Trump and the Trajectory of Interest Rates

By Kerry Pechter *Wed, Nov 9, 2016*

'There could be pressure for rates to go higher as investors digest the deficit spending pushed by Mr. Trump,' said Andrew McCormick, head of T. Rowe Price's U.S. taxable bond team.

As soon as Donald Trump sealed his Electoral College victory over Hillary Clinton, analysts at banks, fund companies and consulting firms released predictions about the election's impact on interest rates. No one can do more than guess.

Until Tuesday, the Federal Reserve appeared on track to raise the fed funds rate by a quarter of a point at its December meeting. Now that looks less likely. Trump said during the campaign that stock prices would drop if rates go up and accused Janet Yellen of holding rates down to help Democrats.

As for the markets' immediate reaction yesterday, Bankrate.com reported that "the prospects of higher government spending and more government borrowing for infrastructure improvements sent long-term Treasury yields racing higher. The 10-year Treasury note yield soared above 2%..., closing at 2.07%, the highest since Jan. 22."

Here are few of the predictions published yesterday. The probability of a December rate increase "has fallen sharply" following the election, said Dominic Rossi, global CIO for equities at Fidelity International.

"The dollar, which has been trending higher in anticipation [of a Hillary Clinton victory], has consequently reversed. Both were threats to the bull market, and these have now been postponed. Monetary policy will remain accommodative," he wrote.

Andrew McCormick, the head of T. Rowe Price's U.S. taxable bond team said in a new white paper that U.S. short-term rates may go lower initially as investors seek the haven of U.S. Treasuries, but "there could be pressure for rates to go higher as investors digest the deficit spending pushed by Mr. Trump."

The *New York Times* noted Wednesday that in the campaign Trump promised a large tax cut, up to $1 trillion in spending on infrastructure, and new barriers to imports. By stimulating the economy, those policies could foster inflation and inspire the Fed to raise rates.

At Aite Group, analyst Julie Conroy seemed to take Trump's accusation of artificial rate-suppression by Yellen as a call for higher rates. "Trump has clearly stated that he believes that interest rates are being held at an artificially low rate, so expect to see a rate hike early in his term," she said.

Her colleague, Gabriel Wang, added, "the market may experience an immediate increase in interest rates. However, given the expected short-term market turmoil, it is unlikely that the Fed would be willing to raise rates immediately in the middle of a market period with heightened volatility."

Some commentators think a December rate hike by the Fed is still possible or even likely. Mark Dowding**,** co-head of investment-grade debt at BlueBay Asset Management, wrote that the U.S. economy "retains reasonable momentum and, … if US asset markets stabilize, the Federal Reserve remains likely to raise rates in December."

David Lloyd, head of institutional fixed-income portfolio management at M&G Investments, said, "Much of what Trump has said suggests the balance of risks is towards a more hawkish Fed. In the short term, the market will obsess over whether Trump's rhetoric softens somewhat – i.e., whether he tries to forge a constructive working relationship with Yellen. If he sticks with his campaign tone, the rates market could get quite lively."

In its post-election commentary, Goldman Sachs Asset Management said it expected "volatility to remain elevated over the near to medium term" and that market reaction to the election result is likely to resemble the UK referendum scenario, including:

- A volatile, risk-off response, followed by
- A gradual reversal as investors recognize that changes under a Trump administration will take time to play out and the Federal Reserve is likely to remain in wait-and-see mode, and then
- Isolated bouts of volatility as the administration's policy priorities, and ability to execute them, become clearer. As a result, we expect volatility to remain elevated over the near to medium term.

One observer believes that Yellen's job is jeopardy. "Given Trump's critical statements on the Fed, it seems likely that he would push for a change of leadership as soon as Yellen mandate's end on January 2018," said Monica Defend, head of Global Asset Allocation

Research, Pioneer Investments.

Once in office, Trump can fill two vacancies on the Fed’s seven-member board. 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.