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US: POWELL, POLITICAL PRESSURE, PUSHBACK

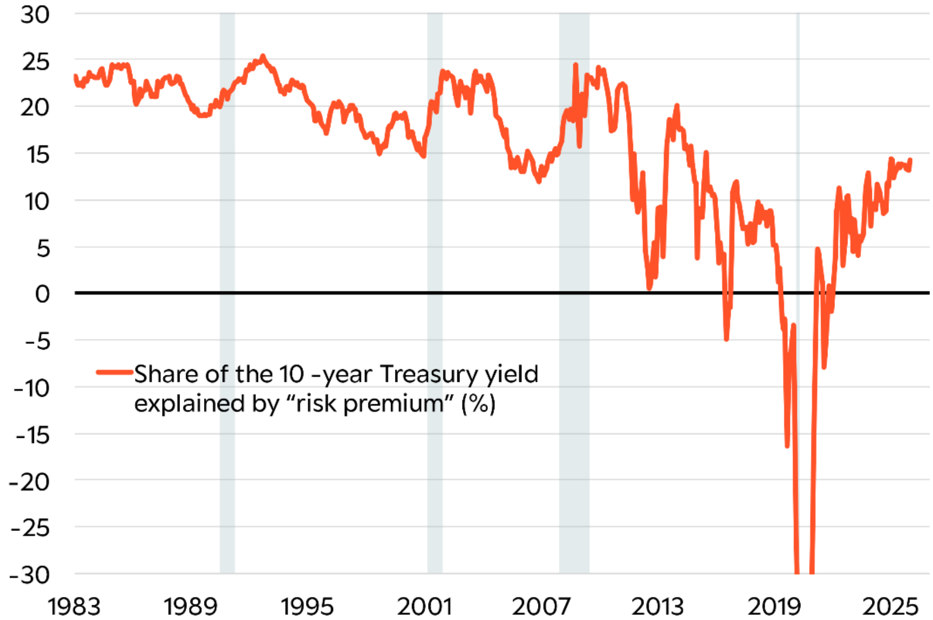
Berenberg Macro View

Fed's independence back in focus once again: 2025 ended the year on a positive note… at least regarding the Fed's independence. The Board announced on 11 December the reappointment of regional Fed presidents, a key event, as the Fed's credibility could face serious risk without such reappointment (see more: No free lunch if you fire the Cook). Just as things seemed stable, Chair Jerome Powell announced yesterday that the Department of Justice threatened the Fed with a criminal indictment related to his testimony before the Senate last June. Powell explained later in his statement that: *"The threat of criminal charges is a consequence of the Federal Reserve setting interest rates based on our best assessment of what will serve the public, rather than following the preferences of the President."* This marks the first time Powell has openly confronted Trump about the Fed's independence. As we have highlighted many times, a Fed that aligns more closely with politics could trigger higher-for-longer inflation, possibly negative real rates at the short end of the curve, elevated long-term borrowing rates and a weaker dollar. Powell's statement shows that he is not ready to back down, but he will remain Fed Chair only until May 2026. June, when we expect the first Fed rate cut of the year, looks set to be a key month, possibly marked by high volatility in June or beforehand.

Will Powell stay until 2028? Although Powell's term as Fed Chair ends in May, he can remain on the Board as a Governor until January 2028. That said, most chairs in the past have left the Fed once their chair tenure expired. If Powell resigns from his Governor position in June, the resulting vacancy would allow President Trump to make a new appointment. If he does not resign, someone else on the Board would need to step down for an outsider -- such as Kevin Warsh or Kevin Hassett -- to become Fed Chair. That person could be Governor Stephen Miran. Unless Trump re-nominates him and the Senate confirms, he would have to step down from his Governor role anyway, as he is completing Adriana Kugler's term, which expires on January 30. If, however Powell resigns, and the Supreme Court allows Trump to remove Lisa Cook from her Governor role, both Kevins could join Miran on the Fed Board. This scenario would significantly increase the likelihood of a Fed willing to cut rates, even if economic data does not strongly support such a move.

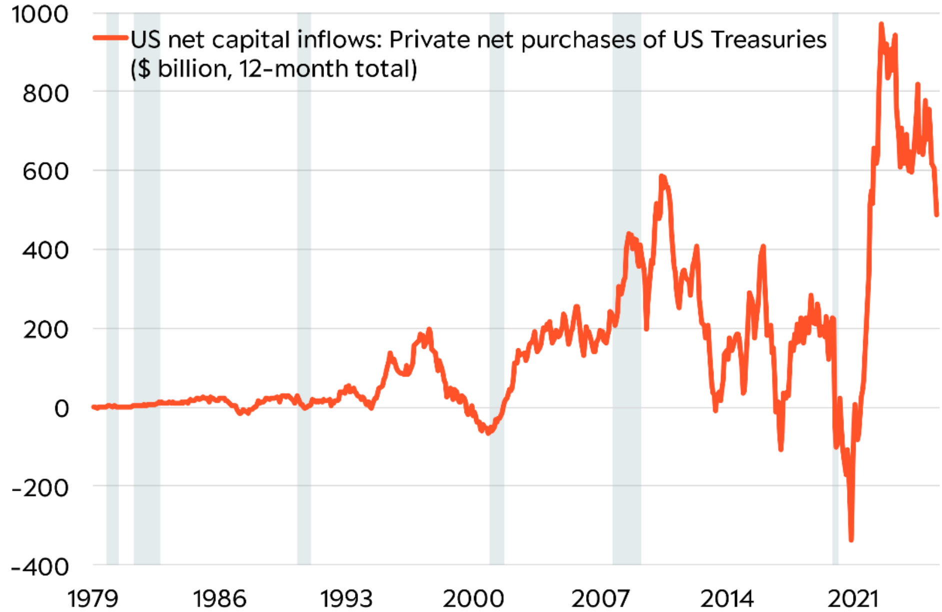
Enough risk priced in? The term premium -- the additional compensation investors demand to hold a long-term bond instead of a series of short-term bonds -- for the 10-year Treasury yield has remained largely unchanged since the start of the year and remains relatively low by historical standards (Chart 1). Similarly, long-term inflation expectations remain well-behaved, projecting an eventual return to the 2% inflation target (see US inflation expectations: anchored, for now). However, the market may be too complacent, in our view. If the Fed pursues an ultra-accommodative monetary policy despite higher inflation, the result could resemble the 1970s in a worst-case risk scenario (see Chart 3). Moreover, if the Fed acts on politics rather than data, foreign investors could pull back on financing the US debt (see Chart 2) and seek new safe havens.

Chart 1: Risk premium not that high despite shaky Fed independence



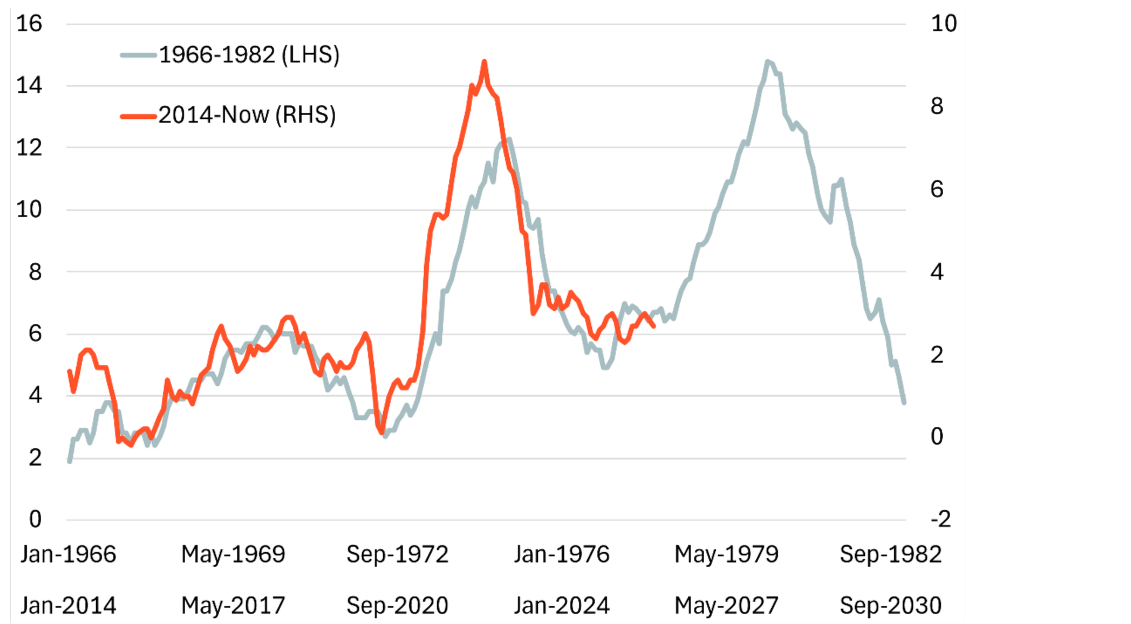
Shading indicates recession. D'Amico, Kim and Wei (DKW) model. Sources: Federal Reserve, Haver Analytics, Berenberg

Chart 2: Will Fed independence fears deter foreign buyers of US debt?



Shading indicates recession. Sources: US Treasury, Berenberg

Chart 3: Growing Fed pressure puts this chart back in focus – Consumer price index (% yoy)



Sources: BLS, Haver Analytics, Berenberg

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