Flash Economics

N° 111
September 11, 2025

Threats to the credibility of the Federal Reserve

The Federal Reserve is now credible, despite the rise in inflation observed since the end of 2021 and the rise in short-term inflation expectations. Long-term inflation expectations have remained stable at around 2.5%.

But there are two threats that could undermine the credibility of the central bank in the United States.

The first threat is the risk of Donald Trump taking control of the Federal Reserve (and the FOMC): appointing Trumpist governors (currently Stephen Miran) and ousting governors who do not support him (Lisa Cook). Such a takeover would imply a sharp fall in interest rates, probably a return to monetary financing of the public deficit, and therefore a loss of control over inflation.

The second threat to the credibility of the Federal Reserve comes from the financing policy of the US Treasury. The Treasury now covers only a small part of its financing needs by issuing long-term debt, which it has replaced with short-term debt (with a maturity of less than 5 years).

If inflation were to rise again, this method of financing the US Treasury would make it very difficult for the Federal Reserve to raise intervention rates, since this would have an immediate effect on the cost of public debt (on the amount of interest on the debt). With these choices (desire to lower interest rates, short-term financing of public deficits), the United States therefore runs the risk of not being able, if necessary, to move away from an expansionary monetary policy, hence the risk of a loss of credibility, which will be seen, if it materialises, in the rise in inflation expectations in the long term.

Patrick Artus
Senior Economic Advisor
patrick.artus-ext@ossiam.com
@PatrickArtus
Patrick Artus

Marketing communication: this document is a marketing presentation. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

The importance of central bank credibility

If a central bank is credible, even if short-term inflation is higher than the central bank's inflation target due to the presence of an inflationary shock, long-term inflation expectations remain unchanged, with financial market participants anticipating that the central bank will conduct a monetary policy that will correct the excess inflation.

The stability of long-term inflation expectations means that wages do not rise, companies' selling prices do not rise, and a price-wage loop is not triggered, leading to very high inflation.

For the time being, the Federal Reserve has preserved its credibility

The United States experienced a violent inflationary shock from the end of 2021 (Chart 1).

Chart 1
United States: Headline inflation and core inflation (as %)



However, long-term inflation expectations (we are looking at the 5-year inflation swap 5 years from now) have remained stable throughout this period of rising inflation (Chart 2).

Chart 2
United States: 5-year inflation swap in 5 years (as %)



The credibility of the Federal Reserve has therefore been preserved.

First threat to the credibility of the Federal Reserve: political intervention

Donald Trump is clearly aiming to take control of the FOMC (the Federal Open Market Committee, the body that sets monetary policy). To achieve this, he has appointed Stephen Miran as Governor of the Federal Reserve and sacked Lisa Cook. He will certainly appoint as Jerome Powell's successor someone who shares his views on the need to bring key interest rates down quickly, and probably to reopen quantitative easing to facilitate Treasury financing.

If Donald Trump succeeds in taking control of the FOMC, short-term interest rates will certainly fall more than financial markets expect (Chart 3) and the size of the Federal Reserve's balance sheet will probably start to grow again (Chart 4).

Chart 3
United States: Federal Funds target rate (as %)

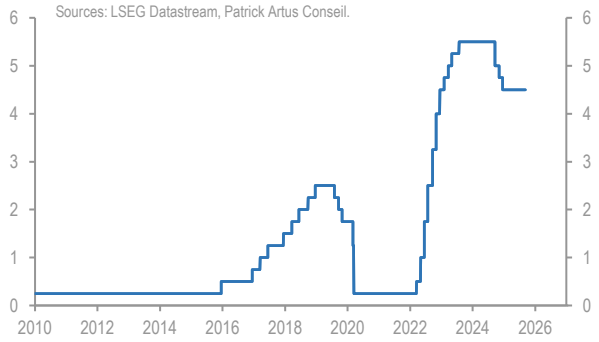
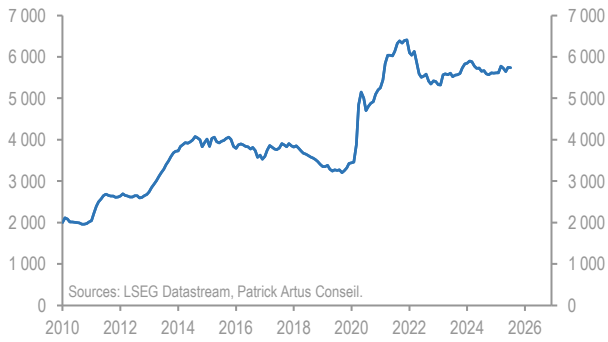


Chart 4
United States: Monetary base (USD bn)



Second threat to the Federal Reserve's credibility: the US Treasury's financing strategy

Since 2017, the US Treasury has financed itself much less through bond issues (10-, 20- or 30- or bonds) and much more through short-term debt issues (bills and 1- to 5-year notes) than before (Charts 5A/B).

Chart 5A
United States: Public debt held by the private sector, by maturity (in USD billions)

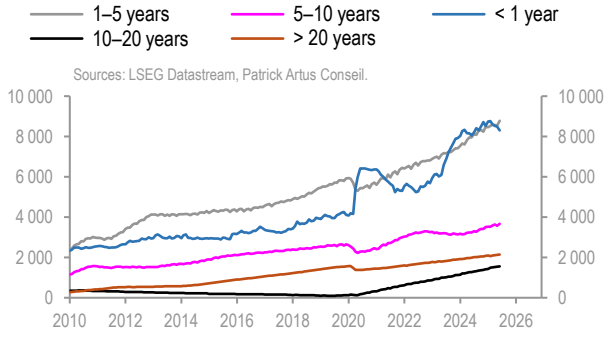
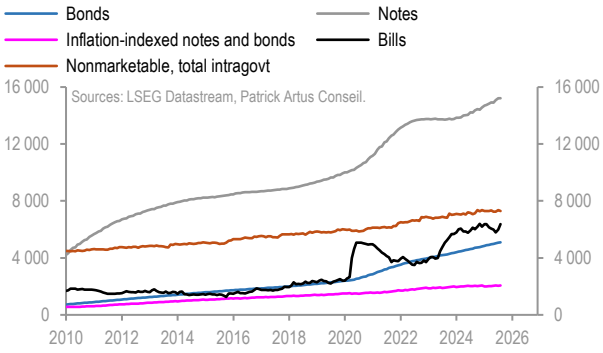


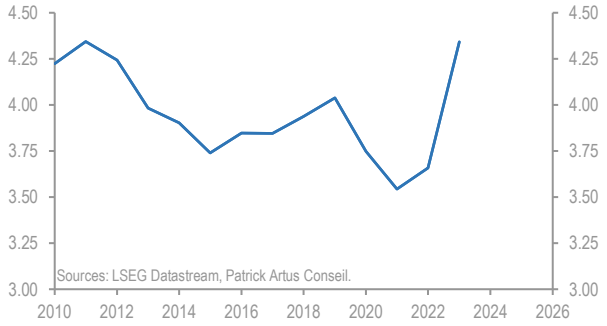
Chart 5B
United States: Federal debt outstanding (USD bn)



*Total Public Debt Outstanding

The fact that there is a large amount of short-term Treasury financing (with securities maturing in less than 1 year) reduces the credibility of the central bank, since it becomes more difficult for it to raise interest rates, if necessary, for example because of inflation trends. The Federal Reserve's interest rate hike has an immediate effect on interest payments on debt (Chart 6), which can cause the central bank to pull back.

Chart 6
United States: Interest paid on the public debt (as % of nominal GDP)



Summary: a double risk of loss of credibility for the Federal Reserve

The credibility of the Federal Reserve is intact today, but it is threatened by two developments:

- The appointments to the FOMC of people close to Donald Trump who share his view on the need for a highly expansionary monetary policy;
- The high proportion of the Treasury's financing requirements that are covered by short-term debt issuance (bills with maturities of less than 1 year and notes with maturities of 1 to 5 years), which discourages the Federal Reserve from raising interest rates if necessary.

Disclaimer

Ossiam, a subsidiary of Natixis Investment Managers, is a French asset manager authorized by the Autorité des Marchés Financiers (Agreement No. GP-10000016). Although information contained herein is from sources believed to be reliable, Ossiam makes no representation or warranty regarding the accuracy of any information of which it is not the source. The information presented in this document is based on market data at a given moment and may change from time to time. This material has been prepared solely for informational purposes only and it is not intended to be and should not be considered as an offer, or a solicitation of an offer, or an invitation or a personal recommendation to buy or sell participating shares in any Ossiam Fund, or any security or financial instrument, or to participate in any investment strategy, directly or indirectly. It is intended for use only by those recipients to whom it is made directly available by Ossiam. Ossiam will not treat recipients of this material as its clients by virtue of their receiving this material. All performance information set forth herein is based on historical data and, in some cases, hypothetical data, and may reflect certain assumptions with respect to fees, expenses, taxes, capital charges, allocations and other factors that affect the computation of the returns. Past performance does not predict future returns. Any opinions expressed herein are statements of our judgment on this date and are subject to change without notice. Ossiam assume no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from, an investment in any security or financial instrument described herein or in any other security, or from the implementation of any investment strategy. This information contained herein is not intended for distribution to, or use by, any person or entity in any country or jurisdiction where to do so would be contrary to law or regulation or which would subject Ossiam to any registration requirements in these jurisdictions. This material may not be distributed, published, or reproduced, in whole or in part.