What if Powell leaves?

In the unlikely event that Fed Chair Powell is removed or steps down before his term ends in May 2026, we would likely see a sharp steepening in the Treasury curve as markets price in cuts, inflation risks, and diminished Fed independence. That could create an even more toxic mix for the dollar than 'Liberation Day', with EUR, JPY and CHF best placed to benefit

President Trump has made his feelings clear on Fed Chair Jerome Powell, explicitly calling for his resignation

US President Donald Trump has ramped up pressure on Fed Chair Jerome Powell, explicitly calling for his resignation as he deems the Fed's stance too restrictive. The probability of Powell leaving before his term expires in May 2026 remains very low. The US government can only remove Fed board members "for cause"; disagreement over monetary policy decisions isn't enough, and Powell has given no indications he might cut his term early.

With the caveat that this is a low-probability event, we discuss what the implications of an early departure of Powell would mean for Treasuries and the dollar. We assume that an early departure of Powell would be followed quickly by a replacement super-dove as head of the Federal Reserve.

An open question, then, is the extent to which such an appointment would directly influence policy. We can acknowledge that the FOMC would swing more dovish than it has been. But we can't conclude that the Committee would then cut rates just because Trump commands it. In the

end, it's a majority decision, and the Committee is likely to remain as divided as the latest minutes suggest, but with a bias to keep rates on hold until the coast is clear to cut them.

Note that another super-dove is likely to be installed from February, as Governor Adriana Kurgler's term ends. Markets would quickly factor this into their turn-of-the-year discount for the funds rate. This combination would probably see the discount for the terminal rate dip below 3%. Getting to 2% might be a stretch, but not improbable. We'd likely end up somewhere in that range as a bottoming discount.

Bond impact: a much steeper curve

Such a deepening in interest rate cut expectations would filter directly into the front end of the curve. The 2yr yield is now at 3.9%. There's a path to (sub-) 3%, based on a theory that, even if the FOMC does not react immediately with big cuts, the market discount could ultimately price the funds rate down towards 2%. It could, but there are challenges to that. The first would be the reaction of longer-dated rates.

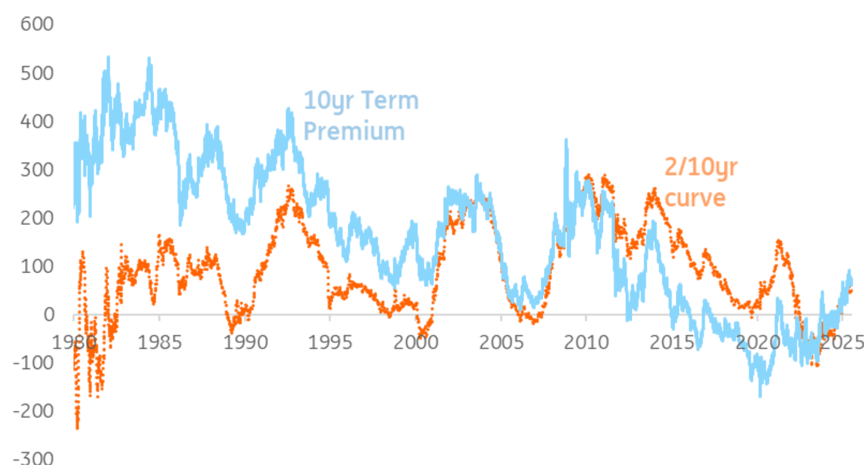
So, how would the 10yr yield, now at 4.4%, deal with a downward lurch in short tenor yields? Usually, it would get dragged down too. But the long end of the bond market is a deeper thinker than the front end. It will be questioning the risks being added to inflation. Holding a 10yr bond means receiving fixed coupons and redemption, so factoring in long-term inflation is key to assessing the real return.

The long end already has an elevated fiscal deficit and upside to consumer price pressures coming from tariffs to worry about. Adding front-end rates that are arguably too low for the economy risks adding permanence to the higher inflation prints. The fact that front-end rates are in the 2-3% range is a relative value factor that's not unimportant when framing where the 10yr yield should be. The aforementioned factors are in fact more important.

The outcome then is a much steeper curve, with front-end yields lower and longer-term yields higher. Think of a (sub-) 3% to 5% (2yr to 10yr) curve. A 200+bp curve sounds ultra steep, but we had a 300bp term premium back in the 1990s, and 400bp in the 1980s (we even hit 500bp). These were different times for many reasons, but it's not like we've not seen those types of levels in the not-too-distant past.

The 2/10yr curve has stretched towards 300bp in the past, and the 10yr Term Premium to 500bp

The 10yr Term Premium is effectively the 10yr market yield versus the market discount for a running bills exposure over the subsequent decade (rolling)



Source: Macrobond, Federal Reserve, ING estimates

An open and relevant question is how equity markets would react to all of this. Equities would likely sell off on impact, on a risk-off flight to safety trade. After all, this would be an effective forced exit of a reputable Fed Chair by the US president, an unprecedented event for the market to get its head around. But thereafter, equities could quickly reassess and choose to rally, on the theory that deep cuts in rates are a boon for corporates, as is a potentially steamy economy. And inflation is not necessarily a bad thing for equities. Higher long-end rates could spook corporates, though.

The question then is how the functioning of the system holds up. Presumably, this “let-it-rip" environment would be supported by an ample liquidity environment as a supportive underpinning. The risk then is for an overheating theme, especially if equity markets decide to put their medium-term risk-blinkers on. In the end, we’d be hoping that this all works out – but there's a feeling among us that this could end badly.

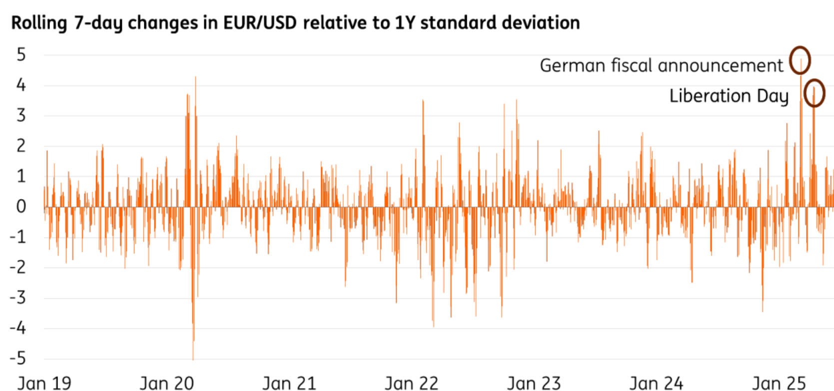
A highly toxic mix for the dollar

Powell’s removal or resignation is likely to trigger a new round of severe downward volatility in the dollar, and the damage would be there to stay. The initial reaction would likely be strictly tied to the size of the long-dated Treasuries selloff, although the dollar would face the additional negative impact from a sharp dovish repricing in Fed rate expectations. The value of the dollar as a reserve currency fundamentally lies in Fed independence, meaning large outflows from the dollar would likely be justified. To us, that looks like an even worse combination for the dollar than 'Liberation Day'.

As shown in the chart below, the 'Liberation Day' impact on EUR/USD was an almost 4-standard-deviation move in weekly terms. That standard deviation is currently 1.1%, meaning a 4 STD move would be worth roughly 4.4%. Under the assumption that Powell’s exit would be a worse event for

the dollar than 'Liberation Day', that is the lower estimate for the initial EUR/USD impact.

Recent outsized moves in EUR/USD



Source: Refinitiv, ING

At a later stage, the depth of the damage done to the dollar would depend on the actual direction taken by the Fed under the new Chair. Beyond the obvious negative implications for the dollar of outsized or fast-paced cuts, lower USD rates would make the dollar cheaper to hedge, and could result in even larger hedging demand that would hinder the ability of the dollar to benefit from any US equity market rebound.

EUR, JPY and CHF would benefit from USD losses

Alongside the euro, the other highly liquid reserve currencies JPY and CHF should be the main beneficiaries of a Fed-independence-led USD selloff. Given the depth of the dollar damage, we would expect EUR/USD upside risks to extend to 1.25 even in the short term, while USD/JPY could drop to 135.0.

Looking at the broader market, a shock departure of Chair Powell would likely rattle the benign conditions which have supported FX carry trade strategies over the last couple of months.

Aside from very popular carry trade strategies in the Turkish lira, we would expect other popular trades such as the Hungarian forint and broad swathes of Latin currencies (Brazil, Mexico and Colombia) to suffer sharp adjustments initially. Here, the spike in volatility would trigger the kind of value-at-risk de-leveraging that financial markets occasionally see.

Not until longer-dated Treasury yields started to settle would we expect to see a return to EMFX. When the dust settles, this could see the Latin commodity-producing currencies favoured again – where commodities could be doing well both on growth prospects and the asset class being seen as an inflation hedge.

On the subject of emerging markets, one of the most recent cautionary tales comes from Turkey. In March 2021, respected central bank Governor Naci Agbal was removed from office. In the immediate aftermath, the Turkish lira fell about 15%. But over the subsequent two years, when the policy rate was cut from 19.00% to 8.50% in the face of persistent inflation, the lira fell close to 60%. No one is saying US assets will suffer a similar fate, but the direction of travel would be clear, and there would be much discussion over the impact of negative real rates on the dollar.

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