Perspectives

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Certainty Over Uncertainty:
Biden Nominates Powell for Another Term as Fed Chair

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AND THE NOMINATION GOES TO...

In a move especially pivotal given today's elevated inflation as the economy is resuscitated out of the pandemic, President Joe Biden announced yesterday morning (November 22nd) that he would nominate the incumbent Jerome Powell for another term as Chair of the Federal Reserve. Additionally, Biden nominated Lael Brainard as Vice Chair. Both Powell and Brainard had been under consideration for the Chair role in uncharacteristically lengthy deliberations on the part of Biden, who had interviewed both for the position on November 4th.

Powell, a Republican, has been Chair since 2018. He was nominated to the Fed's board of governors by Obama, was appointed Chair by Trump, and currently has sizeable support from both parties. Brainard has served on the Fed's board of governors since 2014. Powell's four-year term expires February 2022. Brainard is the only Democrat on the Fed board.

WHO'S MORE DOVISH/HAWKISH?

Powell and Brainard are about the same in terms of their tendencies towards dovishness or hawkishness.[1] The main difference between them centers around their views on bank regulations, with Powell leaning towards relaxing them and Brainard leaning towards making them stricter. Given that their hawkish/dovish tilts are relatively the same, we can expect that in either case the pace of the Fed's unwinding of its Treasury and MBS quantitative-easing purchases to reach zero purchases around the June 2022 timeframe, in keeping with Powell's recent announcement of the commencement of their tapering. Likewise, we can expect in either case the pace of the Fed's interest rate hikes to be about the same, all else held equal.

From their previous voting history, speeches, and written communications, Powell and Brainard share similar views on inflation and employment, but Brainard is notably more aggressive on the subject of controls over financial risks through financial regulation. During his term as Chair, Powell has relaxed some of the key 2010 Dodd-Frank Wall Street reform bank regulations, while Brainard had opposed all of these moves.

Given the growing number of vacancies on the Fed board with a few governors to depart soon, Biden is expected to announce three nominations for the Fed's seven-member board of governors in December. These new members may have more of an effect on the ultimate dovishness/hawkishness of the overall Fed in terms of their votes towards hiking rates and tapering bond purchases.

THE MARKET'S REACTION

Powell's track record of cutting rates drastically during the COVID crisis and instituting large-scale bond purchases to support both the markets and economy has been viewed widely by Wall Street and Congress as favorable. As such, despite Brainard's reputation as a highly respected economist, Biden chose certainty with Powell over uncertainty with Brainard. Given that Powell is a known quantity, the markets rallied to the release of the news early Monday morning. The S&P 500 initially rose in the morning with the announcement but fell during late afternoon trading led by a tech selloff, to end the day down 0.32%. However, the 10-year Treasury yield rose from 1.54% to 1.63% for the day, a sign that the bond markets reacted favorably to Powell's nomination while the equity markets took profits from tech gains.

EXPECTATIONS FOR INTEREST RATES & INFLATION

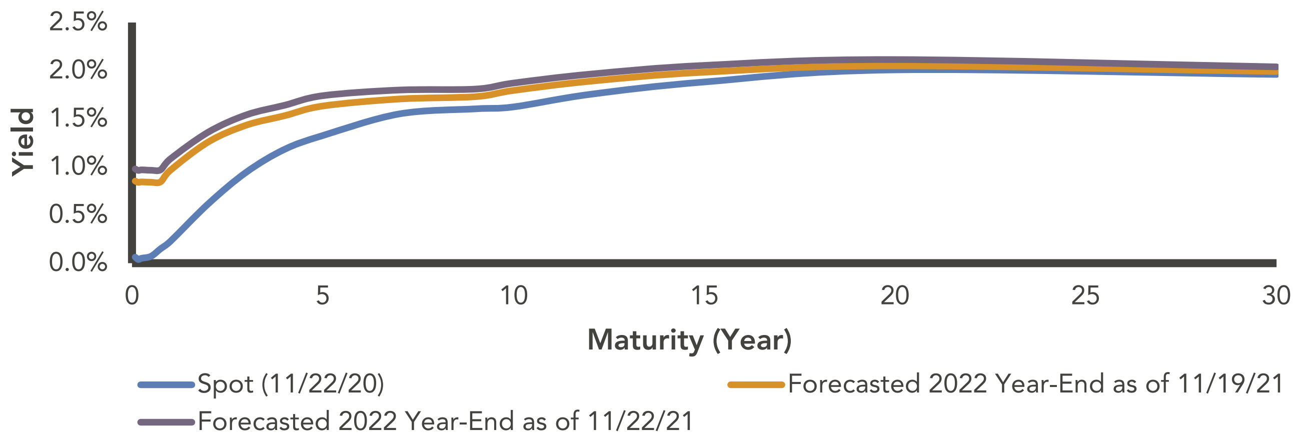
Fed funds futures went from projecting 2.5 hikes in 2022 as of last Friday, November 19th, to 2.8 hikes in 2022 after Biden's announcement at the end of Monday, November 22nd. Interestingly, the markets appear to expect the Fed to be more hawkish now with Powell's nomination. This is profiled in Exhibit 1.

Exhibit 1: Fed Funds Futures Market Forecast of Hikes

	Friday 11/19/21		Monday 11/22/21	
FOMC Meeting	# of Hikes	Implied Rate (%)	# of Hikes	Implied Rate (%)
12/15/21	0.0	0.1	0.0	0.1
1/26/22	0.0	0.1	0.0	0.1
3/16/22	0.2	0.1	0.3	0.2
5/4/22	0.4	0.2	0.6	0.2
6/15/22	0.8	0.3	1.0	0.3
7/27/22	1.1	0.4	1.4	0.4
9/21/22	1.7	0.5	1.9	0.6
11/2/22	1.9	0.6	2.2	0.6
12/14/22	2.5	0.7	2.8	0.8

The Treasury forwards market has upped the forecasted yield curve at 2022 year-end just slightly, with the forecasted 2022 year-end 10-year yield at 1.79% as of last Friday rising slightly to 1.87% after Biden's announcement at the end of Monday. This is highlighted below in Exhibit 2.

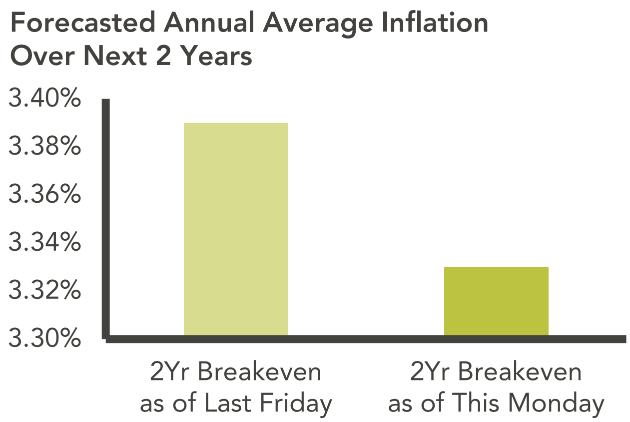
Exhibit 2: Treasury Forwards Market Forecast of Interest Rates

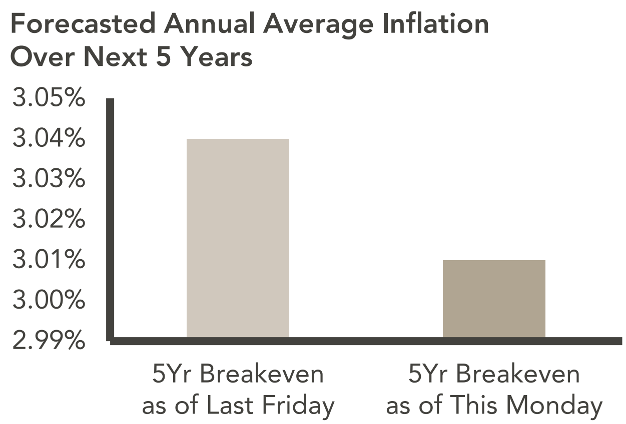


Source: Bloomberg

Inflation in the form of headline CPI has been rising from 5.4% year-over-year as of September 30th, 2021, to 6.2% year-over-year as of October 31st, 2021. The recent new lockdowns in Europe may extend some of the supply chain bottlenecks and keep inflation elevated for some time. Breakeven inflation rates[2] can be used to gauge how the market is forecasting inflation in the form of headline CPI. The two-year breakeven, which is the market's projected annual inflation averaged over the next two years, fell from 3.39% as of last Friday to 3.33% after Biden's announcement at the end of Monday. Similarly, the five-year breakeven, which is the market's projected annual inflation averaged over the next five years, fell from 3.04% to 3.01%. These are graphed in Exhibit 3 below. Overall, the market seems to expect a slightly more hawkish Fed based on these movements.

Exhibit 3: Treasury & TIPS Market Forecast of Inflation





Source: Bloomberg

CONCLUSION

In conclusion, Powell's nomination should mean more of the same in terms of how the Fed will operate in terms of policy. The markets post-nomination appear to expect the Fed to be relatively the same as before with a slightly more hawkish stance, projecting rates to rise a bit sooner and inflation to be a bit more tamed. Lastly, Powell appears to have more than enough support for a confirmation. The previous Fed Chair Janet Yellen, who chaired from 2014 to 2018 and is currently Secretary of the Treasury, supports Powell. We expect Powell to be confirmed by the Senate. Powell was previously confirmed with 84 versus 13 votes in the Senate in 2018 and needs only 50 votes. 68 of the 84 Senators who had voted for Powell are still currently in office, so his confirmation is expected to be relatively straightforward. Marquette will continue to monitor the composition of the Fed, particularly with regard to Biden's upcoming three nominations, and provide updates and assessments when appropriate.

NOTES

[1] A dovish Fed governor tends to want to keep interest rates low in order to stimulate the economy to keep unemployment at bay. A hawkish Fed governor tends to want to keep interest rates high in order to pump the brakes on the economy to keep inflation under control.
[2] The difference between the yield of a Treasury bond and the yield of a Treasury Inflation-Protected Security (TIPS).

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