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First Trust Portfolios Canada
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Fed Independence is a Myth

Every year the Per Jacobsson Foundation hosts and publishes a lecture on Monetary Policy. Back in 1979, Arthur Burns delivered the annual lecture in Belgrade, Yugoslavia (link). He titled the lecture "The Anguish of Central Banking" and he came clean about the Federal Reserve's inflationary policies in the 1970s.

Burns said, "Every time the Government moved to enlarge the flow of benefits to the population at large, or to this or that group, the assumption was implicit that monetary policy would somehow accommodate the action." Not doing this, he explained, "would be frustrating the will of Congress to which it [the Fed] was responsible."

In other words, Arthur Burns admitted the Fed was "not independent." If the people and their politicians wanted a larger government, the Fed can't stand in the way. In fact, as Burns said, the Fed's role was to "accommodate" this new spending, whether inflationary, or not.

Does this sound familiar? The Fed used Quantitative Easing, during both the Financial Panic of 2008-09 as well as COVID, to help accommodate massive spikes in government spending. Call it what you will, but monetary independence it was not.

If the Fed had remained truly independent it would ***not*** have printed money to finance COVID spending. It would have forced the government to go into the open market to borrow more, at higher rates, to ramp up spending. Instead, M2 soared like never before, and inflation followed.

But for some odd reason, Chairman Jerome Powell has drawn the "independence" line in the sand at accommodating tariffs. Even though President Trump raised tariffs in his first term, campaigned on raising tariffs again, and won the popular vote, the Fed has decided that tariffs are inflationary and cutting interest rates now would be risky. So, we suppose whether voters support it or not, the Fed has decided that this policy ***can't*** be "accommodated." Interesting.

To be clear, we do not think tariffs themselves are inflationary…they only cause the *relative* price of tariffed items to rise, whereas inflation is an excess of money printing that causes a general rise in prices. So far, the data back up this theory. Since January, when Trump took office, consumer prices are up 1.8% annualized and producer prices are up 0.2% annualized. Inflation this low means monetary policy is at least moderately tight.

Monetary policy impacts inflation with a significant lag. So, if monetary policy is already tight and inflation should hit the Fed's 2.0% inflation target (on a year-ago comparison basis) sometime in the next year, then now is the time to cut rates.

But for some reason, the same Powell who was willing to hold the federal funds rate below inflation in late 2021– after vaccines had been released and inflation was taking off – won't cut them now, even though inflation is well below the 4.375% federal funds rate and "real" (inflation-adjusted) interest rates are high relative to the past twenty years.

This brings us to discuss all the gnashing of teeth in recent weeks, by pundits and politicians who are now defending the Fed's "independence." They know this history as well as we do, but evidently as long as no politician publicly asks the Fed to do something or threatens to fire a Fed official for resisting a presidential request, they think the Fed remains independent.

But true independence should also mean not accommodating the policy goals of Congress and the President – regardless of party – just because you think you're supposed to. It should also mean consistency in how that approach is applied. And in that sense, Powell has failed and deserves to be replaced.

Unfortunately, doing so before May 2026, when his term as chairman runs out, would be bad for the markets for multiple reasons. First, the courts could step in leading to Powell remaining on the job, but potentially digging in his heels even deeper against cutting rates. Second, even if he's removed promptly, the remaining policymakers at the Fed could dig in their heels even in Powell's absence. Third, even if Trump manages to get a replacement for Powell installed quickly and that replacement is able to persuade a Fed majority to cut rates, markets could sense that future Fed chiefs who refuse to cut rates will be replaced more quickly, leading to a spike in long-term interest rates.

The bottom line is that a truly independent Fed would be good for markets and the economy, but that's not what we have now. Powell deserves to be replaced, but with only ten months left in his term, the better move is to just wait him out.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-23 / 9:00 am	Existing Home Sales – Jun	4.000 Mil	**4.000 Mil**		4.030 Mil
7-24 / 7:30 am	Initial Claims – Jul 19	227K	**225K**		221K
9:00 am	New Home Sales – Jun	0.650 Mil	**0.645 Mil**		0.623 Mil
7-25 / 7:30 am	Durable Goods – Jun	-10.5%	**-12.7%**		+16.4%
7:30 am	Durable Goods (Ex-Trans) – Jun	+0.1%	**+0.1%**		+0.5%