

DAILY SABAH

An independent Fed? No exceptions?

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Federal Reserve Chairman Jay Powell testified before U.S. Congress Wednesday and will continue to testify Thursday after this column goes to print. In short, the Fed chairman did not reverse previous remarks pointing to potential softening in the U.S. economy, warranting a Federal Funds Rate cut.

The rate cut, which is now a near certainty, will come at the end of July, the only question being how big of a cut it will be. Perhaps more interesting, however, is the upcoming nomination hearing for U.S. President Donald Trump's nominee to the Fed's Board of Governors, Judy Shelton. Should Shelton be confirmed, the direction of the Fed may very well change, and it's important that we discuss her views.

"The Fed's practice of paying banks to keep money parked at the Fed in deposit accounts instead of going into the economy is unhealthy and distorting; the rate should come down quickly as the practice is phased out." These are not the words of some fringe academic, but the thoughts of the current U.S. executive director for the European Bank for Reconstruction and Development, Judy Shelton. If this sentiment sounds unorthodox to you, that's because it is. But, may I remind you, we are in the Trump era. Who would have thought only two years ago that a U.S. president would step across the Demilitarized Zone into North Korea or that decades of U.S. trade policy would be reversed nearly overnight? Not me. So, it is through this lens that we must consider Shelton's nomination.

Yes, she has a chance of being confirmed. No, she's not going to withdraw like Herman Cain. Yes, she's serious. What do her comments mean? She wants the Fed to butt out of monetary policy as much as possible. The Fed is "crowding-out" the lending market in that banks would otherwise be lending to firms and households instead of "parking" money at the Fed. The stance of not paying interest on Fed deposits would send rates lower at the federal funds rate, the headline rate which the Fed "hikes" or "cuts." This rate is what the Fed dictates banks charge each other to borrow from deposits at the Fed. Imagine if the Fed no longer intervened. What would happen?

Shelton is also very fond of the gold standard it would appear. She was quoted in a paper at the Cato Institute last year, in which she said: "If the appeal of cryptocurrencies is their capacity to provide a common currency and to maintain a uniform value for every issued unit, we need only consult historical experience to ascertain that these same qualities were achieved through the classical international gold standard ... In proposing a new international monetary system linked in some way to gold, America has an opportunity to secure continued prominence in global monetary affairs." So back to the gold standard then? Not so fast.

While Shelton's views may sound great to those that advocate for a gold standard, having the dollar be exchangeable for gold by the government, it is highly unlikely to ever materialize. The United States multitrillion-dollar debt is currently not backed by gold nor would it be feasible to do so in the near future. The U.S. has three times as much debt now than the total amount of gold ever mined in the history of man. So that's a problem. As for not paying or allowing banks to charge for their deposits at the Fed, this would undermine the very basis of the Fed's role.

For those that have long advocated for an independent Fed, would you now argue the same in the face of a Fed governor nominee - and a potential Fed chair in Trump's second term - that wants to practically gut the Fed?