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How the Fed would guard against a Trump presidency

Rick Newman November 4, 2016

The Federal Reserve's path forward just got clearer—unless Donald Trump becomes the next president.

Investors think a decent October jobs report has paved the way for a Fed interest-rate hike in December, because it showed an improvement in income growth plus 161,000 new jobs. It would be the first Fed hike in a year and a welcome step, for many, back toward more-normal monetary policy.

But that's if there are no big surprises between now and December—and a Trump victory on Nov. 8 would be a big surprise, given that he's trailing in most polls and prediction markets. An upset victory by Trump would introduce a whole new set of variables to the Fed's policymaking equation. What if he kicks off trade wars with China and Mexico, as his policies suggest he would? What if he tries to repeal Obamacare and deport millions of undocumented workers? What if he tries to get rid of Fed Chair Janet Yellen, who Trump has accused of politicizing the Fed to help Democrats?

The Fed is only supposed to worry about inflation and employment, but anything that disrupts the economy can be linked to those issues, especially employment. Several analyses of Trump's plan argue that it would cut growth and kill jobs, which is why the Fed might regard a Trump presidency as a bearish development for the economy. If so, it might be inclined to put off a rate hike and continue its extraordinarily easy monetary policy.

Or, the Fed might decide that a Trump win strengthens the case for a rate hike, compared with a Clinton win. "Should Donald Trump win the White House, a far different set of dynamics come into play that would *still* make it necessary for the Fed to raise rates at their next meeting," **Bernard Baumohl of the Economic Outlook Group** recently wrote to clients. "Yellen will have to raise interest rates next month just to give the Fed some room to lower them again later if the economy starts to wobble under a Trump presidency."

If that reasoning holds, the Fed would have almost no way out of a rate hike in December. A Clinton win would signal policy continuity with President Obama, and no real surprises. So the Fed would have to respond to rising wages and the implied threat of inflation, by hiking. If Trump wins, it would want to hike—perhaps even faster—to get interest rates up to a point where it could cut again if Trump's presidency produces an actual economic downturn.

One assumption buillt into the Trump scenario is the Fed's preference for traditional rate hikes as monetary stimulus, rather than something more unusual such as negative rates, which Fed officials have been skeptical of. But a Trump win could force the Fed into uncharted territory, along with all the rest of us.

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