Mr. Trump's attacks on the Fed and their consequences

We are revising our US key interest rate forecast and now expect three additional rate cuts in 2026. It is becoming increasingly clear that Donald Trump will replace the current chair of the Federal Reserve Board with a dovish monetary policymaker. The politicization of the Fed points more than ever to a weaker US dollar. We have largely confirmed our other forecasts.

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Three additional interest rate cuts in 2026

We had previously forecast three interest rate cuts by the Federal Reserve by the first quarter of next year – which would reduce the key rate from the current 4.5% (upper limit of the key interest rate range) to 3.75%. We now expect three further interest rate cuts to 3.0% in the coming year.

Trump's influence on the Fed is growing more than expected

We always assumed that Donald Trump would push the Federal Reserve toward a looser monetary policy and that the Fed would partially yield to the pressure. But Trump's pressure has now reached a new level:

- Shortly after taking office, Donald Trump accused Fed Chairman Jerome Powell of being “always late and wrong.” He said Powell's departure could not come soon enough and threatened to fire him. After negative market reactions, he withdrew this threat. But he quickly resumed his smear campaign. Most recently, he even called Powell a “knucklehead” and a “fool.”
- Trump accuses the Fed of exceeding the budget by $700 million for the supposedly “ostentatious” renovation of its buildings in Washington. This accusation represents a new level of hostility. Although members of the Fed's board of governors cannot be dismissed for differences of opinion on monetary policy, they can be dismissed “for cause.” Such a reason could be the alleged waste of public funds.
- Among the frequently mentioned successors to Jerome Powell, who is due to step down next May as Board chair, are two men who are loyal to Trump. Kevin Hassett, director of the US President's National Economic Council, has participated in various attacks on Jerome Powell. The same applies to Kevin Warsh, who was Fed governor from 2006 to 2011 and has long been in the Trump camp (see box).

All in all, the likelihood that Powell's successor will pursue a more expansionary monetary policy in line with Trump's wishes has increased in recent weeks. This is the main reason why we now expect three more interest rate cuts in 2026 than previously anticipated.

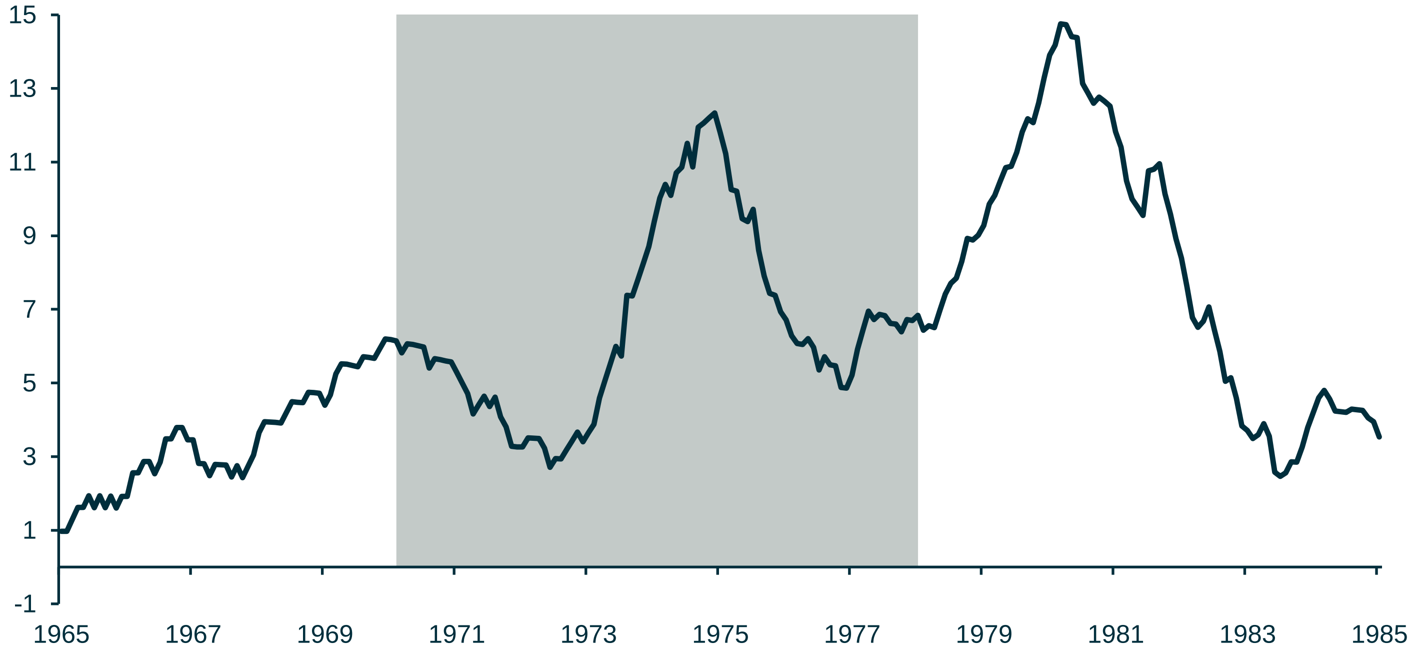
History repeating: The 1970s Fed

The 1970s show how strongly politicians can influence central bankers and thus drive up inflation. This is particularly true of US President Richard Nixon, who appointed the respected economist Arthur Burns as chair of the Federal Reserve Board in 1969. The transcripts of tape recordings made by Nixon from 1971 onwards, which have since been published, show how submissive the Fed chairman was towards Nixon. Nixon complained about Burns' predecessor, Bill Martin, saying that he “always did things six months too late,” to which Burns, who had just taken office, dutifully replied: "Yes, Mr. President. I don't like to be late.“ Nixon then offered to allow him to visit him privately at any time, for which Burns expressed his gratitude, prompting Nixon to remark cynically, ”I know there is a myth of an independent Fed." [1]

In fact, Burns allowed Nixon to enlist his help in loosening monetary policy in the run-up to the 1972 presidential election. As a result, the M2 money supply, which was relevant at the time, rose sharply, and economic growth reached an impressive 7.7% in the 1972 election year, which helped Nixon win the election. Throughout his tenure (1970 to 1978), Arthur Burns was unable to free himself from the demands of successive US presidents for a loose monetary policy. This is an important reason for the high inflation in the 1970s and the early years of the following decade. The rise in prices was only slowed down significantly under the presidency of Ronald Reagan (Chart 1). He gave the Federal Reserve the backing it needed to curb inflation through a restrictive monetary policy.

Chart 1 - If the Fed get too close to the White House ...

Consumer price index, annual rate of change in %, monthly data. Grey-shaded area: Term of office of Arthur Burns as Fed chair



Source: S&P Global, Fed, Commerzbank Research

Eroding Fed independence increases long-term inflation risks ...

We do not yet know how strongly Powell's successor will bow to Trump's will and to what extent he will be able to bring the other members of the Open Market Committee over to his side. But the direction is nevertheless clear: the independence of the Federal Reserve is likely to erode during Trump's second term. This will increase the risk of inflation in the longer term, especially as inflation is likely to rise in the coming months anyway due to the massive increase in tariffs.

Market participants are talking a lot about the threat of erosion of central bank independence. But they seem to be hoping that it will not be so bad in the end because Trump does not want to see a sharp rise in inflation expectations and bond yields. Accordingly, long-term inflation expectations as measured by US inflation swaps have not yet risen significantly. But it would be surprising if the emerging politicization of the Fed did not cause long-term inflation expectations to rise.

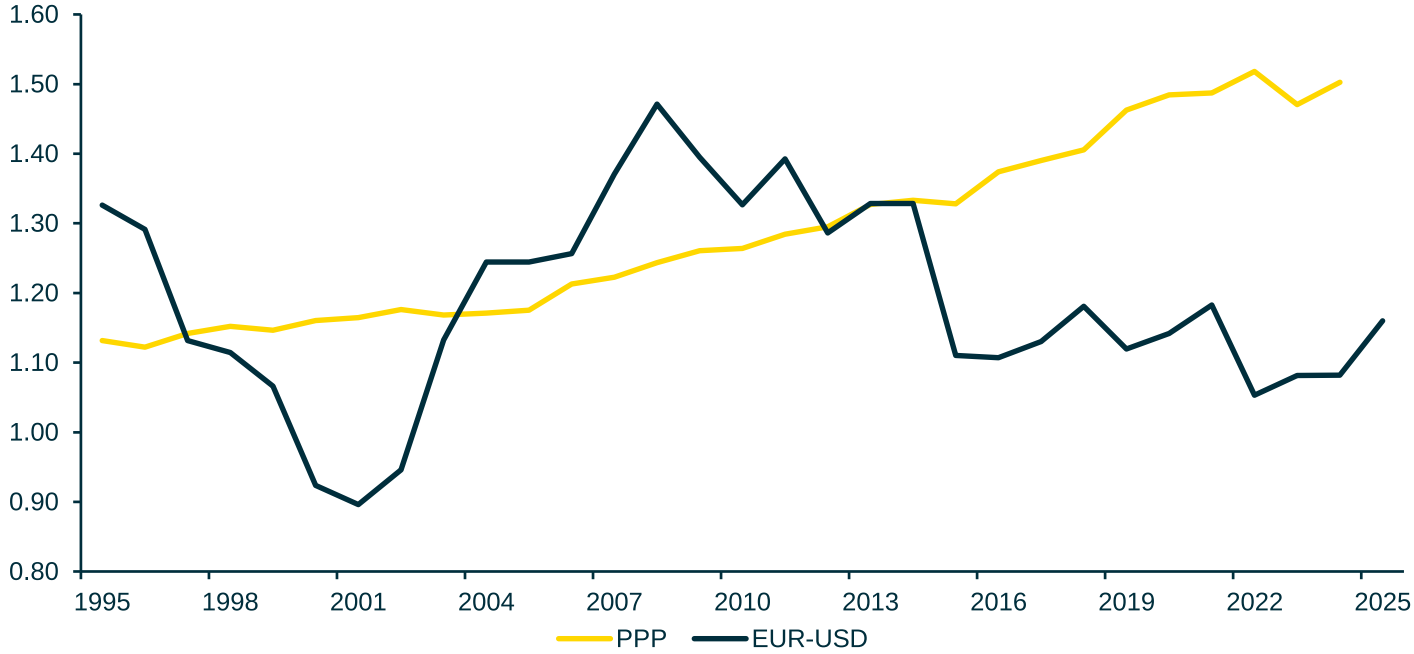
... and weakens the dollar

If the inflation risks posed by Trump's Fed appointments become more apparent, long-term inflation expectations are likely to rise. This argues more than ever for a weaker dollar, especially since it is still significantly overvalued against the euro in terms of purchasing power parity (Chart 2). We have revised our forecast for EUR/USD significantly upward for the next twelve months to 1.25.

We have been expecting yields on ten-year US government bonds to rise for some time now. We are sticking to this assessment. Although the three additional Fed interest rate cuts in themselves argue in favor of a downward revision of our yield forecast, the likely rise in long-term inflation expectations should largely offset this.

Chart 2 - The dollar is too expensive in any case

EUR-USD exchange rate and purchasing power parity (PPP), annual data. EUR-USD for 2025: July 16, 2025



Source: Bloomberg, OECD, Commerzbank Research

The other forecasts remain unchanged

Unlike the US forecasts, we have not changed our forecasts for the eurozone. We continue to expect a moderate economic recovery (2025: 0.7%, 2026: 1.2%). The ECB is therefore likely to cut its key interest rates for the last time in September (deposit rate: 1.75%).

We have raised our 2025 growth forecast for China slightly from 4.0% to 4.5%. Following the surprisingly strong growth in the second quarter, statisticians are unlikely to publish a growth figure for the year as a whole that is too far below the government's 5% target. We remain cautious about China, partly because consumer sentiment has still not recovered from the coronavirus crisis and overcapacity is weighing on corporate profits and investment.

[1] Burton A. Abrams, **"How Richard Nixon Pressured Arthur Burns: Evidence from the Nixon Tapes."** Journal of Economic Perspectives, Volume 20, Number 4, Fall 2006, Seite 177 - 188. (back to text)

BOX: Fed Board and FOMC

The Fed's central governing body ("Board") is based in Washington and consists of seven members, known as governors. Governors are nominated by the president and must be confirmed by the Senate. Governors serve 14-year terms, with one term expiring every two years. If a governor resigns before the end of his or her term, which is the norm rather than the exception, his or her successor is appointed only for the remainder of the predecessor's regular term. The chair of the Board, currently Jerome Powell, serves a four-year term. Powell's term as chairman expires in May 2026 (his term as governor, however, does not expire until January 2028). Trump can then nominate a new board chairman.

The Board is currently at full strength. Adriana Kugler's term ends in January. Donald Trump can then appoint a new governor, who would then probably also be his candidate for the position of chairman. It is generally expected that Powell will also step down as governor at the end of his term as Board chairman; Trump could then nominate a second new governor in May.

The Fed's monetary policy-making body is the Federal Open Market Committee (FOMC). It consists of the seven board members, the president of the New York Fed, and, on a rotating annual basis, four of the remaining eleven regional Fed presidents. The FOMC elects its own chair. Traditionally, this is the chair of the Federal Reserve Board.

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