

EDITORIAL

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THE FED UNDER PRESSURE: A TEST WITH GLOBAL STAKES

The independence of the Federal Reserve (Fed) has been challenged by the US administration, but it remains intact. As the Kevin Warsh era begins with the 16-17 June FOMC meeting, the simultaneous strength of inflation and the labour market set the stage – should it persist, as we anticipate – for monetary tightening to start by the end of the year. Yet the turbulence at the end of Jerome Powell's term is a reminder that central bank independence is not a given. The stakes go beyond price stability alone and extend to the global financial architecture itself.

Since returning to the White House, Donald J. Trump has not spared the Fed, openly criticizing its former Chair, Jerome Powell, for rate cuts deemed insufficient and, in the process, exerting explicit and sustained pressure on the central bank's independence. The former Fed Chair — but still an FOMC member — has even described the episode as a "stress test", that is, resilience probed under heavy pressure. Initially verbal, the pressure shifted onto administrative and legal ground: first in August 2025, against Governor Lisa Cook, then in January 2026, with proceedings aimed at Powell himself over the renovation of the Fed's headquarters.

For now, the Fed is passing the test, and it should continue to act independently. The judicial rulings handed down so far have generally favored the institution's autonomy from the executive¹. The Fed's internal culture has also played a role, not only in keeping Cook on the board. The FOMC has stayed on the course, keeping an approach dictated by the data and the economy outlook. It held the policy rate through the first half of 2025, when the effects of the additional tariffs on inflation were not yet known. And it eased in the second half of the year because the labour market was weakening, not because of political pressure. Dissent was voiced, admittedly more frequent than usual, but Powell's legitimacy was never called into question.

CHAIRMAN AND FED FUNDS: A TWOFOLD CHANGE OF DIRECTION

Warsh's arrival at the head of the FOMC should not, in itself, change the situation. We expect monetary policy to continue aligning with the dual mandate and to be driven by economic conditions. The committee's voting structure is the first safeguard, not least in fixing the Fed Funds target range. Warsh's vote does not carry more weight than any other governor's or voting regional Fed president's — and the latter generally appear concerned by the elevated and growing level of inflation.

Furthermore, Kevin Warsh's track record and public positions do not suggest much appetite for instrumentalizing the central bank for political or fiscal ends. His first departure from the Board of Governors (2011) stemmed from a disagreement on quantitative easing (QE), and he reiterated his critical view of the use of the Fed's balance sheet at his confirmation hearing before the Senate Banking Committee. In his view, the size of the balance sheet has become "an ordinary recurring force", diverted from his purpose as an instrument used "in times of emergencies". Warsh therefore considers that this tool has become "unhelpful" in "achieving the dual mandate" and that shrinking it is imperative.

In recent months, the Fed had leaned towards the risks surrounding the maximum employment objective, while inflation remained above-target but was edging closer to it. With inflation having resumed an upward path and employment concerns having receded, the

FOMC should now rebalance its stance. Although driven by energy prices, the combination of that inflationary dynamic with a rebounding labour market and still-strong growth cannot be ignored by the Fed. Governors Waller and Bowman have each acknowledged, to differing degrees, that their earlier dovish stance no longer holds. The debate is thus no longer about whether rate cuts are warranted, and the Fed's next move should be upward. That is our call — a first 25bp hike in December, followed by two more, in January and March 2027, taking the target range to 4.25%-4.5%. These three increases would reserve the three insurance cuts implemented in 2025 in the face of labour-market risks that have since faded.

INDEPENDENCE: A FRAGILE CONSENSUS

The pressure on the Fed is a live reminder that the independence of advanced economies central banks is never settled for good. It earned its legitimacy through the empirical demonstration of its effectiveness, most visibly in bringing the inflation of the 1970s to an end. It is written into law, too: the Federal Reserve Act in the United States, the Maastricht Treaty for the European Central Bank (ECB). But ultimately it rests on a continuous consensus among all relevant actors: the executive, the legislature, markets and the general public.

For political executives, there is a line between a natural preference for low rates to support growth and limit the cost of debt, and a more problematic slide into "fiscal dominance", whereby monetary policy becomes subordinate to fiscal policy. The former can no longer focus solely and independently on controlling inflation or maximizing employment. The US president's criticism of Powell sits within this framework: it targeted rates he judged too high, detrimental to growth and to the cost of servicing the federal debt.

The case of the Bank of Japan (BoJ) is an interesting example of blurred lines: independence is legally guaranteed yet is bound by coordination with the Ministry of Finances. During the 2010s, the BoJ rolled out unconventional tools on a scale never seen before, aimed at supporting the government's "reflationist" agenda. This took shape in 2013 with massive asset purchases (Quantitative and Qualitative Easing, QQE), before the yield curve control (YCC) was introduced in 2016. The scale of the interventions has pushed the BoJ's balance sheet beyond 100% of GDP, which can be associated with the emergence of a *de facto* fiscal dominance. While endemic deflation justified the support at the time, the exit from this extremely accommodative policy is now proving complicated. It is complex for the government, whose debt-servicing costs grow as sovereign yields rise and whose bond issuance must be absorbed more by the market and less by the BoJ, which is scaling back its purchases. And it is equally complex for the BoJ, which must move cautiously in normalizing its monetary policy, as it must raise rates sufficiently to counter inflation, but neither too much nor too fast, in order to contain the rise in long-term rates.

¹ The Trump vs. Cook case, however, has not yet been decided by the Supreme Court, and the Department of Justice's (DoJ) dropping of charges against Jerome Powell did not, in his view, proceed with the expected 'transparency and finality,' which is why he remains a member of the Board of Governors."



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CENTRAL BANK CREDIBILITY: BEYOND INFLATION, A SHARED CONCERN

Central bank's primary role is to ensure price stability, even if differences may exist regarding the targets and the wording of their mandate. The ECB is prioritizing inflation², whereas the Fed runs a more explicit dual mandate (price stability and maximum employment). Any threat to their independence would compromise those goals, since the proper anchoring of household, corporate and market inflation expectations is based on the credibility of central banks' commitment to their mandate.

Furthermore, the central banks' status, embodied in their independence and credibility, is a pillar of the financial architecture of advanced economies and, increasingly, that of emerging economies. In the United States, it underpins the dollar's role as a reserve currency and the central position of Treasuries as the risk-free asset. The country is thereby able to finance its imbalances on more favorable terms than the size and trajectory of its government debt would probably warrant. The reasoning extends beyond the United States — by analogy, and by contagion. Japanese, German, and British government bonds likewise benefit, albeit to a lesser extent, from a privileged status tied to the credibility of their signature, to which their respective central banks are no strangers. The ultimate risk is a generalized rise in interest rates.

Since the start of 2025, we have seen an illustration of how markets could be rattled by Donald Trump's threat to the Fed's independence. These tensions were initially acute, then more contained³. Kevin Warsh will have to steer through those same waters, and the likeliest outcome is that he holds course. Were he to decide otherwise, he would face major opposition within the FOMC, which would weigh on his own credibility. In addition, being outvoted would undermine his objective of institutional changes, on which he hopes to leave his mark at the Fed: a smaller balance sheet and reshaping the institution's style and cadence of communication. And if he was to lose the control of inflation, his legacy would echo that of Arthur Burns — it is certainly not how he wants to be remembered.

In his first speech as a former Fed Chair, Powell declared: "Our credibility has been built and sustained over many decades, and we have a duty to safeguard that priceless asset for our fellow citizens and for generations to come." The statement concerns the Fed, but it holds equally for every independent central bank. Calling these principles into question would carry such costs that it appears, rationally, unlikely. In the end, the safest way for central banks to preserve their independence is to honor their mandate.

Anis Bensaidani

anis.bensaidani@bnpparibas.com

² The Treaty also requires the ECB to support the economic policies of the European Union once the price stability objective is achieved – and without prejudice to that objective.

³ In April 2025, President Trump's ambiguous remarks about ending Powell's "termination which cannot come fast enough" triggered a sharp sell-off across equity and bond markets. Market reactions were less pronounced when Governor L. Cook faced an attempt to remove her (August 2025) and when the Department of Justice's (DoJ) subpoenas served to Jerome Powell were publicly disclosed by the latter.

