may protect a host-country operation or endanger it – circumstances dictate how this would work in practice, but significant experience makes clear it is highly risky and then some.

Emerging-market economies are particularly starved of key financial services because the cost of maintaining subsidiary banks often proves prohibitive. Emerging-markets economies robbed of cross-border flows are emerging market economies that will be even harder pressed to ensure liquid access to dollar funding and thus the uninterrupted bond payments essential to financial stability under stress. Emerging-market economies succumbing to stress are emerging-market economies that can and have caused financial crises. And there are lots of countries that aren't emerging-market economies – think Greece – where the same is true with still more systemic impact.

If America-First trade policy also leads the U.S. to withdraw from multilateral financial institutions, then U.S. influence in crises will erode and there will be still more pressure on the Federal Reserve to preserve global stability through central-bank borrowing facilities or even foreign-exchange intervention. Would a Trump Administration Federal Reserve agree to intervene, especially if a red-hued Congress picks up the complaints about prior central-bank facilities already voiced in recent months in the House?[5] And, as noted, Mr. Trump might block the Fed's ability to provide emergency liquidity or bar OLA resolution, making the U.S. still more vulnerable to global financial-market instability.

Race to the Bottom

If Donald Trump takes the U.S. not only out of the World Bank and IMF, but also out of NATO as occasionally threatened, then his Administration may not have time to also take the U.S. out of the array of global financial standard-setters that have tried to bring order out of self-interested cross-border competition since the late 1980s. But, there are a lot of Republicans who think he should and the global standard-setters' record is far from convincing. But, like the United Nations, the Financial Stability Board and its offspring help to keep order and enhance transparency. Would pulling out of them cause a systemic crisis? No, but it sets a precedent that frees other nations to protect their banks and further fragment global finance under fewer and fewer rules that encourage more and more finance in safe-haven states for high-risk practices. That's not for the greater good.

Inequality and Instability

Finally, Trump trade and fiscal policies could prove highly inflationary.[6] Inflation is hardest on lower-income households, as are the high rates the Fed uses to reduce it.[7] The more inequality, the more financial instability because fragile households are often awash in debt from eager lenders – many outside the reach of safety-and-soundness and consumer-protection rules. Fragile households in greater numbers enabled by more and more financial assets across the global financial system means it's more and more likely that even small amounts of macroeconomic or financial-system stress can quickly turn toxic.

Been there, done that, and let's not do it again.

There are other possible Trump II risks to note even if they don't necessarily force midnight wakefulness. What happens to the dollar-dominated payment system if Mr. Trump scrambles sanctions, releasing those on Russia and imposing new ones on China? How risky is a crypto-friendly regime without federal safeguards? How volatile will cross-border finance become as Mr. Trump picks new friends or enemies as circumstances seem to him to warrant, especially if global buffers and Fed shock-absorbers are eroded or eliminated? Trump I was chaotic, but largely economically and financially stable even after the pandemic threw the world into the great unknown because the U.S. more or less stayed within the global construct. Will it the next time crisis comes calling?[8]

[1] Andrew Restuccia, Nick Timiraos, and Alex Leary, "Trump Allies Draw Up Plans to Blunt Fed's Independence," *WSJ*, (April 26, 2024) https://www.wsj.com/economy/central-banking/trump-allies-federal-reserve-independence-54423c2f.

[2] Federal Reserve Governor Bowman, "Brief Remarks on the Economy and Monetary Policy," (speech, Key Biscayne, FL, May 3, 2024) https://www.federalreserve.gov/newsevents/speech/bowman20240503a.htm.

[3] See for example the Bailout Prevention Act of 2015, S. 1320, 114th Congress (2015) https://www.congress.gov/114/bills/s1320/BILLS-114s1320is.pdf.

[4] Jeff Stein, "Trump advisers explore vast new legal powers for global trade war," *Washington Post*, (May 7, 2024) https://www.washingtonpost.com/business/2024/05/07/trump-trade-war-tariffs/.

[5] See for example Lender of Last Resort: Issues with the Fed Discount Window and Emergency Lending: Hearing before HFSC, 118th Congress (February 15, 2024) (opening remarks of Chairman Andy Barr) https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=409146; The Federal Reserve's Semi-Annual Monetary Policy Report: Hearing before HFSC, 118th Congress (March 6, 2024) (remarks of Rep. Davidson) https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409159.

[6] Bloomberg Editorial Board, "You Won't Like Trumponomics 2.0," *Bloomberg*, (May 14, 2024) https://www.bloomberg.com/opinion/articles/2024-05-14/election-2024-trump-economic-outlook-is-more-inflation-less-sanity?sref=BSO3yKhf.

[7] Aparna Jayashankar and Anthony Murphy, "High Inflation Disproportionately Hurts Low-Income Households," *Federal Reserve Bank of Dallas*, (January 10, 2023) https://www.dallasfed.org/research/economics/2023/0110#:~:text=Low%2Dincome%20households%20most%20stressed,few%20ways%20to%20reduce%20spending%20.

[8] Karen Petrou, *Engine of Inequality: The Fed and the Future of Wealth in America,* (New Jersey: John Wiley & Sons, Inc, 2020) https://fedfin.com/engine-of-inequality/; and Anni T. Isojaervi and Sam Jerow, "Inequality and financial sector vulnerabilities," *FRB FEDS Notes*, (April 19, 2024) https://doi.org/10.17016/2380-7172.3482.