Trump's Squeeze on the Independence of the U.S. Federal Reserve

Risks and global consequences

- President Trump's unprecedented and controversial political pressure campaign to demand interest rate cuts is testing the institutional independence of the U.S. Federal Reserve.
- Institutional risk remains elevated and capitulating to these demands risks triggering a crisis of credibility that could de-anchor inflation expectations, increase market volatility, and destabilize the U.S. and global financial system.

Introduction
The principle of central bank independence is a core tenet of modern Western economic policy, designed to insulate monetary decisions from short-term political whims and prevent inflationary spirals. In the United States, this autonomy, enshrined in law and reinforced by institutional norms, has enabled the Federal Reserve (Fed) to serve as a key pillar of macroeconomic stability and a model for policymakers worldwide.

Mounting pressure from President Donald Trump–marked by personal insults, coercive demands, and now efforts to oust one of its leaders–presents a stark challenge to its institutional autonomy. Trump's tactics are testing the resilience of Fed independence, the credibility of U.S. monetary policy, and the stability of the global financial system.

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The rationale for independence
The independence of a central bank is not an academic abstraction. Experience has shown that political institutions often fail to maintain stable prices.[1] When politicians control monetary policy, they are tempted to create short-term economic booms by pursuing artificially low interest rates or buying government debt. This approach inevitably leads to damaging, high-inflation, volatile growth, and weakened currencies.[2] Notable examples include Germany in the 1920s, Hungary in the 1940s, Zimbabwe in the late 2000s, and Turkey in the 2020s. There are also examples of central banks maintaining their independence in the face of political pressure, such as Germany in 1990, Mexico in the 1990s, and India in the 2010s.

In the United States, the Federal Reserve Act, first enacted in 1913, includes several protections to guard against political interference.[3] Governors are appointed to 14-year terms in staggered terms. They can only be removed "for cause" to insulate them from political influence. And the Federal Open Market Committee's (FOMC) voting structure is designed to foster consensus-based, data-driven decisions.

The country learned firsthand about the risks of politicizing the Fed in the 1970s and 1980s. President Nixon exerted political pressure on Chairman Arthur Burns to lower interest rates in advance of the 1972 election, which contributed to runaway inflation in the 1970s.[4] The next Chairman, Paul Volcker, undertook a painful and unpopular disinflationary campaign of aggressive rate hikes in the early 1980s. The policies initially triggered a deep economic recession before they successfully returned inflation to low single digits.[5]

By comparison, the European Central Bank (ECB) has demonstrated greater resilience than the Fed in maintaining its independence since its creation in 1998. Like the Fed, it prioritizes making decisions on interest rates and asset purchases by unanimity, further reinforcing its non-political nature.[6] However, the ECB's multinational structure inherently diffuses political influence from any single government, and its appointment process involves multiple stakeholders, making it difficult for one political entity to exert undue influence.[7]

A president's war on the Fed

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Trump has long been a vocal critic of Powell, whom he appointed in 2018, during his first term. His attacks have escalated from insults and criticism to threats to fire Chairman Powell. He informed members of Congress in July that he drafted a letter to fire Powell.[8] He publicly criticized Powell for cost overruns of building renovations, using it as a possible justification to push Powell out of his position before his term as Chair expires in May 2026.[9]

However, in late August, Trump shifted his focus to Lisa Cook, who was appointed by former President Biden in 2022 to serve a 14-year term on the Fed Board of Governors. Trump announced in late August that he fired her "for cause," alleging that she committed mortgage fraud in 2021. This move was seen by many as a politically motivated and legally dubious move to test the boundaries of the law and relevant Supreme Court rulings. It also marked the first time a President had attempted to fire a Fed governor.[10] In response, Cook sued Trump, calling her firing an "unprecedented and illegal" move.[11]

Underlying this political pressure is the stark reality of the U.S. debt trajectory. With rising deficits and ballooning servicing costs, the White House is increasingly motivated to lower interest rates to manage the government's borrowing expenses. President Trump has claimed that a significant rate cut could save the government $1 trillion annually in interest costs.[12]

Powell's tightrope walk

Caught between the mounting political pressure and his mandate to guide the economy, Chairman Powell has been forced into a delicate balancing act.

In a late August speech, Powell highlighted inflation risks, noting early signs of rising price pressures, while also acknowledging slack in labor and growth, especially amid soft wage data and a cooling expansion.[13] He struck a carefully balanced tone, though he opened the door to a potential interest rate cut at the Fed's upcoming 16-17 September meeting. U.S. financial markets soared on the prospect of a forthcoming rate cut.[14]

The challenge for Powell is that any interest rate reduction–even if justified by economic data–risks being perceived as political capitulation. If markets and other external actors question the Fed's commitment to discipline, the long-term consequences could be severe.

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Implications

The loss of the Fed's credibility would distort the transmission mechanisms of monetary policy, potentially impairing the bank's credibility. In turn, this could lead to less effective monetary policy, higher inflation expectations, and a weakened ability to control long-term interest rates.[15] It would also lead to reduced capital flows, loss of currency confidence, and higher borrowing costs in international debt markets.[16]

In the near term, the effects are likely to include heightened volatility in U.S. Treasuries and the dollar, along with higher risk premiums on U.S. assets as markets demand compensation for the new political risk.[17] In the longer term, it could lead to the potential de-anchoring of inflation expectations, create a precedent for future political meddling in Fed policymaking, and erode global confidence in the United States as a stable anchor of monetary policy.[18]

The spillover effects would be felt acutely by different actors.

For investors, political interference undermines confidence in predictable, data-driven policymaking, which would lead to market instability. They may also retreat from U.S. assets, which could heighten future funding costs.

The United States would suffer from higher long-term borrowing costs and a tarnished credibility in inflation targeting, undermining one of its key economic strengths.[19]

These risks are not confined to U.S. markets. The erosion of Fed autonomy would also threaten to destabilize the global financial system.

The erosion of Fed autonomy poses grave risks that extend far beyond the United States, threatening to destabilize the global financial system

For emerging economies, a loss of confidence in the Fed could weaken the dollar and lead to increased capital outflows from the United States. More importantly, those with large amounts of dollar-denominated debt would face higher repayment costs. They could also experience capital flight as investors seek safer havens, making it more expensive to finance their development.

In Europe, significant monetary policy divergence between the United States and the EU could destabilize transatlantic capital flows and create new economic challenges.

Globally, more volatile dollar cycles, increased emerging market debt stress, and warnings from international agencies about fragile resilience underscore the gravity of the threat. The International Monetary Fund (IMF) and other international bodies would face immense challenges without the United States as a stable monetary anchor. It could trigger a wave of financial crises, leading to a surge in bailout requests that could strain IMF resources and reduce trust in the global financial order.

Conclusion

The debate is not whether the Fed should be independent–that principle is broadly settled. The critical question today is how severe the consequences will be if Trump succeeds in imposing his will on the institution. Currently institutional risk is high. By pressuring the FOMC and threatening its leadership, he risks setting a dangerous precedent for future political meddling that could take decades to reverse.

It is worth noting that there are extraordinary circumstances under which short-term coordination between fiscal and monetary policy can be justified, such as preventing a total economic collapse or financing a significant war effort.[20] For example, the Fed agreed to the Treasury Department's request to keep interest rates low to support the war during and after World War II.[21] The current situation, however, does not meet those criteria.

Whether Powell's actions are ultimately viewed as credible policymaking or political submission will test the durability of the Fed and place at risk the role of the United States as the bedrock of global financial stability

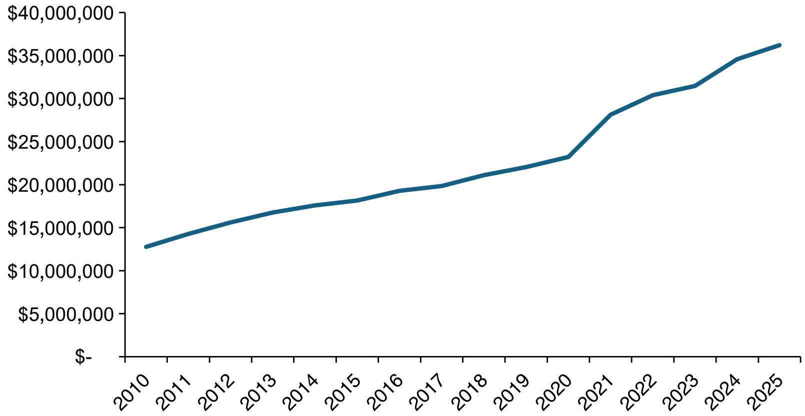
The most likely outcome in the short term is a 25 basis point cut in September, driven primarily by the data. However, Powell is not just navigating economic data; he is defending an institutional pillar of global finance. Whether his actions are ultimately viewed as credible policymaking or political capitulation will test the durability of the Fed and the resilience of international monetary systems.

EXHIBIT 2.0 – HISTORICAL EXAMPLES OF POLITICIZED MONETARY POLICY

Country	Decade	Economic Consequence
Germany	1920s	Hyperinflation
Hungary	1940s	Hyperinflation
United States	1970s	Runaway inflation
Zimbabwe	2000s	Hyperinflation
Turkey	2020s	Runaway inflation

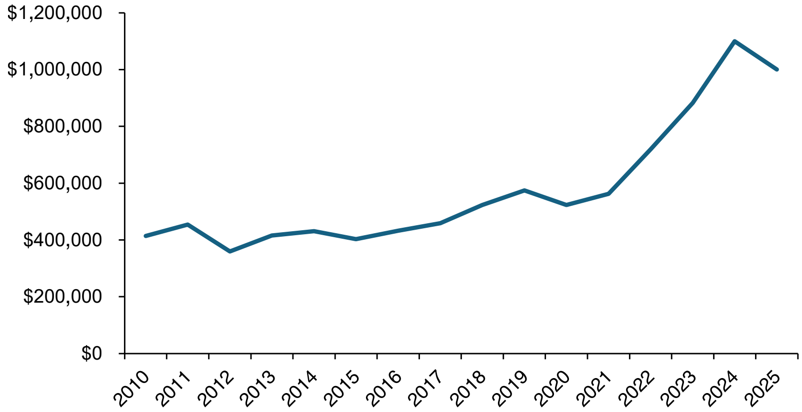
Source: International Monetary Fund.

EXHIBIT 3.0 – TOTAL U.S. PUBLIC DEBT, Q1 2010 – Q1 2025 (MILLIONS OF DOLLARS)



Source: Federal Reserve Bank of St. Louis.

EXHIBIT 4.0 – – INTEREST EXPENSE ON THE NATIONAL DEBT, FY 2010 – FYTD 2025 (MILLIONS OF DOLLARS)



Note: Last updated July 31st, 2025.
Source: U.S. Department of the Treasury.

Notes

[1] https://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/10/May/Fic/ref0318.pdf

[2] https://www.ft.com/content/d2eab80f-1314-41f1-8c1e-5fc3bbfb1e43

[3] https://www.nytimes.com/2025/08/27/us/politics/supreme-court-fed-trump.html

[4] https://www.nytimes.com/2023/04/21/business/economy/arthur-burns-inflation-paul-volcker.html

[5] https://fortune.com/2025/08/22/why-federal-reserve-independence-matters-trump-powell-reagan-volcker/

[6] https://www.bruegel.org/system/files/2022-07/PC%2012%202022.pdf

[7] *Ibid.*

[8] https://www.nytimes.com/2025/07/16/us/politics/trump-powell-firing-letter.html

[9] https://www.bbc.com/news/articles/c1ljlvg1e7eo

[10] https://www.nytimes.com/2025/08/27/us/politics/supreme-court-fed-trump.html

[11] https://www.nytimes.com/interactive/2025/08/28/business/lisa-cook-lawsuit-trump.html

[12] https://www.reuters.com/world/us/trumps-interest-rate-demands-put-fiscal-dominance-market-spotlight-2025-08-19

[13] https://www.federalreserve.gov/newsevents/speech/powell20250822a.htm

[14] https://edition.cnn.com/business/live-news/fed-powell-jackson-hole

[15] https://english.elpais.com/economy-and-business/2025-08-27/why-is-central-bank-independence-important-and-what-happens-when-it-is-under-attack.html

[16] *Ibid.*

[17] https://www.morningstar.com/markets/why-feds-independence-matters-markets-economy-your-wallet

[18] https://www.reuters.com/business/finance/loss-central-bank-independence-could-lead-instability-imf-warns-2025-07-29/

[19] https://www.ft.com/content/d2eab80f-1314-41f1-8c1e-5fc3bbfb1e43

[20] https://www.imf.org/en/Publications/fandd/issues/2023/03/an-unconventional-collaboration-giancarlo-corsetti

[21] https://www.ft.com/content/d2eab80f-1314-41f1-8c1e-5fc3bbfb1e43