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Trump Pressuring the Fed*

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Abstract

After appointing Federal Reserve Chairman Powell, President Trump steadily put pressure on the Fed to cut interest rates. We show that, on average, a statement from Trump led to lower long-term interest rates, consistent with expectations of lower expected future short rates. However, the impact of Trump's statements declined over time.

Keywords: Federal Reserve, monetary policy, yield curve, political economy, central bank independence

1 Introduction

On November 2, 2017 President Trump nominated Jerome Powell as the new chair of the Board of Governors of the Federal Reserve (Fed). Soon thereafter, the president started to criticize the Fed for communicating future interest rate increases. In a rant of tweets, interviews and public statements, President Trump put pressure on the Fed to cut interest rates and questioned his decision to nominate chair Powell. These attacks raise concerns about the independence of the Fed from political pressure (Volcker et al, 2019).

On July 19, 2018, Trump issued his first attack on the Fed: "I don't like all of this work that we're putting into the economy and then I see rates going up."[1] On

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[1]The complete list of public tweets or statements on the Fed is contained in Condon (2019), from which the examples cited here are taken.

October 10, 2018 during a rally President Trump said: "... they're so tight. I think the Fed has gone crazy." Later that day, he claimed the Fed is "going loco". On December 24, 2018, Trump tweeted: "The only problem our economy has is the Fed" and on June 26, 2019 Trump publicly said the U.S. would be "better off" with Mario Draghi, the president of the European Central Bank, as a Fed chair. After raising rates five times, the Fed eventually cut rates on July 31, 2019 referring to "global developments" as the main motivation.

In this note, we test whether these and many other lines of attack had an effect on long-term interest rates and, hence, on expected future short-term rates.[2] Ultimately, this amounts to a test of the perception of market participants of the Fed's independence from political interference.[3]

2 Empirical evidence

We construct a dummy variable, D_t^{Trump}, which equals one on every day news about Trump putting pressure on the Fed emerge and zero otherwise.[4] The news could be a tweet, a remark at a rally or an interview. We take these dates from the time line of events provided by Condon (2019). In total, the news index has 40 entries of one.

The estimated model is straightforward. We regress the daily change in the n-period interest rate, $\Delta y_t^{(n)}$, on a constant and the D_t^{Trump} dummy. The coefficient on the dummy then reflects the effect of a Trump statement on the change in the interest rate. The assumption is that there are no other news systematically emerging on the sequence of 40 event days. The dependent variable is the fitted n-year yield taken from Adrian et al. (2013). This is because we will also use a decomposition of yields into the expectations component and the term premium. Our sample period begins on July 1, 2018 and ends on August 1, 2019.

To account for the possibility that market participants pay more or less attention to each Trump statement as time progresses, we let D_t^{Trump} interact with a linear time-trend, t.

Since Trump's attacks might be triggered by releases of macroeconomic news, we include the change in the Scotti (2016) macroeconomic surprise index, ΔS_t, as an additional control variable. The estimated model is thus given by

[2] Of course, this is not the first incident of political pressure on the Fed. See Havrilesky (1993) and Weise (2012) for an extensive analysis of other episodes.

[3] See Binder (2018) for an empirical cross-country study of the effects of political pressure on central banks. Demiralp et al. (2019) show that political pressure influences interest rate expectations in the U.S. and the euro area.

[4] If the news emerges on the weekend, we assign the value of one to the following Monday.

$$\Delta y_t^{(n)} = \beta_0 + \beta_1 D_t^{Trump} + \beta_2 t + \beta_3 \left(t \times D_t^{Trump}\right) + \beta_4 \, \Delta S_t + \varepsilon_t, (1)$$

such that

$$\frac{\partial \Delta y_t^{(n)}}{\partial D_t^{Trump}} = \beta_1 + \beta_3 \times t, \tag{2}$$

where the first part is the unconditional effect and the second part is the effect conditional on the timing of the political intervention.

Table (1) reports our key results. We find that the coefficient on D_t^{Trump} is significantly negative across all maturities. Thus, a statement putting pressure on the Fed to lower rates reduces longer-term bond yields. However, this coefficient reflects the effect of the first news event only. The estimated β_3 is significantly positive. This suggests that over time comments from President Trump about Chairman Powell and the Fed become less effective in driving yields. It seems that markets adapted to the constant noise from the White House. Accounting for news releases as reflected in the Scotti (2016) index, weakens the evidence for a declining impact of Trump's statements on longer maturities. The results remain qualitatively unchanged (which is why we do not report them here) if we use a quadratic time trend instead of a linear trend.

We also use the decomposition of yields into the component reflecting expectations of future short rates and the term premium provided by Adrian et al. (2013). Table (2) reports the results for the n-period expectations component as the dependent variable, while Table (3) contains the results from a regression of the change in the term premium on the left-hand side in equation (1). Both sets of results show that the significant response of yields to Trump statements is entirely driven by the response of the expectations component, not by the response of the term premium. Allowing for news releases to enter the equation does not change the response of the expectations component to Trump's comments.

In Table (4) we run the regression with the daily change in log stock prices as the dependent variable. A statement from Trump on the Fed reduces stock prices by about one percentage point. This, in combination with the fall in bond yields, suggests that markets interpret the drop in expected short rates as reflecting bad news for the economy. Stock prices also respond less to Trump's statements over time as the estimated β_3 is significantly positive.

3 Conclusions

We showed that statements from President Trump that put pressure on the Fed to cut interest rates do indeed reduce expectations of future short-term interest rates. However, over time these statements lose power as markets seem to pay less attention. This suggests that after adjusting to the new tone from the White House, market participants do not doubt the independence of the Fed.

A a matter of fact, public comments are only one way to influence Fed policy. Another could be through presidential appointment of Federal Reserve governors or through indirectly forcing the Fed to offset the fallout from other bad policy decisions.

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Table 1: Change in n-year yield

	maturity							
	$n=1$		$n=2$		$n=5$		$n=10$	
constant	0.012 (0.003***)	0.013 (0.003***)	0.012 (0.005**)	0.013 (0.004***)	0.011 (0.005*)	0.010 (0.005*)	0.009 (0.005*)	0.008 (0.005)
D_t^{Trump}	−0.028 (0.008***)	−0.023 (0.008***)	−0.039 (0.012**)	−0.033 (0.012***)	−0.041 (0.015***)	−0.032 (0.016**)	−0.031 (0.016*)	−0.022 (0.018)
t	−0.000 (0.000***)	−0.000 (0.000***)	−0.000 (0.000***)	−0.000 (0.000**)	−0.000 (0.000***)	−0.000 (0.000**)	−0.000 (0.000***)	−0.000 (0.000*)
$t \times D_t^{Trump}$	0.0001 (0.00004***)	0.0001 (0.00001**)	0.0002 (0.0001***)	0.0002 (0.0001**)	0.0002 (0.0001**)	0.0001 (0.0001)	0.0001 (0.0001*)	0.0001 (0.0001)
ΔS_t		0.018 (0.009**)		0.034 (0.017**)		0.044 (0.020**)		0.038 (0.016**)
R^2	0.064	0.092	0.044	0.057	0.030	0.047	0.025	0.037
#obs.	271	248	271	248	271	248	271	248

Notes: The dependent variable is the daily change in the n-year yield. Robust standard errors in parenthesis. A significance level of 1%, 5% and 10% is denoted by ***, ** and *.

Table 2: Change in n-year expectations component

	maturity							
	$n=1$		$n=2$		$n=5$		$n=10$	
constant	0.009 (0.003***)	0.010 (0.003***)	0.009 (0.003***)	0.010 (0.003***)	0.008 (0.003**)	0.009 (0.003***)	0.006 (0.003**)	0.007 (0.002***)
D_t^{Trump}	−0.021 (0.008**)	−0.017 (0.009*)	−0.028 (0.009***)	−0.023 (0.009**)	−0.030 (0.009***)	−0.025 (0.009***)	−0.025 (0.007***)	−0.021 (0.007**)
t	−0.000 (0.000***)	−0.000 (0.000***)	−0.000 (0.000***)	−0.000 (0.000**)	−0.000 (0.000***)	−0.000 (0.000***)	−0.000 (0.000***)	−0.000 (0.000***)
$t \times D_t^{Trump}$	0.0001 (0.0000**)	0.0001 (0.0001)	0.0001 (0.0000***)	0.0001 (0.0000**)	0.0001 (0.000***)	0.0001 (0.0000**)	0.0001 (0.0000***)	0.0001 (0.0000**)
ΔS_t		0.008 (0.006)		0.017 (0.010*)		0.023 (0.013*)		0.021 (0.011*)
R^2	0.051	0.046	0.050	0.059	0.040	0.052	0.038	0.050
#obs.	271	248	271	248	271	248	271	248

Notes: The dependent variable is the daily change in the n-year expectations component. Robust standard errors in parenthesis. A significance level of 1%, 5% and 10% is denoted by ***, ** and *.

Table 3: Change in n-year term premium

	maturity							
	$n=1$		$n=2$		$n=5$		$n=10$	
constant	0.002 (0.003)	0.002 (0.003)	0.003 (0.003)	0.002 (0.004)	0.002 (0.004)	0.001 (0.004)	0.002 (0.004)	0.001 (0.004)
D_t^{Trump}	−0.007 (0.007)	−0.007 (0.007)	−0.011 (0.009)	−0.010 (0.010)	−0.011 (0.012)	−0.006 (0.014)	−0.006 (0.015)	−0.001 (0.017)
t	−0.000 (0.000)	−0.000 (0.000)	−0.000 (0.000)	−0.000 (0.000)	−0.000 (0.000)	−0.000 (0.000)	−0.000 (0.000)	−0.000 (0.000)
$t \times D_t^{Trump}$	0.0000 (0.0000)	0.0000 (0.0000)	0.0001 (0.0000)	0.0000 (0.0000)	0.0000 (0.0001)	0.000 (0.000)	0.0000 (0.0001)	−0.0000 (0.0001)
ΔS_t		0.010 (0.006)		0.017 (0.009*)		0.021 (0.009**)		0.017 (0.008**)
R^2	0.011	0.002	0.010	0.005	0.008	0.012	0.007	0.002
#obs.	271	248	271	248	271	248	271	248

Notes: The dependent variable is the daily change in the n-year term premium. Robust standard errors in parenthesis. A significance level of 1%, 5% and 10% is denoted by ***, ** and *.

Table 4: Percentage change in stock prices

	index			
	Dow Jones		S&P 500	
constant	0.178 (0.121)	0.169 (0.125)	0.107 (0.120)	0.094 (0.124)
D_t^{Trump}	-1.242 (0.567**)	-1.323 (0.602**)	-1.108 (0.563***)	-1.170 (0.591**)
t	-0.001 (0.001)	-0.000 (0.001)	-0.000 (0.001)	-0.000 (0.000)
$t \times D_t^{Trump}$	0.004 (0.002**)	0.005 (0.002**)	0.004 (0.002*)	0.004 (0.002*)
ΔS_t		0.377 (0.575)		0.532 (0.568)
R^2	0.031	0.036	0.027	0.036
#obs.	271	248	271	248

Notes: The dependent variable is the daily change in the log of the main stock market indices. Robust standard errors in parenthesis. A significance level of 1%, 5% and 10% is denoted by ***, ** and *.