Republicans looking to turn up heat on Fed in 2015

By Kate Gibson
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Republican efforts to limit the power of the Federal Reserve are expected to gain traction in 2015, when the GOP takes majority control of the Senate after midterm election victories.

"For sure, the scrutiny on both the regulatory and the monetary side will be turned up a notch in the Senate compared to what it was," said former Fed Vice Chairman Donald Kohn, now a senior fellow in the economic studies program at the Brookings Institution, a think tank.

That dial was already turned up in the Republican-controlled House, where a proposal was introduced in June to curtail how the central bank sets monetary policy, with the move made just before Fed Chair Janet Yellen gave semiannual testimony on Capitol Hill.

The measure, sponsored by Rep. Scott Garrett of New Jersey and Rep. Bill Huizenga of Michigan, would mandate the Federal Open Market Committee to map a plan or rule for how it would adjust interest rates.

At a February House Financial Services Committee hearing, Yellen said the Fed should be transparent, but that the measure would interfere "with the independence of monetary policy, by bringing political pressures to bear on the committee's judgment."

"There is a little bit of talk about the Senate Banking Committee, which will go Republican in terms of its chairmanship, and Republicans historically have been very critical of the Fed, especially recent policy," said Jim Russell, a portfolio manager at Bahl & Gaynor.

Republican control of the Senate makes it likely that Alabama's Richard Shelby, the senior Republican on the Committee on Banking, Housing, and Urban Affairs, will become its chair, steering the committee that oversees the Fed.

"I don't think he's a big fan of the Fed," Hugh Johnson, chairman of Hugh Johnson Advisors, said of Shelby, a onetime central bank backer who turned into a Fed critic during the financial crisis.

Shelby opposed Yellen's nomination as vice chair in 2010 and then as chair last year. He also fought President Barack Obama's 2010 nomination of Nobel Prize-winning economist Peter

Diamond to serve as Fed governor, with Diamond subsequently withdrawing from consideration. Two of seven board seats remain vacant.

"Anyone very dovish is not even going to get a hearing or a vote," said Mark Calabria, a former staff member for Shelby and now director of financial regulation studies at the Cato Institute, a libertarian think tank.

"Shelby, who is expected to chair the banking committee, is sympathetic to getting the Fed out of bank regulation, but getting 60 votes for that is a tough thing to do," Calabria added.

Legislation that passed the House in September and sponsored by Georgia Republican Paul Broun would require the comptroller general to audit the Fed's board of governors and banks within a year and report back to Congress on its findings. Rand Paul, R-Kentucky, has introduced companion legislation in the Senate.

"Rand Paul will likely come down and demand a Fed audit, but it's an open question at this point whether there will be a vote. There's a small handful of Republicans who were not terribly sympathetic to it," Calabria said.

The measure has a good chance of passing should it be brought to a vote, Calabria said.

House Financial Services Committee Chairman Jeb Hensarling, a Texas Republican, told Bloomberg News in an October statement that he had already "held a number of conversations with Sen. Shelby, who might, and hopefully will, be the next Senate Banking Committee chairman, and we have had preliminary discussions about what he would like to achieve."

But it remains to be seen whether the Senate would actually take up the House's efforts to reduce Fed authority.

"There have been some pretty intense periods of political backlash, and this is among the more intense," said Kohn. He voiced optimism that the Senate "will have a more reasoned" approach in considering the role of the central bank.

"Republicans have been vocal about wanting to tighten the reins on the Fed, and will probably make an attempt to do that, but it won't happen until all the new members are in place next year," said Randy Frederick, managing director of trading and derivatives at Charles Schwab.

The idea of curbing the central bank's authority is a topic of discussion on Wall Street, and Frederick and others generally oppose the idea of limiting the Fed's power or independence regardless of their political affiliation. Supporters of the central bank credit it with rescuing the U.S. and global economy during the financial crisis, while its critics often deride it for easy money policies they fear will create a bubble and the next financial crisis.

"I personally think it would be a disaster to put guard rails in place that would not allow the Fed to do its job," said Russell, who added that the U.S. economy's recovery in recent years is "by and large a construct of the Fed's actions."

"Any idea of insisting the Fed detail its exit strategy to me is troubling, but I don't think that that will get far, because it will be greeted by a veto by Obama," said Johnson.

And, while Obama would surely veto any attempt to curtail the central bank's independence, the Fed and Yellen are likely to encounter pushback should they opt to slow the central bank's departure from its record stimulus.

"If the markets roll over and everyone says the Fed needs to do another round of quantitative easing, that would get politically difficult. That's where Republicans have more of a problem is in the unconventional space," said Peter Boockvar, chief market analyst at The Lindsey Group.

Conversely, Calabria believes once the Fed starts raising interest rates, the central bank will face an outcry from the left, which he predicts will argue the labor market is not yet doing well enough for Fed tightening.

As Calabria put it: "To continue an exit strategy, Republicans will be more her friends than Democrats. The best thing to happen to Yellen is Republicans taking the Senate."