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Trump vs. the Federal Reserve

The Battle of Wills Threatening an Eminent Institution

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Economic Studies Unit

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From the moment he returned to office, US President Donald Trump has charted an economic course for the United States based on his deep personal convictions, blending a strong desire for trade deals with protectionist zeal and a firm conviction that the US had long been taken advantage of by its global partners. To advance these convictions, he has surrounded himself with a team of officials who either genuinely shared them or quickly realized that their own professional survival depended on emulating and praising them. This blurring of the lines between his personal convictions and the tools of institutional power could have far-reaching, long-term repercussions, perhaps most prominently through his attempts to reshape or even seize total control of the Federal Reserve, which since its creation has managed (with limited exceptions) to shield itself from political interference and pressure.

I. Trump vs. the Federal Reserve

In the structure of American economic governance, the Federal Reserve is a vital backstop against day-to-day political shifts as the institution entrusted with preserving long-term monetary stability. Yet Trump appears unconvinced of the role interest rates play in regulating monetary stability, viewing them not as a balanced, technical tool for controlling inflation and employment, but rather seeing rate cuts as a direct lever for boosting growth, revitalizing markets, winning voter support, and enhancing his electoral prospects.

Trump has used every means at his disposal – from relentless public pressure to scathing tweets and carefully calculated leaks – to persuade Federal Reserve Chairman Jerome Powell of the need for a rapid interest rate cut. Had it been legally and politically possible, Trump would have summarily fired Powell. However, aware of the constitutional and legal immunity the Fed chairman enjoys, the president has lately resorted to alternative means of pressure, most notably by stoking public anger over the Fed's allocation of funds to renovate its headquarters, which he has presented as a sign of extravagance and detachment from the suffering of ordinary Americans.

Trump has sought to link this behaviour to the policies of the Democrats, led by his arch-rival former President Joe Biden, and the Federal Reserve, whose strategy he has described as foolish and uninspired. As well as constantly questioning the competence and motives of Fed officials, especially Powell, and insinuating that they are harming the American economy, Trump has continued his relentless quest to subjugate the institution to his will. The more his criticism and attempts to overthrow the staff of the Fed have intensified, the more this has unsettled the markets, stoking fears among investors and setting exchange rates fluctuating.[1]

1 Carolina Mandl & Davide Barbuscia, "Investors Fear Trump's Attacks on Powell Will Pile on Pain", *Reuters*, 22/4/2025, accessed on 13/7/2025, at: https://acr.ps/1L9GPzE.

II. US Presidents and Intervention in Monetary Policy: A Crisis-Riddled Path

Presidents exerting pressure over monetary policy is not a new phenomenon. Throughout the history of the Federal Reserve, politicians have on numerous occasions attempted to manipulate its decisions to serve their immediate political goals – generally with disastrous consequences. In the mid-1960s, President Lyndon Johnson exerted intense pressure on then-Fed chairman William McChesney Martin Jr. to adopt an expansionary monetary policy to finance the Vietnam War and Johnson's "Great Society" programmes. In a heated meeting in 1965, Johnson confronted him, saying: "Martin, my boys are dying in Vietnam, and you won't print the money I need." The situation escalated until he began physically shoving Martin around the room. While Martin resisted at first, he eventually capitulated.[2]

The most prominent example of such an approach came with President Richard Nixon, who exerted intense pressure on then-Fed chairman Arthur Burns to lower interest rates in the run-up to the 1972 election. The economy rebounded in the short term, but at a cost: the country subsequently entered an era of stagflation, combining the worst aspects of both inflation and recession.[3] This was not a new phenomenon; the late 1920s had witnessed underlying pressures that prompted the Federal Reserve to cut interest rates in 1927, fuelling stock market speculation and helping form the bubble that later burst, sparking the Great Depression. President Herbert Hoover, who took office in 1929 just before the depression, was criticized for this policy despite bearing no direct responsibility for it. [4]

In this context, the Bretton Woods crisis of 1971 also stands out as a pivotal moment at which investors lost confidence in the dollar. The crisis began when President Nixon suspended the gold standard, spelling the end of a global monetary system that had been based on the stability of the greenback in the years following World War II. In essence, the crisis stemmed from the adoption of expansionary fiscal and monetary policies without regard to the long-term inflationary consequences.

Today, political pressure on the Federal Reserve to cut interest rates despite persistently high inflation is driving dynamics that are disturbingly similar to these past experiences. Just as historical political interventions led to a loss of confidence in the dollar and undermined monetary stability, attempts to undermine the Federal Reserve's independence could prompt a new wave of inflation and undermine the dollar's status as the global reserve currency. However, the fundamental difference in the current context is that the world economy no longer operates on a fixed exchange rate system. This means that any collapse in confidence could manifest in more dangerous forms, such as countries shifting their reserves to alternative currencies, or an acceleration of capital flight, potentially with consequences that far exceed those of previous crises.

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2 Mark Thoma, "Federal Reserve Independence: The Never-Ending Story", *Milken Institute Review*, 20/10/2017, accessed on 16/7/2025, at: https://acr.ps/1L9GPzj.

3 Burton A. Abrams, "How Richard Nixon Pressured Arthur Burns: Evidence from the Nixon Tapes", *Journal of Economic Perspectives*, vol. 20, no. 4 (Fall 2006), pp. 177-188.

4 Stella Nolan, "Presidents Trump and Nixon: A Tale of Two Tariff Policies", *EV Magazine*, 3/4/2025, accessed on 22/7/2025, at: https://acr.ps/1L9GPLj.

The example of Türkiye represents another case reminiscent of the current Trump-Powell standoff in terms of origin and context. In 2018, Turkish President Recep Tayyip Erdoğan began intervening directly in the Central Bank's policies, after repeatedly objecting to the bank's decisions to raise interest rates in order to curb inflation and achieve economic stability. Erdoğan then dismissed five central bank governors, while continuing to insist on a policy of lowering interest rates. As a result, Türkiye experienced unprecedented inflation, which peaked at nearly 85% in 2022. While this subsequently declined, the country continues to face high inflation. Consequently, the Central Bank was forced in 2023 to implement a series of sharp interest rate hikes, from 8.5% to 50%, while the short-term interest rate at the time of writing stood at 45%. Although the US is unlikely to witness such levels of inflation, especially given the strength of its monetary institutions, the Turkish experience represents a clear warning to the Trump administration about the risks of undermining the Federal Reserve's independence and influencing its decisions outside a sound professional and economic framework.[5]

III. The Risks of Cutting Interest Rates Without Solid Fundamentals

Amid the escalating confrontation between Trump and Powell – or rather, the war the former is waging against the latter – Trump appears convinced that aggressively pushing for interest rate cuts, even in the absence of sufficient evidence that inflation forecasts are stabilizing, will deliver immediate benefits for the US that are consistent with his other policies. Proponents of this approach argue that it would stimulate aggregate demand, revive economic growth, and reduce the cost of servicing the US federal debt, which has reached (and is even expected to exceed) historic levels, in light of the controversial tax reforms and economic packages passed by Congress in the form of Trump's "Big Beautiful Bill."

However, the risks in the medium and long term may be more evident. If attempts to remove Powell under political pressure succeed, an interest rate cut could backfire, with negative consequences both for the economy and the reputation of the Fed itself. Although such a cut may be intended to reduce borrowing costs and alleviate Washington's debt burden – which is rising due to the passage of the Big, Beautiful Bill and the unprecedented additional deficits it will impose on the US Treasury – markets may interpret that as rolling back the Fed's commitment and ability to combat inflation under political pressure. This would push Treasury yields and long-term interest rates higher, rather than lower, undermining the intended economic stimulus and plunging the US budget into a spiral of ever-increasing deficits.[6]

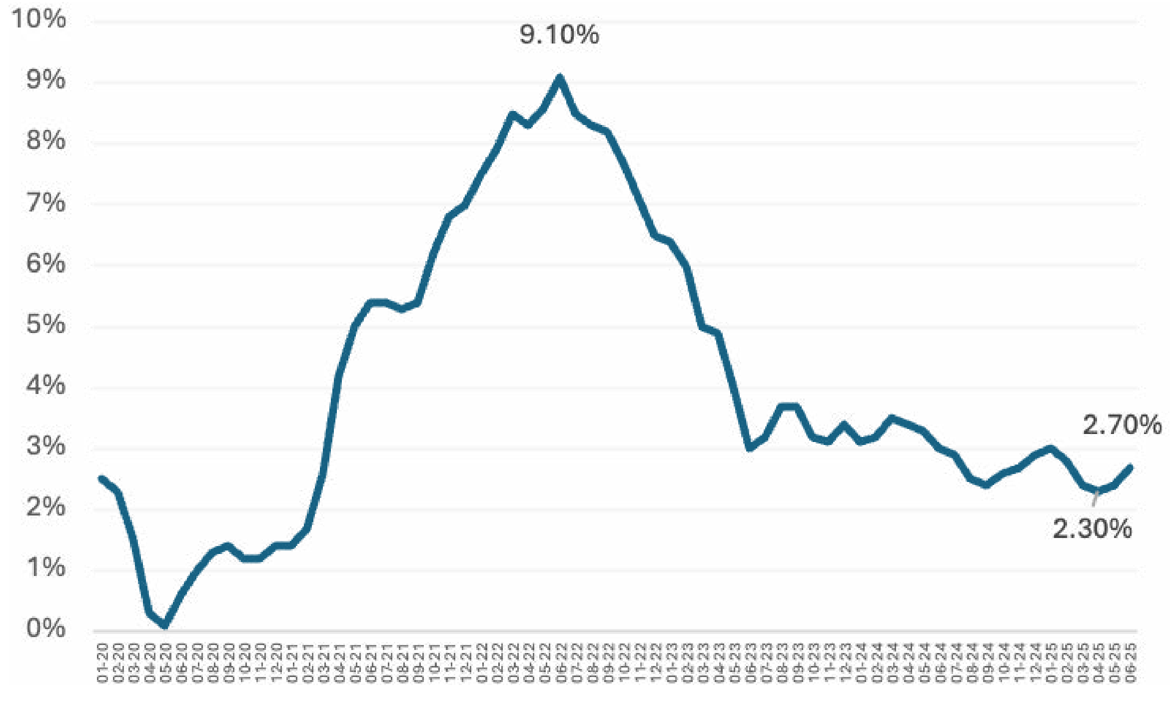
5 William Edwards & Brent D. Griffiths, "Look at Turkey if you Want to Know Why Markets Hate the Idea of Trump Messing with the Fed", *Business Insider*, 18/7/2025, accessed on 22/7/2025, at: https://acr.ps/1L9GP7X.

6 Jeff Cox, "Unraveling the Legal, Economic and Market Ramifications if Trump Tries to Fire Fed Chair Powell", *CNBC*, 19/7/2025, accessed on 20/7/2025, at: https://acr.ps/1L9GPgN.

Rising government bond yields could also lead to higher mortgage costs, as mortgages are more closely linked to bond yields than to Fed interest rates.[7] Furthermore, harming the Fed's independence would incur irreparable reputational costs, and could even prompt it to tighten its stance at a time of rising inflation forecasts. Such an approach could also foreshadow the rise of speculative bubbles, especially given the growing disconnect between US markets and their real-world economic fundamentals. This situation bears worrying similarities to the dynamics that prevailed in the period leading up to the global financial crisis of 2008.

The latest official inflation figures also paint a murky picture regarding the future trajectory of prices, especially in light of the uncertainty surrounding customs arrangements and US trade relations with its partners, particularly those who take a hard line in negotiations. The data for June 2025 suggests that a new wave of inflation may be in the offing, following a period of relatively low inflation over the first few months of the year. A number of analysts have suggested that this increase stems from Trump's tariff hikes on certain imports and their delayed impact on domestic price levels, due to the depletion of commodity inventories that had swelled due to an unusual increase in imports during the first quarter, as firms sought to pre-empt the new tariffs. As these inventories gradually decline, inflationary pressures are expected to tick up again in the second half of the year, complicating the task of monetary policy in achieving a balance between price stability and supporting economic growth.

Figure 1. US Monthly Inflation Rate (Year-on-Year)

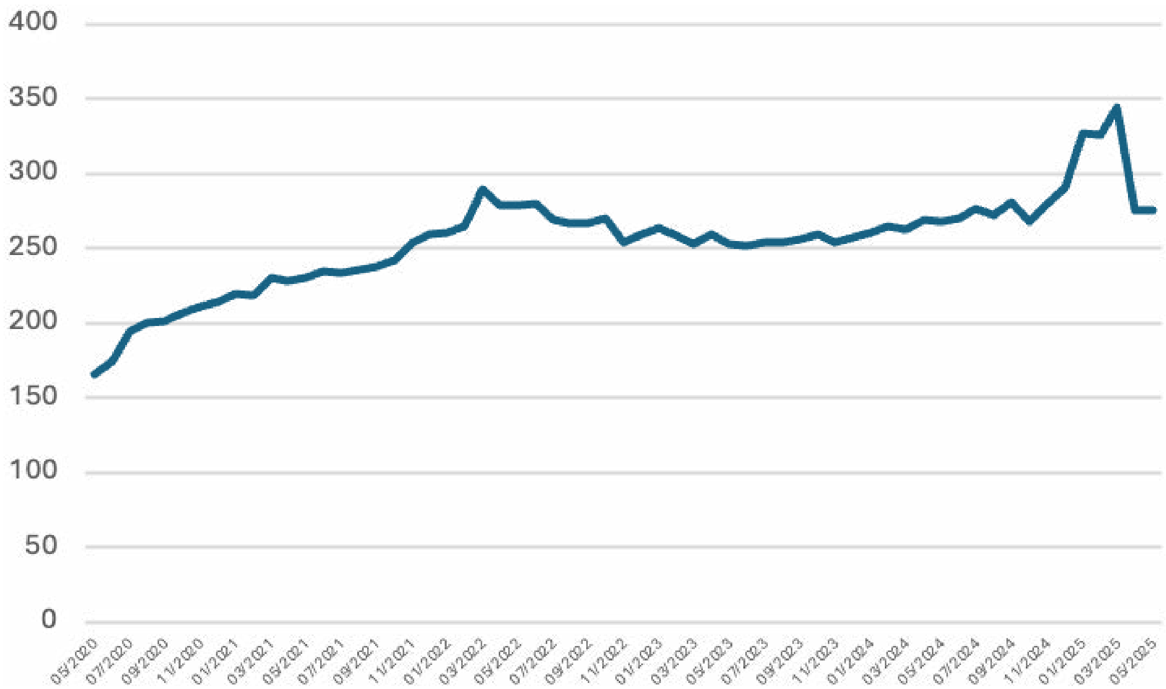


Source: US Bureau of Labor Statistics, "12-Month Percentage Change, Consumer Price Index, Selected Categories", accessed on July 21, 2025, at: https://acr.ps/1L9zRkU.

7 Jessica Dickler, "What a Trump, Powell Faceoff Means for your Money", *CNBC*, 18/7/2025, accessed on 20/7/2025, at: https://acr.ps/1L9GPtF.

The worst-case scenario facing the US economy is that of a slide into stagflation, resulting from the interaction of several factors and policies pursued by Trump. On the one hand, the US president's public confrontation with the Federal Reserve and its chair is putting pressure on inflation forecasts, as well as deliberately undermining the Fed's independence and ability to use its monetary tools to control inflation. On the other, Trump's aggressive trade policies, through which he is trying to impose his dictates on trading partners – especially given the faltering negotiations with some of the biggest – could inflict significant damage on supply chains and production within the US, leading to ever more uncertainty. Given these factors, the US economy may experience a slowdown, especially given that in 2025 it recorded its first quarterly contraction in three years, driven primarily by an exceptional increase in imports during the first quarter, alongside a decline in consumer and federal spending.[8] Although imports declined in the second quarter, they remained higher than they were in the same period in 2024, a situation that may persist into the second half of 2025, placing additional downward pressure on economic growth.

Figure 2. Monthly US Merchandise Imports (USD billions)



Source: US Bureau of Economic Analysis (BEA), "International Trade in Goods and Services", accessed on 22/7/2025, at: https://acr.ps/1L9zQoA.

8 Paul Wiseman, "US Economy Shrank 0.5% in the First Quarter, Worse than Earlier Estimates Had Revealed", *AP Business*, 26/6/2025, accessed on 21/7/2025, at: https://acr.ps/1L9GPqZ.

IV. Pressures on Inflation Forecasts and the Exacerbation of the Fiscal Deficit

If Trump emerges victorious from his showdown with Powell – either by pushing him to resign in order to replace him with a new Fed chair more willing to accommodate the president's whims on interest rate cuts, or by pressuring Powell to cut rates without waiting for the right economic foundations for such a move – this could affect confidence in US government bonds and increase the risks they carry, thus limiting demand for them. These factors, along with the additional deficit resulting from the Big Beautiful Bill, will add to the downward pressure on bond prices. This will lead to higher yields,[9] exacerbating the problem of the public debt burden, which continues to break new records.

V. Where Does this Leave Arab Countries that Peg Their Currencies to the Greenback?

The Federal Reserve's monetary policy poses a perennial challenge to Arab countries that peg their currencies to the US dollar or maintain a fixed exchange rate regime, such as Saudi Arabia, the United Arab Emirates, Qatar, Bahrain, and Jordan. Since 2022, these countries have been forced to mimic the Fed's decisions to raise interest rates despite having few domestic reasons for doing so, in order to maintain the stability of their currencies and prevent capital flight. This has entailed tangible economic costs, most notably slower domestic growth, a decline in investment, and higher financing costs, especially in non-oil sectors that rely on bank lending. Consequently, these countries – like others with dollar-pegged economies – ultimately find themselves hostage to decisions made outside their borders. Looking forward, were Trump to succeed in asserting his dominance over the Federal Reserve, they may be forced to follow the dictates of a US president driven by a political agenda that pays little heed to their economic needs.

As tensions escalate between Trump and the Federal Reserve, these countries are left with complicated options, as they face two main scenarios. First, if the Fed yields to pressure from Trump and cuts interest rates, they will be obliged to cut their own domestic lending rates to maintain exchange rate stability, even if this does not align with the broader needs of their economies. This could give rise to credit bubbles in sectors such as real estate and consumer spending, as happened in Dubai in 2008 as a result of sharp interest rate cuts. Second, if the Fed maintains its hawkish stance and refrains from cutting interest rates, high borrowing costs will continue to stifle economic growth, exacerbating pressure on countries with a large portion of their sovereign debt denominated in dollars.

9 Howard Schneider, "Why Trump's Push for a 1% Fed Policy Rate Could Spell Trouble for US Economy", *Reuters*, 14/7/2025, accessed on 21/7/2025, at: https://acr.ps/1L9GP6G.

VI. The Political Economic Consequences for the US

There is a stark paradox in the relationship between Trump's pressure on the Federal Reserve to cut interest rates and the nature of his fiscal and trade policies, which collude against monetary easing. Even as Trump seeks to force the Federal Reserve to adopt an expansionary policy, supposedly in order to stimulate growth and avoid a recession, his decisions to increase government spending, under the Big Beautiful Bill, and to impose high tariffs on imports, have conspired to create a complex inflationary environment in which it is even more difficult to justify a rate cut. Such tariffs constitute an indirect tax on consumers and raise the cost of living; a study by the Peterson Institute for International Economics showed that the tariffs Trump had imposed in 2018 were mostly passed on to consumers.[10]

According to the principles of conventional monetary policy, interest rate cuts are only justified by weak aggregate demand or the threat of economic contraction—not in an economy driven by accelerated government spending and protectionist policies that raise prices. Under these circumstances, combining fiscal and monetary stimulus essentially pours fuel on the fire of inflation, threatening to lead to a dynamic known as "cost-push inflation", a catastrophic scenario similar to the stagflation experienced by the US in the 1970s. This poses a double danger: a slowdown in growth accompanied by a rise in prices, a conundrum that is difficult to solve using traditional tools.

These realities place the Fed in an extremely delicate position. It makes no sense to adopt a policy of cutting interest rates at a time when core inflation is persistently rising; financial data suggests that the US economy's need for additional stimulus is far outweighed by its need for a balanced macroeconomic policy. The matter comes down to one fundamental question: How can an institution of the size and stature of the Fed make monetary decisions based on political pressures, rather than objective macroeconomic indicators?

The political and economic landscape in the US increasingly exposes the fragility of the institutional and constitutional structure that has been the foundation of American stability for decades. What we are witnessing today – the ability of a populist leader, no matter how popular, to singlehandedly ride roughshod over regulatory and executive controls that had evolved over centuries of institutional accumulation and historical experience – sends a worrying message with implications far beyond the current moment. The issue is no longer limited to the immediate repercussions of a potential interest rate cut or a temporary crisis of confidence. Rather, it will now impact future confidence in the ability of the American economy to recover within a cohesive and independent institutional framework.

If this gradual erosion of institutional independence is left unchecked, it will not only weaken the effectiveness of economic policy, but also threaten the ability of the US to maintain its position as a pillar of global financial stability. From this perspective, strengthening the prestige of institutions

10 Gary Clyde Hufbauer & Ye Zhang, "Trump Jawbones Retailers to Eat Tariff Costs", Peterson Institute for International Economics, 3/6/2025, accessed on 22/7/2025, at: https://acr.ps/1L9GPAR.

– first and foremost, the Federal Reserve – is strategically vital, in order to maintain confidence in the American economic model. It is also essential to examine other international cases where leaders might adopt an approach similar to Trump's. Such practices add an additional aspect to the assessment of economic risk and highlight the importance of institutional infrastructure as a crucial factor in the stability of economic systems around the world.

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