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Three Reasons Trump's Push to Oust Powell Could Harm the US Economy

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The prospect of President Donald Trump attempting to remove Federal Reserve Chair Jerome Powell has sparked concern among economic experts, with potential consequences that could destabilize markets and undermine confidence in America's financial system. While the legal barriers to such a move make it unlikely, the mere threat has already caused ripples in global markets. Here are three reasons why this action could backfire spectacularly, threatening economic stability.

Firing Powell would likely trigger immediate volatility across financial markets. On Wednesday, reports of Trump's potential move to oust Powell led to a sharp drop in the US dollar index by nearly 1%, with long-term bond yields spiking to 4.86% on the 30-year Treasury, the highest in over a month. Krishna Guha, vice chairman at Evercore ISI, noted in a client update: "Financial markets sent a warning shot as to what would happen if President Trump tried to fire Fed Chair Powell." Although markets later stabilised when Trump clarified he had no immediate plans to act, the episode underscored the risks.

An independent Federal Reserve is critical for maintaining investor confidence. If its autonomy is compromised, investors may demand higher yields on bonds to offset perceived risks, driving up borrowing costs for the government, businesses, and consumers. Stephen Brown, deputy chief North America economist at Capital Economics, warned: "Any gain for the administration in influencing the policy rate risks being offset by higher long-term yields, as investors price in higher inflation expectations." This could burden Americans with higher mortgage and loan rates, stifling economic growth.

The US dollar's status as the world's reserve currency relies heavily on the stability of America's institutions, including an independent Federal Reserve. Francesco Pesole, an FX strategist at ING, described a potential Powell dismissal as "a highly toxic mix for the dollar," predicting "severe downward volatility" that could persist. A weakened dollar would reduce foreign investors' returns on US debt, potentially triggering a sell-off in the bond market and further elevating yields.

Such a move would also erode trust in the US as a haven for global investment. Investors value the US for its robust rule of law and institutional checks, but compromising the Fed's independence could signal a shift toward politically driven economic policy. This could accelerate the dollar's decline, already evident this year as concerns grow about America's fiscal trajectory. The ripple effects would hit consumers hard, raising the cost of imported goods and adding to inflationary pressures.

The Federal Reserve's ability to manage inflation and support economic growth depends on public and market trust in its independence. Trump's public criticism of Powell, including brandishing a draft termination letter, risks eroding this confidence. Dominic Pappalardo, chief multi-asset strategist at Morningstar Wealth, stated: "The biggest outcome of Trump's ongoing threats is the possibility of erosion of the Fed's credibility and their policies." This is particularly concerning as Trump's proposed tariffs are already pushing up prices, complicating the Fed's efforts to balance inflation and growth.

Jason Furman, a Harvard economist and former chair of the Council of Economic Advisers, wrote in a New York Times column: "Firing Powell would unleash a massive amount of uncertainty, litigation, and market turmoil." If the Fed is perceived as bowing to political pressure, inflation expectations could surge, forcing the central bank to raise rates higher than intended, counter to Trump's desire for lower rates. Republican Senator John Kennedy of Louisiana told CNN: "If Powell were to bend to Trump's demands and unilaterally cut interest rates, the bond market would go into a fit," driving up borrowing costs and threatening economic stability.

While Trump's threats against Powell may be more rhetorical than actionable, their implications are profound. Undermining the Federal Reserve's independence could lead to market chaos, a weaker dollar, and diminished credibility for the central bank, ultimately harming American consumers and businesses. As Ernie Tedeschi, director of economics at the Budget Lab at Yale, wrote in a Bloomberg column on 16 July: "Undermining trust in the Fed for short-term political gain is a recipe for higher costs and lower living standards for all Americans over time." The stakes are high, and the risks of such a move far outweigh any short-term political gains.