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Trump Victory Could Prompt Fed to Raise Rates More Quickly

By BINYAMIN APPELBAUM NOV. 9, 2016

WASHINGTON — The Federal Reserve remains on course to raise its benchmark interest rate in December as investors generally reacted with equanimity to the election of Donald J. Trump as the next president of the United States.

And some analysts said Mr. Trump's economic plans could prompt the Fed to keep increasing the rate.

The president-elect has promised to stimulate faster economic growth with measures that include a large tax cut and as much as $1 trillion in spending on infrastructure. He has also promised new barriers to imports, which could drive up inflation. Economists appear deeply divided on the impact of such policies.

"His market-positive agenda will begin to emerge and, with a Republican Congress behind him, the potential for many of these policies to become law is high," said Stephen Auth, chief investment officer for equities at Federated Investors.

Others, however, took a bleaker view of the likely consequences of Mr. Trump's election, arguing that he could push a fragile economy into recession.

"A blanket of uncertainty now hovers over the private sector of the economy," wrote **Bernard Baumohl, chief economist at The Economic Outlook Group.** "The cost of that uncertainty should be palpable. Growth will reverse course fairly significantly."

Markets fell sharply overnight Tuesday as it became clear that Mr. Trump would win, then bounced back Wednesday morning. By midday, the odds of a December increase as implied by asset prices had stabilized, down to 72 percent from 76 percent.

The yield on the benchmark 10-year Treasury note topped 2 percent for the first time since the first quarter of the year, suggesting that investors are anticipating higher rates.

The quick rebound appeared to reflect a first impression among investors that Mr. Trump's partnership with congressional Republicans was likely to lift the economy. But analysts cautioned that the market's mood could change.

"The rates market is pricing in more of a fiscal stimulus rather than a growth shock," economists at TD Securities wrote in a note Wednesday. "But we should be sure not to extrapolate immediate reactions to long-term implications."

Looming over all such deliberations are the president-elect's trade policies. He has promised to impose more tariffs and to tax sharply goods imported from American companies that move operations overseas. That could increase inflation and depress productivity gains.

The Fed has signaled in recent months that it would like to raise rates for the second time since the financial crisis, barring any signs of fresh economic weakness. The Fed's policy-making body, the Federal Open Market Committee, said after its most recent meeting last week that the case for higher rates "continued to strengthen."

Mr. Trump's election was viewed as one of the few developments that might throw a wrench into the works. The Fed, which started the year predicting that it would raise rates four times, has instead left rates untouched in a range between 0.25 percent and 0.5 percent. The low rates are intended to stimulate economic activity by encouraging borrowing and risk-taking. If financial conditions tighten in the coming weeks, or volatility rises, the Fed might decide to delay a rate increase again.

"Faced with such a tightening in market-driven financial conditions, the Fed would be less likely to add a higher federal funds rate to the mix," wrote Vincent Reinhart, chief economist at Standish Mellon Asset Management, a division of BNY Mellon.

But a growing number of Fed officials are publicly advocating a rate increase, and the Fed has carefully prepared markets for the likelihood that it would raise rates. Moreover, the Fed has several weeks to watch and wait before its next meeting on Dec. 13 and 14.

“While fiscal and economic policy uncertainty has increased, it would be a challenge for Fed rhetoric to maintain an aura of being above the political fray if that were the only rationale for not moving next month,” said Michael Feroli, chief United States economist at JPMorgan Chase. He said he still expected a rate increase in December.

Mr. Trump will also have the opportunity to quickly overhaul the Fed’s leadership. Once in office, he can fill two vacancies on the Fed’s seven-member board. And in 2018, when their terms end, he can replace the Fed’s top officials, Janet L. Yellen, the chairwoman, and Stanley Fischer, the vice chairman.

Mr. Trump sharply criticized Ms. Yellen during the campaign, claiming without evidence that the Fed was delaying increasing rates until after the election to improve the fortunes of Democrats. Raising rates, he said, would pop “a big, fat, ugly bubble.”

Under Ms. Yellen, the Fed has embraced a responsibility to reduce unemployment by holding down interest rates to stimulate economic growth. Some conservative economists have sharply criticized this campaign, arguing that the Fed is trying to do too much, and that it is sowing the seeds of financial instability and higher inflation.

Officials appointed by Mr. Trump are likely to urge the Fed to focus on fighting inflation, meaning they probably would favor raising rates more quickly.

“A reasonable assumption is that these nominees will all be more hawkish than would have been the case under Clinton,” Krishna Guha, head of central bank strategy at Evercore ISI, said, referring to Hillary Clinton, the Democratic nominee. Mr. Guha noted that Mr. Trump’s selections would be constrained by the need to win the support of congressional Republicans.

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