MarketWatch

The Fed

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What's behind Republican attacks on the Fed

By Greg Robb, MarketWatch

WASHINGTON (MarketWatch) — The Federal Reserve has been working for months on improving its communication with financial markets. But the central bank does not seem to speak the same language as one key group — Republican primary voters.

During the Republican presidential campaign, attacks on the Fed have become as commonplace and unremarkable as images of fluttering American flags and the national anthem.

Hardly a week goes by without some negative reference to the central bank.

THE FED
This week's schedule:
Tuesday: Federal Open Market Commitee starts meeting.
Wednesday, 12:30 p.m.: FOMC rate decision and statement.
2 p.m.: FOMC growth, inflation, unemployment and interest rate forecast
2:15 p.m.: Fed Chairman Ben Bernanke press conference

Texas Gov. Rick Perry started the attacks off by threatening bodily harm to Federal Reserve Board Chairman Ben Bernanke and accusing him of treason.

Front-runner Mitt Romney has since said he would fire Bernanke. Former House Speaker Newt Gingrich also said he would fire Bernanke and went further to propose a commission to examine returning the U.S. to the gold standard. And Texas Rep. Ron Paul has reveled in his unwavering stance of simply ending the Fed.

What is behind these unprecedented attacks from a party that used to be synonymous with business and banking? And what may be in store for the Fed if Republicans take the White House and the Senate in November?

In a series of interviews, Republican and neutral observers said that the sharp criticism of the Fed comes from several sources, but the over-riding theme that emerges is that many Republicans think the Fed has been working hand and glove with the Obama administration.

Waiting too long to raise rates?

The Federal Reserve's commitment to near-zero interest rates complicates its exit, says Prof. Michael Bordo, a monetary-policy historian. The Fed must mull higher rates if unemployment falls to 8%, he tells MarketWatch's Greg Robb.

- **Fed holds rates steady, sees moderate growth**
- **Fed, central banks slash dollar borrowing costs**
- **Bernanke denies hiding size of crisis loans**
- **Obama to nominate Stein, Powell to Fed board**
- **Fed's Beige Book more upbeat about economy**

Douglas Holtz-Eakin, who was chief economic adviser to Senator John McCain's bid for the presidency in 2008, said that the Fed's second round of bond purchases made by printing money was horribly timed politically.

The Fed first floated the idea of more quantitative easing in August 2010, ultimately pulling the trigger in November, just after the mid-term election.

"QE2 was where it came undone. It had severe political costs," Holtz-

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Eakin said.

Many Republican candidates viewed the quantitative easing as assistance of Democrats and the Obama White House leading into the mid-term election.

“If you are a [Republican] running for Congress — those freshmen in the House — they thought that Bernanke was walking around talking about buying assets for Obama to make it easier for him to spend,” Holtz-Eakin said.

“It lit the fuse,” Holtz-Eakin said.

A Federal Reserve spokeswoman declined to comment on the charges.

But Donald Kohn, who was vice chairman at the time, said the central bank was simply responding to economic developments.

“In the fall of 2010, the economy was not growing fast, unemployment was very high, and deflation seemed like a real threat — the Fed was at risk of missing all its mandates,” said Kohn, now a senior fellow at the Brookings Institution. “The Fed would have done the same thing if Republicans had been in power,” he added.

Kohn, seen as a close ally to Bernanke, said it was the tone of the rhetoric about the Fed that concerned him most.

“There are legitimate questions about the Fed’s actions in the crisis, which should be subject to public debate. We had never been in this type of situation before. But the tone of the conversation has been particularly harsh, not very thoughtful or constructive, and threatening to the independence of the Fed,” he said.

Bernanke: ‘An Obama guy’

Mark Calabria, director of financial regulation studies at the Cato Institute, a libertarian think-tank, said that he doesn’t think Republican primary voters even remember that Bernanke worked in the White House of President George W. Bush as his chief economic adviser.

“The perception is that Bernanke is far more an Obama guy than a Bush guy,” Calabria said.

“Obama has pretty much wrapped his arms around Bernanke,” Calabria added.

There has never been criticism for the Fed from the White House similar to the “abuse” hurled at Ed DeMarco, the acting director of the Federal Housing Finance Agency, he noted.

“There seems to be a very close working relationship between Treasury and the Fed,” Calabria said.

Compounding the criticism of the Fed is the role the central bank has played in the political career of Ron Paul.

“Paul’s position hasn’t changed in decades. He’s opposed to the Fed as an institution, preferring a gold standard and free banking,” said Michael Bardo, an economic professor at Rutgers University.

Other candidates are keen to woo some of the independents and young voters who have flocked to Paul during the primary season, analysts said.

Bardo said that the candidates are also reflecting the views of many academic economists who believe the Fed moved too far into the fiscal policy arena during the financial crisis.

In general, they continue to believe that the central bank threatened its independence by taking such a prominent role in the rescue of Bear Stearns and the collapse of Lehman Brothers, he said.

Calabria said Bernanke has failed in his efforts to reach out to Main Street. In a first for a Fed chairman, Bernanke sat down for an interview on the CBS News program “60 Minutes” which featured footage of Bernanke walking down the Main Street of his hometown of Dillon, South Carolina. He’s also initiated quarterly press conferences, including one scheduled for Wednesday.

"He just hasn't done it very well. He hasn't come across in a way that people feel a connection to him," Calabria said.

Another factor is that the typical Republican primary voter is older and living off pensions and savings.

The last three years of zero interest rates engineered by the central banks has been a "horrible environment for savers," Calabria said.

Savers tend to worry more about inflation from the Fed's bond purchase program than other voters.

"The problems facing Republican voters are not the problems that Bernanke is talking about," Calabria said.

Analysts differ on the question of whether a Republican victory in November would severely damage the Fed.

Stephen Stanley, chief economist at Pierpont Securities, said it appears quite possible that the new president would call for Bernanke to step down.

Bernanke's term as chairman does not end until January 2014 in a conscious decision to remove the post from presidential politics.

Bernanke does not serve at the pleasure of the president and it is unclear how he might respond.

"A standoff could do immense damage to the Fed's institutional prerogatives," Stanley wrote in a recent note.

Bardo of Rutgers said that Bernanke would be able to finish his term.

"I would be surprised if he was encouraged to leave early," Bardo said.

Holtz-Eakin said the Fed is wrong if it thinks that this anger will go away.

Paul is seeking to be "a little kingmaker" in the Republican Party, Holtz-Eakin noted.

"It is Paul's goal to permanently establish within the Republican Party a group that is dead set on not having the Fed. This is not going away," he said.

Calabria thinks the Republicans anger might coalesce behind legislation to end the Fed's twin goals of low inflation and low unemployment in favor of a single low-inflation mandate.

Brian Gardner, the senior vice president for Washington research at Keefe Bruyette & Woods, believes that the anger at the Fed will dissipate after the Republican convention.

"I think a lot of frustration with the Fed is largely driven by state of economy. If we get into 2012 and the economy stronger than it is now, my gut tells me a lot of this anti-Fed talk is going to be taken down," Gardner said.