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Fed’s Rate Hike in March and Possible “Imperial Presidency”

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Fed decided on March 15 to raise its policy rate for the third time on the current normalization process. The greatest surprise for this hike was not on the decision itself at the FOMC meeting but rather on the intense communication made somewhat in an abrupt manner within a several days after end-February in an effort to smooth out the way for the rate hike at the March meeting. At around the end of February, there were successive statements from the district Fed presidents and Board Director Lael Brainard, a leading dove, to support a raise of policy interest rate, followed by the suggestions on March 3 by two major players of the Fed, Chair Janet Yellen and Vice Chair Stanley Fischer as if further confirming the possibility of a hike. These careful communications easily guided the market to incorporate the increase of the rate in March. As of February 22 when the minutes of January FOMC meeting was published, the consensus view of the market was that the first rate hike would take place in June. So what happened in the meantime?

On the side of the FRB, it may be nothing more than that they have had no intention of suddenly changing the policy guideline and that the market had just misunderstood the signal for an early interest rate hike. With hindsight, the US economy, which is close to full employment, is surely entering into a caution zone with the recent rapid rise of stocks and consumer and business sentiments, coupled with the high increase of lending. Indeed, the statement for the current Fed meeting declares that they are almost meeting the inflation target with many upward corrections of price projections. At the same time, on February 28, President Trump made his first speech to the Congress (the Senate and the House). I can’t help but think of a possibility that the speech has become one factor that encouraged the Yellen-led FRB to decide on the rate hike as she had always been on a cautious stance to the fiscal expansionism by the Trump administration. Although his speech did not disclose any details of his policy, it completely differed from his past speeches including his inaugural message and had the contents to deliver what-seems his seriousness to behave like a traditional president. The fiscal stimulus measures such serious Trump administration will implement are, however, much concerned for an economic overheating, higher than expected inflation, and ever-expanding fiscal deficit and require a careful watch. Is it missing the point to think that this concern had prompted the Fed to decide to urgently move to a rate hike in March?

Changing the subject, as is well known, various executive orders have been issued in rapid succession after President Trump took office. However, implementation or authorization of these orders has been temporarily suspended, for instant, by the Supreme Court (judicial branch) to the order on "Protecting the Nation from Foreign Terrorist Entry into the United States and by the Congress (legislative branch) to the "nominations of secretaries". As far as these cases show, it can be seen that the ideal written in the US Constitution of check and balance between government branches by separation of powers has been well functioning and that the US political system itself has not been paralyzed. Although the FRB is not necessarily incorporated in the framework of this idea of separation of powers, it is encouraging that the FRB seems to be checking the actions of the president office (administrative branch). It will be a sound direction that, amid a strong uncertainty on the fiscal policy, the central bank firmly promotes the normalization process of super-easy monetary policy, making a clear distinction from the policies of the administration.

Among the US political terms there is an expression of "Imperial Presidency". Although it is unfamiliar to the Japanese and no appropriate translation is available in Japanese, it is used in the meaning of a "president who wields the power larger than defined in the Constitution." As mentioned above, a spirit of check and balance is incorporated in the US Constitution to prevent the concentration and overruns of political powers and the constitution has a mechanism to put in many ways a brake on the exercise of presidential power. In spite of such precautions, a concept of Imperial Presidency emerged in the 20th century. President Franklin Roosevelt who took the office during the Great Depression to the World War II became the first president to accelerate concentration and strengthening of power in facing a national crisis. The post of presidential aid and original National Security Council (NSC) are believed to have been established under the Roosevelt administration. President Richard Nixon upgraded the NSC that had consisted of selected few members to a practical foreign policy making organization, and at that moment the power of diplomatic policy was completely transferred from the Congress (legislative branch) to the Office of President (administrative branch). In the following period of a continued Cold War, President Ronald Reagan became the president who was called the last imperial president.

Incidentally, during the period of these three presidencies implemented were very important policies that respectively marked a major turning point in the history of monetary policy. In the days of Roosevelt presidency, John Maynard Keynes proposed, in the midst of the Great Depression, that the FRB intervene in the government bond market to lower the long-term interest rates, which was realized in 1942 in the manner that the FRB met the requirement to procure the war expence. In the days of President Nixon, monetarism increased its influence and the FRB disclosed in 1970 a policy based on monetary targeting that put much importance on money stocks and bank credits. Finally, in the period of Reagan presidency, the main frame of monetary policy was shifted from monetary targeting to interest rate control, with setting of monetary target for M1 discontinued in 1987.

From this point of view, the FRB seems to be preparing now for the situation where President Trump may become an imperial president and conduct economic management with an iron fist. Whether the Trump administration will collide with the Congress with his unique (unusual) policy management, bringing a political vacuum that would lead to an economic downtown, or whether his expansionary fiscal policy will be widespread to raise the inflationary risks, it is still to be seen. That may lap over the choice between whether he will stay within the traditional check and balance framework or whether he will become an imperial president. If the latter is the case, the lesson of history tells us that there will be a discontinuity in monetary policy and I would like discuss this point in another article.