

The US election aftermath for central banks

Why Donald Trump's victory in the US presidential election means fewer Fed rate cuts and more from the ECB than we'd previously expected



A likely Republican clean sweep in the US has sent our previous expectations for the timing and pace of future Fed easing slightly off-kilter

Federal Reserve

We had previously looked for the Federal Reserve to cut its policy rate down to 3.5% by next summer on the view that the central bank felt it had scope to loosen policy closer to neutral, in an environment where the jobs market is cooling and inflation is less of a threat. However, the likely Republican clean sweep of the presidency, the House and the Senate gives Donald Trump the power to push ahead forcibly with his plans for immigration controls, tax cuts and higher tariffs on goods. This may generate a stronger growth story in the near term, but with more inflation pressures over the medium to longer term – which may make the Fed more reluctant to cut interest rates as far and as quickly as we had previously expected.

A 50bp cut in September and a 25bp move in November are still expected to be followed by a 25bp interest rate cut in December, but there is now a greater chance of a pause at the January FOMC meeting. Indeed, rather than cutting rates 50bp per quarter, we are now favouring 25bp per quarter from the first quarter of 2025 with rates perhaps bottoming higher than we previously

thought at 3.75% in the third quarter of 2025.

This would still be above what we would term the “neutral” rate, which is itself likely to shift higher since the Fed may take the view that if fiscal policy is going to be kept looser by president-elect Trump relative to its previous baseline forecast, then it needs to run monetary policy tighter to keep inflation at its 2% target.

There may be some speculation that given Trump’s sweeping mandate he may choose to exert more influence or control over the Federal Reserve. Chair Jerome Powell would undoubtedly push back against this, thereby asserting the Fed’s independence. However, Powell’s term expires in February 2026 and Trump could nominate a candidate that is more willing to accommodate his views on interest rate policy.

That all said, the likelihood of rising term premium (resulting from inflation fears and large fiscal deficits) implies the prospect of a higher and steeper Treasury yield curve. This will push up both household and corporate borrowing costs and with the dollar likely to strengthen further, monetary conditions will become tighter. This may mean the Fed feels it doesn’t need to hike short-term rates in 2026 despite tariffs likely pushing inflation above target.

European Central Bank

October was the month of an important turnaround at the ECB. Instead of inflation concerns related to still-high and sticky domestic inflation, it seems that growth concerns have become the predominant factor driving monetary policy. As a result, the ECB has stepped up the pace at which it is reducing interest rates, and a further stepping up with larger sized rate cuts can no longer be excluded.

However, with eurozone GDP growth in the third quarter being higher than the ECB’s September projections (0.4% quarter-on-quarter vs 0.2%) and inflation rebounding in October, some ECB members might start doubting the chosen U-turn. Everything seemed as if the ECB’s December meeting would be affected by two main questions: were the disinflationary trends just halted at the end of October, or are they for real? And will the ECB acknowledge structural weakness in the eurozone economy, or continue believing in a return to potential growth from early 2025 onwards?

That was before the US elections. With the outcome now clear, risks to the eurozone growth outlook have clearly shifted to the downside and a 50bp rate cut at the December meeting has again become more likely. Even if the ECB normally doesn’t speculate about possible policy changes elsewhere, it would be almost irresponsible not to take the US elections into account. At least if the central bank wants to get ahead of the curve.

And getting ahead of the curve seems to be an important motive for the ECB currently. Having been slow to address rising inflation and arguably late in stopping rate hikes last year, it now appears determined to get ahead of the curve and return interest rates to neutral as quickly as possible. For the doves, this is a no-brainer, and for the hawks, the argument might be that getting rates back to neutral quickly could be enough to avoid another episode of unconventional monetary policy with quantitative easing and negative interest rates further down the line.

With the incoming Trump administration posing new economic risks for the eurozone, we now expect the ECB to cut interest rates to around 1.75% by next summer, below neutral levels. While

this will be an attempt to support growth in the eurozone, the longer term inflation picture has not changed. 'Greenflation', demographics and changes to globalisation are still likely to push up price pressures over the longer term.

It clearly looks as if the ECB will be caught for a long while between disinflationary risks in the short term and inflationary risks in the long term.

Bank of England

The latest UK government budget, which saw big tax rises but even bigger spending increases projected for 2025-26, has forced markets to rethink Bank of England expectations. Rates are expected to stay above 4% for the next two years, which would mean considerably fewer rate cuts overall in this cycle than the ECB or the Federal Reserve.

Investors also seem to have concluded in the immediate aftermath of Donald Trump's election that the assumed hit to European growth (which the UK isn't immune to), will have a more marginal impact on the Bank of England's rate-cutting cycle, relative to the ECB.

We think this is misplaced. Services inflation, the key guiding light for the BoE, has been undershooting central bank projections. If that continues in the new year – and we think it will – then that is likely to be a catalyst for faster rate cuts through the spring.

Admittedly, we agree with markets that a December rate cut now looks less likely, though it remains possible should the two intervening inflation reports prove more benign than anticipated. Our base case is that the Bank will cut rates again in February, and at every meeting thereafter until rates reach 3.25%.

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