Flash Economics

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How long can the Federal Reserve and the Trump administration prevent a correction in the U.S. equity market?

The U.S. stock market is extremely overvalued. Whether one looks at the price-to-earnings ratio, Robert Shiller's CAPE ratio, or the scale of share purchases financed through margin credit, all indicators stoke the fear of a sharp downward correction in equity indices.

However, it is important to take into account the economic policies that will seek to extend the upward trend in the markets:

- monetary policy, including interest rate cuts by the Federal Reserve and a return to quantitative easing;
- fiscal policy, with rising public deficits;
- Treasury financing policy, aimed at keeping long-term interest rates low, as well as a support for stablecoins, which attract international savings into the U.S. government debt market.

A correction in U.S. equity markets is a given, but it may occur only after additional gains in 2026. Of course, such an extension would only be possible once the conflict in the Middle East has come to an end.

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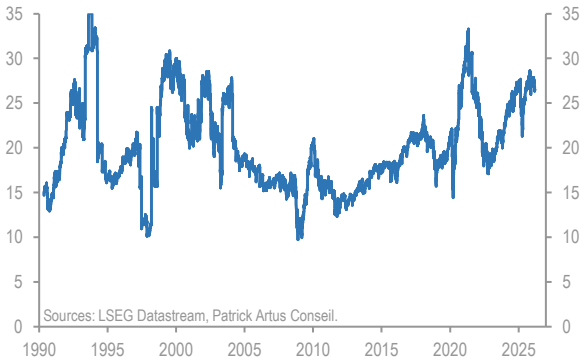
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The U.S. equity market is extremely expensive

All indicators point to a highly overvalued U.S. stock market. In particular:

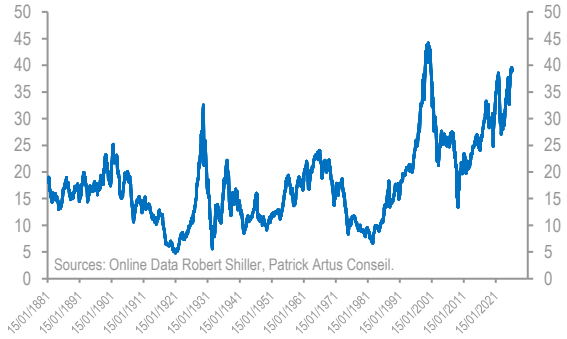
- the elevated level of the price-to-earnings (P/E) ratio (Chart 1);

Chart 1
S&P 500 P/E ratio



- the historically high level of Robert Shiller's CAPE ratio (the CAPE being the ratio of market capitalization to inflation-adjusted, 10-year smoothed earnings) (Chart 2);

Chart 2
CAPE / Shiller PE Ratio



The CAPE ratio has exhibited three major peaks: August 1929 (31.5), August 2000 (42.9), and January 2026 (40.7). Following the peaks in 1929 and 2000, equity indices collapsed.

- the sharp increase in outstanding margin credit (i.e. margin lending used to finance equity purchases) (Chart 3);

Chart 3
United States: Margin loans outstanding (bn USD)



Periods of rapid expansion in margin credit (1999–early 2000, 2006–mid-2007, 2020–2021, 2025, and early 2026) have consistently heralded sharp declines in equity indices, amplified by the forced selling triggered by margin calls.

The correction in the equity market may be delayed by the economic policies pursued by the Federal Reserve and the Trump administration

All factors therefore point toward **a sharp downward correction in the U.S. equity market**. However, this correction may be delayed by ongoing economic policies.

1. Increasingly expansionary monetary policy

The Federal Reserve will probably continue lowering interest rates (**Chart 4**) and resumed quantitative easing in December 2025, which will contribute to a decline in long-term interest rates (**Chart 5**). Naturally, as long as rising oil prices linked to the conflict in the Middle East suggest increasing inflationary pressures, rate cuts may be delayed.

Chart 4
United States: Eurodollar contracts (3-month)

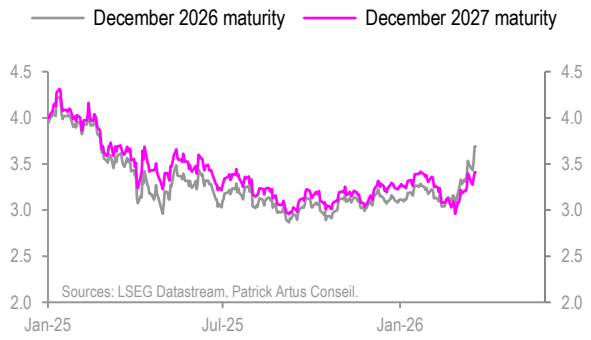
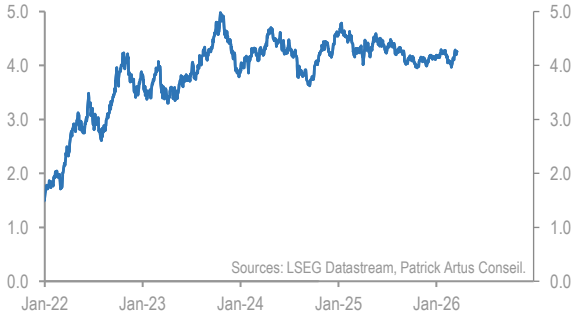


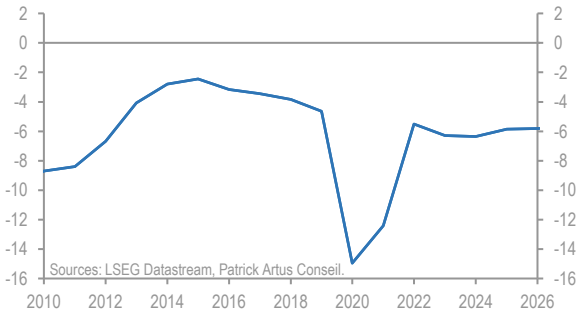
Chart 5
United States: Interest rate on 10-year government bonds (as %)



2. Expansionary fiscal policy

The U.S. public deficit ultimately reached 5.9% of GDP for fiscal year 2025 and 5.3% for calendar year 2025. **In 2026, with the implementation of the "One Big Beautiful Bill Act," the deficit is expected to exceed 5.9% of GDP**, driven by tax cuts, increased military and security spending, and financial support for children. The Congressional Budget Office (CBO) estimates that the One Big Beautiful Bill Act will increase the budget deficit by $3.4 trillion over 10 years (approximately 1.1 percentage points of GDP per year) (**Chart 6**).

Chart 6
United States: Budget deficit (as % of nominal GDP)



Moreover, if the administration is required to refund the tariffs invalidated by the Supreme Court, the deficit would be significantly higher (by approximately 0.6 percentage points of GDP).

3. Treasury financing policy

The structure of U.S. public debt financing is increasingly tilted toward **short-term instruments**:

- Treasury Bills (maturities of 1 month to 1 year) account for 21% of funding;
- Treasury Notes (2 to 10 years) represent 51%;
- Treasury Bonds (20 to 30 years) now account for only 17%;
- other instruments make up 11%.

The average maturity of U.S. public debt is 5.4 years, compared with 8.2 years in France and Germany, 7.6 years in Spain, and 7 years in Italy.

A shorter average maturity reduces upward pressure on long-term interest rates.

4. Support for the U.S. dollar stablecoin market

The Genius Act, which requires stablecoin issuers to hold 100% reserves invested in U.S. Treasury securities or in repos backed by Treasuries, supports the dollar stablecoin market. This legislation aims to ensure the safety of the dollar-based stablecoin system but actually serves **to attract global savings—particularly from emerging economies affected by inflation or currency depreciation—into U.S. dollar assets**.

Conclusion: ultimately, a correction in the U.S. equity market is a given but it will be delayed by current economic policies

The U.S. equity market is too expensive and too reliant on credit for its valuation to be sustainable in the long term. However, increasingly expansionary monetary policy, stimulative fiscal policy, the relatively short-term orientation of U.S. Treasury financing, and the attraction of global savings through dollar stablecoins could **lead to lower short- and long-term interest rates in the United States. This, in turn, could further support the equity market before it eventually undergoes an unavoidable downturn**.

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