Trump's Fed Picks Contain Seeds Of Dollar Disaster

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The other day I wrote an article here about the appointment of Christine Lagarde as the new ECB President. I concluded that her appointment "**should be seen as a small negative for the price of the euro, but a positive for its long-term future."**

But as everyone knows, a currency rate has two sides to it – in this case, EUR/USD is the rate of the euro vs the dollar. So while looking at what's going on with the ECB, we should also look at what's going on with the Fed.

And it's not very good.

In fact, **while Lagarde may be a "small negative" for the euro, what's going on with the Fed may well be a "big negative" for the dollar** as Trump tries yet again to stuff the Fed's Board of Governors with people who have no business being anywhere near the monetary steering wheel of the country.

One of the distinguishing features of the current administration has been the president's refusal or inability – I don't know which, and I don't want to speculate – to fill empty positions in the government. The US is in its seventh month without a Secretary of Defense, for example.

The Fed's Board of Governors is supposed to be comprised of seven people. When Trump took office, there were only five. Now, with more than half of his term of office finished, there are ... still just five.

Trump made two appointments to the Board of Governors that were not particularly controversial. He appointed Randall Quarles as Vice Chair for Supervision. Quarles is a lawyer by training with a long resume of appointments at the IMF, Treasury, and in private equity. Trump also appointed Michelle Bowman to the seat for community banking. She was previously a bank executive and state bank commissioner. Both individuals are well qualified for these roles.

As for the two remaining openings, he's had some problems. He nominated former Fed economist and professor **Marvin Goodfriend** in 2017, but the nomination died in the Senate under resistance from Democrats and Trump didn't renominate him, probably because of his hawkish stance on inflation. **Nellie Liang**, another former Fed official with long experience in financial regulation, withdrew her nomination in the face of opposition from the banking industry and their friends in the Republican Party.

Trump floated the idea of appointing former Wall Street Journal editorial writer **Stephen Moore** and pizza executive **Herman Cain**. Moore at least had a background in economics: he has an MA in economics and was an economist on the US Congress Joint Economic Committee.

Never mind that he said in 2015 that "We have got to get rid of the Federal Reserve and move towards a gold standard in this country." On the other hand, in 2016 he demonstrated his commitment to the Fed's full employment mandate by saying, "I'd get rid of a lot of these child labor laws. I want people starting to work at 11, 12."

Herman Cain was an executive with Burger King and Godfather's Pizza. He became Chairman of the Federal Reserve Bank of Kansas City, which sounds a lot grander than it is – according to Fed insiders, this is more of a ceremonial role that consists of going to meetings every now and then and getting a briefing on the economy. It has no role in policy decision-making.

In any event, both pulled out for various personal reasons. Now Trump is looking around for two more people, and this is where it gets interesting.

One of the two – **Christopher Waller ---** is a conventional, if telling, choice. He's currently the Head of Research at the St. Louis Fed. Head of Research is often a stepping stone to greater things – at least four of the current regional Fed presidents held that job or one like it before taking over the helm at their bank. The key point about Waller is that his boss, St. Louis Fed President James Bullard, is the guy who's competing (with Minneapolis' Neel Kashkari) to be the most-dovish person on the FOMC.

Bullard was the only person to dissent at the last FOMC meeting; he wanted to cut rates ASAP. Waller was Bullard's professor in graduate school, and the two must obviously agree on a lot or else Bullard wouldn't have appointed him to his job and kept him there. Trump apparently asked Bullard to take the job, and when he declined, tapped Waller as the closest-possible substitute.

Waller is clearly at one end of the policy spectrum, but even those who disagree with his conclusions have to admit that his views are grounded in significant original research.

Waller's nomination shows how Trump wants to tilt the Feb board towards a more dovish policy. That's his prerogative. That's also why the Constitution requires the Senate to confirm the appointments, to provide the famous "checks and balances."

It's the other person, **Judy Shelton**, that raises eyebrows.

First off, let me say that I have no objections to iconoclasts on boards. On the contrary, I think they are essential in any decision-making group. In *Thinking, Fast and Slow,* Nobel Prize winner Daniel Kahneman points out the tendency of people in groups to disregard or even disdain those whose opinions diverge from the majority.

He notes that in the Israeli armed forces, where decisions are a matter of life and death for the whole country, one person is actually assigned the job of arguing against all the others just to avoid "groupthink."

One real-life example: Nobuyuki Nakahara, a member of the Bank of Japan's Policy Board from 1998 to 2002, put forward over 50 resolutions during his tenure but didn't get even one single vote for any of them – but subsequently saw most of his recommendations implemented sooner or later (usually later, by which time they were less effective).

However, being different doesn't always mean you're right.

In a paper written for the Cato Institute last year, Shelton argued that "Today there are compelling reasons—political, economic, and strategic—for President Trump to initiate the establishment of a new international monetary system."

Her idea?

"A new international monetary system linked in some way to gold." She suggested tying it somehow to cryptocurrencies. "A modern version of this approach—one that permits the issuance of virtual currencies in tandem with government-issued currencies, adapting legal tender laws to permit healthy currency competition—should be put forward."

"We make America great again by making America's money great again," she said, referring to Trump's trademark slogan.

Personally, I doubt if Shelton will go through the nomination procedure, and if she does, I doubt if she'll be confirmed. But that won't prevent the damage being done to the Fed anyway as the market observes the kind of people that Trump is trying to get onto the Fed's Board of Governors. Several of them have been utterly unsuitable, utterly unqualified.

Even worse – *they didn't even agree with Trump himself!* Going back to the gold standard, as both Moore and Shelton advocated, would be deflationary and restrict the Fed's ability to stimulate the economy.

Worse, it would give some control of US monetary policy to China, the top gold producing country in the world, and Russia, the #3 (hmmm...). If Trump wants a looser monetary policy, he should get Haruhiko Kuroda on board, not Auric Goldfinger.

The main criterion that these people have that qualifies them for the Fed Board is a simple one: fealty to Trump. He is putting loyalty over competence. And **that has the potential to erode confidence in the Fed over the longer term**, especially as Governors serve long 14-year terms.

Don't believe me? Look at Turkey, where the President just fired the central bank governor for not cutting rates fast enough and replaced him with someone whose Master's thesis was basically cut-and-pasted from other articles. The policy rate there is 24%.

That's what happens in countries where the politicians are in charge of the central bankers. Oh, and Turkey's president also appointed his son-in-law to be Minister of Finance and Treasury. Sound familiar?

Fortunately, the Governors have to be approved by the Senate, which has shown that there are some things even they won't tolerate from Trump, believe it or not. Furthermore, there are 12 voting members of the FOMC when there is the full complement of Governors, and so one or two iconoclasts – to be polite – wouldn't necessarily change the way most votes go.

But as the market sees Trump trying to push out people who disagree with him (Powell); people put in positions of power for loyalty, not competence; hears him talk about how the Fed "doesn't know what it's doing" (he who bankrupted a casino, twice); and in general sees the major economic institutions of the country being stacked with those willing to do the bidding of politicians, **confidence in the Fed and in the dollar is likely to erode.**

Combine that with statements Trump made about matching China and Europe at their "big currency manipulation game," and **you have a recipe for a dollar crisis that would shake the financial world.** Let's hope it doesn't happen.