President Trump vs. Jerome Powell: Trump's problematic messaging to the Federal Reserve

By David Parkinson
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If you wanted to cook up a recipe for inflation, you couldn't do much better than the one U.S. President Donald Trump has concocted in the past year.

First, deliver a huge tax cut to an economy that's already running at full speed and full employment, thus juicing demand when the economy has little spare capacity to meet it. Do this at a time when your federal budget is already running a large deficit, plunging your government into a deep fiscal hole.

Next, impose tariffs on an ever-widening range of imports from major trading partners, pushing up costs of those goods for U.S. consumers.

Finally, turn up the heat under that mixture by denouncing your central bank and making veiled threats at its boss for raising interest rates to keep a lid on the inflationary forces that you're eagerly stoking.

In an interview with The Washington Post, Mr. Trump launched an attack on the Federal Reserve and its chairman, Jerome (Jay) Powell, that would have been unprecedented and deeply disturbing had it come from any other president. (For Mr. Trump, we call that "Tuesday.")

"So far, I'm not even a little bit happy with my selection of Jay. Not even a little bit," the President said of the man he hand-picked for the job a year ago. "And I'm not blaming anybody, but I'm just telling you I think that the Fed is way off-base with what they're doing."

"I'm doing deals, and I'm not being accommodated by the Fed," he said.

It's not the first time the President has criticized the central bank, but it's the latest and strongest in what has been a week of escalating attacks against it. Mr. Trump's own measure of the success of his presidency hinges on maximizing economic growth and stock-market returns. He has decided that the Fed stands in the way of both.

But what the Fed truly stands in the way of is the President's most self-destructive impulses. Its monetary policy is effectively designed to lean against an economy that has been over-stimulated by raising rates to stabilize growth and cool prices. That's the Fed's job, and it was long before Mr. Powell took the reins. The President has his own policies to blame for turning up the pressure for the Fed to act.

The Fed is also supposed to operate independently of the government, immune from political influence. Other presidents have respected this division of economic powers. Mr. Trump is not other presidents.

If Mr. Trump didn't already have a reputation for spouting off in decidedly un-presidential ways, this might have sent shock waves through financial markets. But the markets shrugged off the comments.

They paid more heed to a speech from Mr. Powell on Wednesday, in which he said that the Fed's benchmark federal funds rate, at its current range of 2 per cent to 2.25 per cent, is "just below the broad range of estimates" for the so-called "neutral" interest rate – the level that neither accelerates nor slows economic growth. The markets interpreted this as a signal that the Fed is near the finish line in its rate hikes; the U.S. dollar and bond yields declined accordingly.

This was probably a misinterpretation of Mr. Powell's comments. Members of the Fed's policy-setting committee have estimated the neutral rate as anywhere between 2.5 per cent and 3.5 per cent – which means that the federal funds rate is, indeed, only another couple of quarter-point hikes away from entering that range. Mr. Powell was merely repeating this.

The timing was unfortunate, given that it seemed – at least to the casual eye – to accommodate Mr. Trump's concerns. But what's more likely is that the Fed will irritate the President further before it's done.

The midpoint of the Fed's neutral range is 3 per cent, and Mr. Powell has previously suggested that the central bank may have to go beyond neutral to cool the U.S. economy, which, with unemployment at a half-century low, has almost certainly overheated somewhat in this cycle. A federal funds rate of 3.5 per cent is certainly not unrealistic – meaning another five or six quarter-point hikes may still be in store.

Perhaps the bigger concern is that Mr. Trump's displeasure might push him to replace Mr. Powell. The President does have the power to fire a Fed chair "with cause," although most experts believe "cause" would probably have to be criminal, not merely a disagreement on policy. But anyone who has been watching the Trump presidency wouldn't put it past him to try.

Do that and you won't have pesky interest rates or an inflation problem to worry about, Mr. President. You'll have traded them for something much, much worse: A shock wave of uncertainty and instability big enough to trigger a global recession. How's that for an economic legacy, Mr. President?