

Fed Independence & The Third Mandate

"The ability to speak does not make you intelligent" - Qui-Gon Jinn, Star Wars, Episode I: The Phantom Menace

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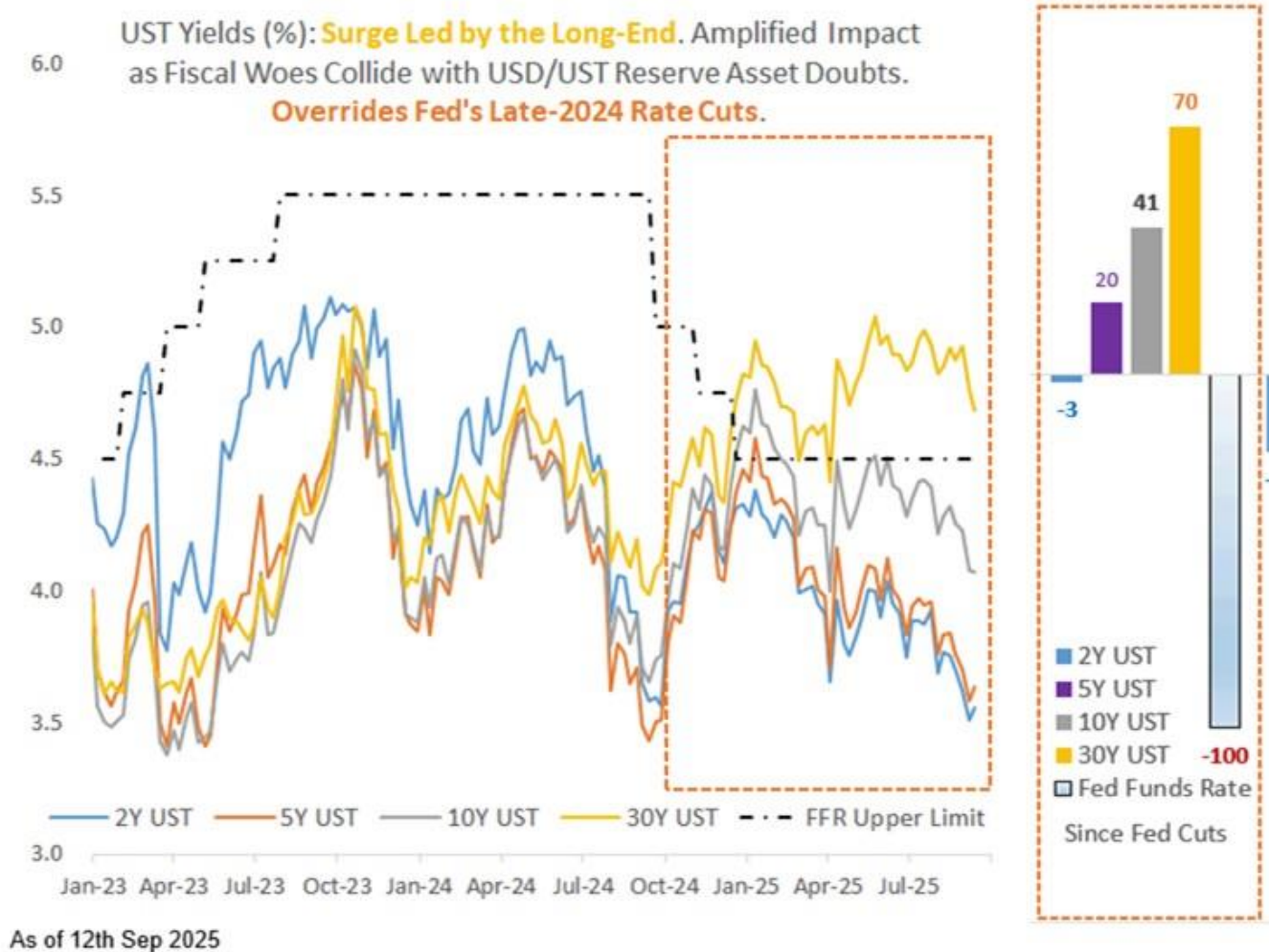
[In a Nutshell:](#)

- Granted that **Stephen Miran's contemporaneous White House appointment alongside his Federal Reserve Board confirmation** is **troubling** by itself.
- But what's potentially **far more problematic for Fed independence** is **Miran's allusion to the "third mandate"**.
- Which refers Section 2A of the Federal Reserve Act outlining *"moderate long-term interest rates"* as one of the FOMC's objectives, alongside "price stability" and "maximum employment".
- ***If aggressively perceived and overly pursued as the overriding remit, active policy efforts to anchor/lower long-end yields threaten to seriously compromise the Fed's autonomy/independence.***
- Monetary **policy credibility inadvertently undermined** as a consequence will **perversely back-fire, raising long-term rates to account for debasement risks.**
- In which case more aggressive rate cuts may lead to QE-type policies heavy on "Operation Twist"/YCC flavour to forcibly anchor yields.
- This in turn threatens to **exacerbate the adverse feedback loop of USD debasement/pressures** and **fiscal dominance.**

SEC. 2A. The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of **maximum employment, stable prices, and moderate long-term interest rates.** [12 U.S.C. 225a]

- **Stephen Miran's appointment to the Fed Board**, now confirmed by the Senate, to (temporarily) take the place vacated by Fed Kugler could **potentially cast** (even more) **doubts on Fed independence.**
- Not just **because of his refusal to relinquish his contemporaneous White House appointment/office, which raises obvious conflict of interest** (political bias) **issues.**
- But **more problematically** from his **overt allusions to the Fed's "third mandate"** *"to promote effectively ... moderate long-term interest rates"*.
- That the **so-called "third mandate"** is in fact **enshrined in Section 2A** [see extract below] of the **Federal Reserve Act** (Fed Act) of 1913 renders this a **potentially serious affront to Fed independence.**

- Even more acutely so, **if the “third mandate” is weaponized as a direct, overriding policy objective rather than being treated as an indirect by-product from the Fed’s “dual mandate”**.*.
- What’s more, **faith in Fed independence could turn more precarious if the Administration coerces the overt adoption of the “third mandate” by the FOMC.**
- To be sure, **markets derive comfort from**, the **Fed’s well-defined and time-tested “dual mandate” for good reasons.**
- Notably because it serves as *objective, transparent, policy trade-off calculus based on which the Fed may exercise policy autonomy* (to verifiably address departures from, and attaining balance towards, this “dual mandate”).
- But with the “third mandate” both Fed autonomy and **markets’ ability to objectively** (and more assuredly) **gauge Fed independence risk being eroded.**
- Crucially, **consequent dangers of “fiscal dominance”***** may mount quickly, *as perceptions of monetary policy credibility are degraded and faith in the USD is undermined amid growing debasement risks.*
- Any signs of **“third mandate” creep into FOMC remit** will materially raise the **threat of perverse policy-market response** and **adverse (policy) credibility-confidence** (in USD and USTs) **loops.**
- Sequentially this may end up following a path of aggressive policy easing and sharpening trade-offs,
 - i. Initially, the “third mandate” imaginably makes the **case for far more aggressive, compensatory rate cuts, given long-end yields have risen, not fallen, since last year’s 100bp cut.**
 - ii. But **perversely**, insofar that the cuts come at the expense of perceived independence, it **may lead to more stickiness and/or upside risk in long-end yields as circular USD debasement and fiscal dominance risks mount.**
 - iii. Consequently, **frustration with the inability to “transmit” rate cuts to the long-end** compels/convince the **revival of Fed balance sheet programs** with a strong “Operation Twist”/YCC flavour **to forcibly anchor long-yields.**
 - iv. Inevitably, this may end up **exacerbating the USD debasement-fiscal dominance-Fed balance sheet reliance adverse feedback loop.**
- The upshot is that **invoking the Fed Act to assert the “third mandate”**, even if it may be argued **on legal grounds, risks being a policy minefield** that *entails spectacular and prohibitively costly failure* on the **optics of Fed politicization.**



* For the record, the Fed's **"dual mandate"** is a reference to;

- "stable prices"**, which is associated with the Fed's 2% inflation target and;
- "maximum employment"**** (or commonly known as "full" employment) that is associated with unemployment rate around 4%) and

** "maximum employment", used interchangeably with "full employment", is strictly speaking, unobservable and non-static. But is widely recognized to be around 4% in the case of the US, once unavoidable labour market friction is accounted for.

*** "Fiscal dominance" refers to a situation in which Fed policies (and independence) are subordinated to fiscal (debt financing) objectives, therefore eroding Fed credibility. Consequently, lifting long-end UST yields alongside pressuring the USD in the case of the US.

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