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Fed Faces Overhaul as Washington Braces for Trump-Led Shakeup

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The leadership, powers and policies of the Federal Reserve may look very different in 18 months.

President-elect Donald Trump can't remove Fed Chair Janet Yellen from office before her four-year term expires. By mid-2018, however, Trump can replace the Fed's top personnel and potentially alter monetary and regulatory policies. Some members of the Republican-controlled Congress may also take aim at the Fed's independence from political influence.

"Trump will have the ability to substantially reshape the nation's central bank," said Aaron Klein, a research fellow at the Brookings Institution in Washington.

Still, discussion of potential remakes come with one massive caveat. No Fed watchers seemed confident in predicting even what kind of nominees Trump is likely to put up for the Fed, nor what kind of regulatory approach he is likely to favor. During his campaign, Trump railed against the 2010 Dodd-Frank Act, which greatly increased restrictions on banks operating in the U.S., but also said he would reinstate a separation between bank lending and securities underwriting.

As Sarah Binder, a political science professor at George Washington University, puts it: "In every conversation I have about a President Trump, there is an asterisk of unpredictability."

Election Surprise

Trump scored a surprise victory over Democrat Hillary Clinton for the White House Tuesday, while Republicans retained control of both the House of Representatives and the Senate.

Changes at the Fed can start with two vacancies on the Board of Governors in Washington, whose seven seats -- when all filled -- form a majority and center of influence on the policy-making Federal Open Market Committee. Trump is likely to name one of his new picks to the also-vacant post of vice chair for supervision, a job created by Dodd-Frank.

Mark Calabria, director of Financial Regulation Studies at the Cato Institute in Washington, called that job the Republican Party's "best lever to shape the Fed in the near term."

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Filling that role may also create another opening on the Board. Governor Daniel Tarullo has led the Fed's efforts on bank supervision and regulation for years, but never took on the formal title of vice chair for supervision, which requires Senate confirmation and annual testimony at public hearings on Capitol Hill. Several people interviewed said that they'd expect Tarullo to step down if his biggest job at the Fed were handed over to an incoming governor.

A Fed spokesman didn't respond to requests for comment.

Trump will also get to name the central bank's two most powerful officials when Yellen's four-year term runs out in February 2018 and Vice Chairman Stanley Fischer's expires in June of that year. Trump accused Yellen during the campaign of holding interest rates low to boost the economy until President Barack Obama left office.

Won't Quit

While many economists dismiss the notion that Yellen may resign under a Trump presidency, few expect him to reappoint either Yellen or Fischer, leading to a wide variety of opinions over the type of replacements he might favor.

Fed leadership roles "could be filled with individuals less prone to follow the gradualist course laid out in recent" Fed policy statements, according to Michael Feroli, chief U.S. economist at JPMorgan Chase & Co. in New York.

Ward McCarthy, chief financial economist at Jefferies LLC in New York, was more dubious. "Probably Trump was very critical of Janet Yellen when he thought she was helping Hillary Clinton," McCarthy said . "A President Trump is going to be a lot more sympathetic to an accommodative Fed because he wants the economy to do well."

Other big changes could come through Congress, where Republicans have already crafted a number of bills the Fed views as hostile.

Taylor Rule

One would force the Fed to set interest rates according to a formula -- along the lines of the so-called Taylor Rule created by Stanford University Professor John Taylor -- or to otherwise explain to lawmakers why they strayed from the formula. Trump economic adviser Stephen Moore said as recently as last month he favors the idea.

Another proposal, backed by Kentucky Senator Rand Paul, would subject the Fed's monetary policy making to regular "audits," or reviews. Yet another bill, backed by Alabama Republican Senator Richard Shelby, proposed creating a commission to review the structure of the central bank.

The Fed has said the proposed changes weren't necessary and largely represented attempts to influence monetary policy. None of the proposals passed Congress, and faced a likely veto from

Obama if they had. While it isn’t clear that Republican leadership would back any of those measures next year, protection from the White House might now disappear.

“Legislation to change the mandate, mission and independence of the Federal Reserve is very much on the table for this next Congress,” Brookings’ Klein said. “The Fed can no longer count on a veto from the president to save its independence.”

McCarthy, from Jefferies, agreed: “The Fed has never had fewer friends in Washington than it has right now.”