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Eyes back on the Fed (and on interventionist financial policies)

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In Summary

- **We continue to expect only one rate cut (-25bps to 3.50%) from the Fed this year. This cut is now expected in June instead of March, which confirms a normalization of monetary policy to neutral settings. A May surprise (-50bps) and resumption of an easing cycle could spook investors.** Though investors remain wary of the Fed's increased politicization, they seem reluctant to price in a substantial threat to its independence. Implied rate volatility remains low, market-based inflation expectations are stable at around 2.4% in both the short and long term and institutional checks and balances are considered strong. We expect only one rate cut (25bps to 3.50%) from the Fed this year, pushed back to June from March. While weak hiring remains a top concern for Fed policymakers, the FOMC is divided on the balance of risk between the labor market and inflation. Only accelerating productivity, easing labor costs (-0.5pp over the past year) in the context of the AI rollout and a decrease in tariffs would allow the Fed to cut key rates to 3% this year with inflation cooling faster. An abrupt 50bps rate cut would magnify negative effects on markets. Overall, financial conditions could tighten, with most of the risk concentrated at the long end of the curve. The term premium could rise by up to 50bps, causing a steepening of the yield curve. GDP growth would likely be negatively impacted with a lag, and disorderly movements in the bond market and global spillovers would magnify this impact. Another downside risk is the noise surrounding yield-curve control measures i.e. increase in Treasury demand through regulation or even quantitative easing if long-term yields were to rise.
- **Recently announced affordability interventions, such as the interest rate cap, the housing policy package and the sectoral intervention require increased scrutiny.** These interventions could squeeze credit, interfere with efforts to tame inflation and affect wealth creation from equity markets. First, the one-year cap on credit card interest rates at 10% (down from an average of 25%) will likely counteract the recent increase in credit creation. It will also reduce credit availability for subprime borrowers by cutting the excess spread by nearly 50%. Historically, such caps have proven detrimental to supporting credit expansion and, thus, to the transmission of monetary policy. Second, the purchase USD200bn of mortgage-backed-securities risk pulling forward demand, inflating prices and skewing benefits toward incumbents. On the other hand, the impact of banning large institutional investors from buying single-family homes is likely to be limited, given small institutional ownership relative to the overall stock. Last, the targeted squeeze on sectors that combine high margins, limited competition and shareholder-friendly capital returns, namely defence, consumer finance, pharma and clean energy, could dent wealth effects.

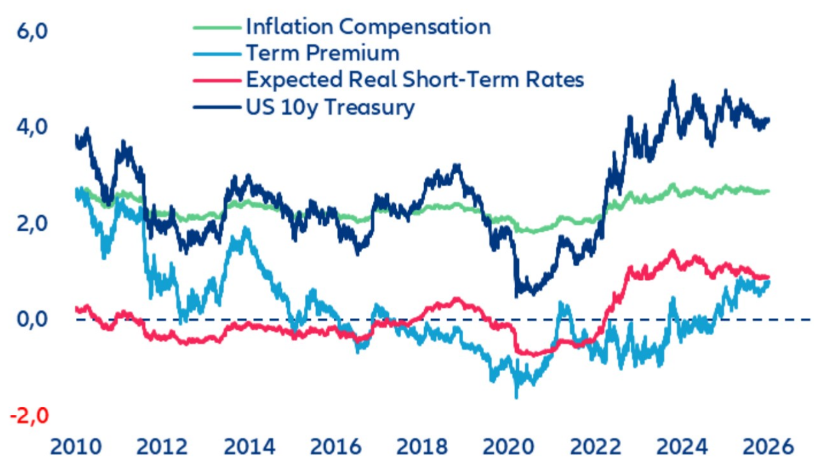
Strong institutional checks and balances should preserve Fed independence

Ahead of its next monetary policy meeting on 28th January, the Federal Reserve's independence is in question again after the Department of Justice (DoJ) launched a criminal investigation into Chairman Jerome Powell, escalating concerns over the conduct of US monetary policy. The White House has been heavily critical of the Fed, calling for it to lower interest rates more aggressively. The DoJ investigation, centered on Powell's testimony to Congress last year about a USD2.5bn renovation of the Fed's headquarters, follows the prosecution of Board Member Lisa Cook over mortgage fraud allegations last summer. The result is still pending, with a Supreme Court decision to be potentially delivered in the coming weeks.

Nevertheless, strong institutional checks and balances should keep the Fed's independence intact. Many obstacles stand in the way of seriously jeopardizing the Fed's independence. First, as we have highlighted before[1], the shifting composition of the FOMC this month will bring in new hawkish voting members, thanks to regional Fed governors. The White House's stance, as well as the potential removal of Lisa Cook as Fed governor, could embolden them to double down on maintaining prudent monetary policy, given sticky inflation. Powell himself could decide to remain on the Board even after his term as Chair ends in May as his term as a Board Member does not expire until 2028. In all, with the President likely to have a maximum of three voting FOMC members open to cutting rates aggressively (the new Chair, S. Miran and potentially the replacement of L. Cook), the Fed is unlikely to loosen policy much. We suspect that conventional doves C. Waller and M. Bowmann, while both appointed by the President in the past, would remain loyal to the Fed and not push for aggressive rate cuts in the current economic environment of strong growth, above-target inflation and improvements in the labor market, though they would be in favor of lower rates than other most other FOMC members. Second, since the DoJ has not even initiated a grand jury to investigate whether there is enough evidence to indict Powell, any legal proceedings would likely take years to reach a conclusion. Finally, Republican Senator Thom Tillis, who holds a key position on the Seante Banking Committee, has pledged to oppose President Trump's nominees until the potential legal case against Powell is resolved. Given the Republicans' narrow majority (53 seats) in the Senate, confirmation hearings for the next Chair could stall. If no Chair is confirmed by May 2026, the Fed Board would presumably vote to keep Powell as temporary Chair.

Markets remain in a wait-and-see mode for now, with a moderate reaction, particularly in fixed-income markets. Investors are still wary after months of policy back-and-forth and seem reluctant to price in a substantial threat to Fed independence. Implied rate volatility (MOVE index) remains compressed, signaling little hedging demand in the short run. But the US rate will become more sensitive to the political news flow in coming months, especially related to the nomination of the new Fed Chairman. Recent statements by the President positioning Kevin Warsh as the leading candidate pushed yields up at the front and long end of the curve, signaling confidence that Warsh would pursue a tighter policy in the short run but with a higher risk for fiscal dominance in the long run. The Fed independence risk is in fact concentrated at the long end of the US curve, where the term premium may rise by up to 50bps and cause a steepening of the curve. The term premium is the compensation investors ask for the risk to hold long-term bonds rather than rolling over short-term debt. Over the past year, it has been the main upside force on US rates, fueled by the absorption pressure from the surge in debt supply and growing concerns about fiscal dominance (Figure 1).

Figure 1: Decomposition of 10y US Treasury yield (in %)



Sources: LSEG Datastream, Allianz Research
Note: based on AACMY Model (Abrahams et al. 2016)

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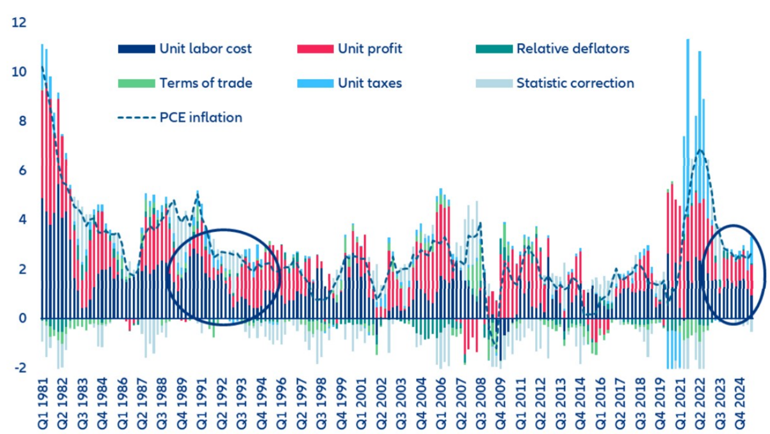
[1] *See our report What to Watch 5 December 2025.*

Inflation expectations embedded in financial market, consumer and business surveys will flash warning signals if the private sector perceives any weakening of Fed independence. Market-based inflation expectations (inflation swaps) remain anchored in both the short and long run at around 2.4%, indicating further that there are no serious doubts yet that institutional checks will crack and that the Fed will be unable to fulfill its price stability mandate in the future. Long-term inflation embedded in 10y Treasury yield remain stable so far (Figure 1). The latest one-year inflation expectations from the Cleveland Fed, which combine financial data and survey-based measures, show that these inflation expectations have not de-anchored either. As a result, we do not expect the latest developments to meaningfully alter these reassuring trends, but risks could increase if the Fed shows signs of yielding. In such a scenario, US inflation would accelerate by around +0.3/0.5pp to above 3% in a relatively short horizon, sending a warning signal of uncontrolled inflation.

We continue to expect only one rate cut (-25bps) from the Fed this year, pushed back to June (from March), amid a normalization of monetary policy to neutral settings. While weak hiring remains a top concern for Fed policymakers, the FOMC is divided on the balance of risk between the labor market versus inflation. While the latter remains sticky and stubbornly above the Fed's target, it has eased in some services components, and some business surveys suggest it could ease further in coming months. This should convince a majority of the FOMC to pause rate cuts through June to gather further evidence of easing supercore price components, before cutting -25bps in the June meeting. Nevertheless, strong GDP growth and persistently above-target inflation should convince a majority of FOMC officials to oppose further rate cuts afterwards. Overall, the latest attacks on the Fed do not alter our view that inflation will remain sticky around 2.6-2.9%, with the economy operating a bit above potential, but not accelerating. A positive development which could prevent inflation from accelerating is the pickup in productivity growth, which is starting to push down unit labor costs, mimicking a pattern observed during the 1990s internet revolution (Figure 2).

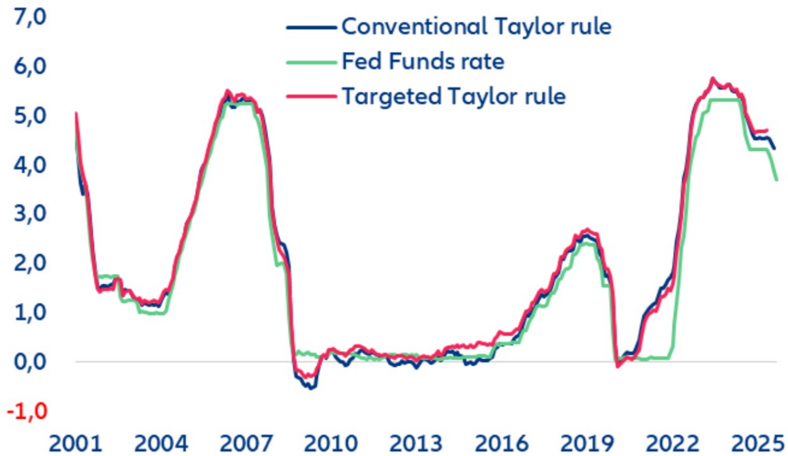
Figure 2: Historical decomposition of PCE inflation (%year-on-year)



Sources: LSEG Datastream, Allianz Research

After May, multiple rate cuts to below 3% in an environment of above-target inflation would signal weakening Fed independence and potentially lead to a rise in inflation expectations and an overall tightening of financial conditions. A weakening of the Fed independence would manifest if it cut interest rates below 3% while GDP growth holds up well, inflation remains sticky, and the labor market does not deteriorate (our baseline scenario). The Fed's interest rates already look very low compared to what a monetary policy rule would prescribe based on the deviation of inflation from target and the output gap (Figure 3). In this scenario, inflation expectations could likely start to drift up, pushing up actual inflation in a short time horizon (two to three months). In the politized environment, the market would interpret this as a sign of complying with the administration's demands. Instead of declining, long-term yields would likely rise as the scenario of fiscal dominance would become more entrenched, increasing the term premium and causing a pronounced steepening of the yield curve.

Figure 3: Taylor rule: effective versus prescribed Fed policy rates (%)



Sources: LSEG Datastream, BIS, Allianz Research
Note: In a Taylor rule, the policy rate depends on i) the natural interest rate, ii) the output gap (slack in the economy) and iii) inflation relative to the target. The natural interest rate is derived from market pricing; the output gap is derived from labor market and capacity utilisation surveys ; "targeted" Taylor means that the central bank gives more weight to demand-driven inflation than supply-driven inflation.

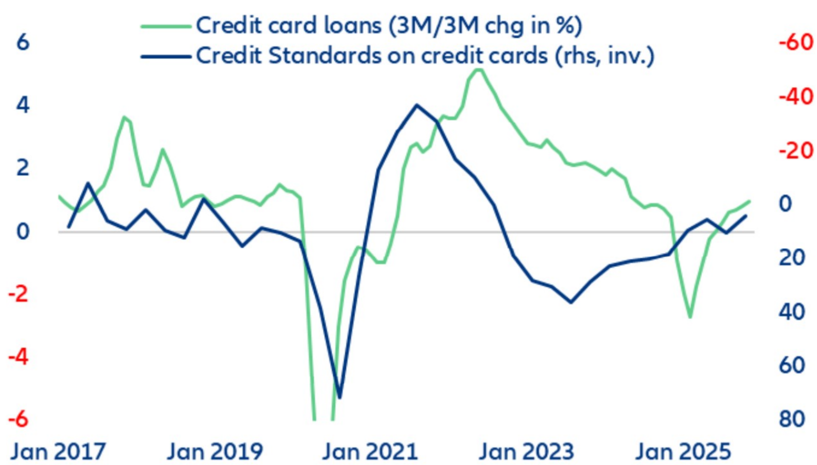
Consequently, a 50bps cut could actually tighten financial conditions rather than ease them, increasing public financing costs and weighing on GDP growth. A politically driven steepening would be inadequate for the late-cycle expansion of the US economy, building up imbalances and heightening recession risks. Worsening financial conditions would likely weigh on GDP growth, with higher long term borrowing costs spilling over to mortgage rates, knocking the housing market further and increasing the cost for long-term corporate investment. We estimate this growth effect at -0.3pp, which would bring our 2027 GDP growth forecast down to +1.7%. If the US government aims to contain this term premium effect, it must act on debt supply-demand dynamics. As fiscal consolidation is not in the cards and broadening the investor base through stablecoins and tokenized Treasuries remains anecdotical, two powerful options remain: push the Fed to conduct direct duration extraction via Quantitative Easing on the entire US Treasury curve (currently purchases are limited to Treasury Bills) or boost demand for US Treasuries through regulatory requirements for banks, pension funds and insurers. However, both approaches are forms of financial repression and would certainly impair the attractiveness of the US Treasuries, especially for foreign investors. For global markets, the steepening pressure could extend to the Eurozone and other developed markets as term premia tend to be globally correlated. But the biggest risk would be that a highly politized Fed starts weaponizing its emergency USD swap lines. This would weaken the global liquidity security net, creating a much more volatile global financial system with more severe tail risks. The ultimate release valve would be FX markets where USD is likely to pay the price if Fed independence gets seriously impaired. The gold trade will increasingly also become a gauge for the Fed independence risk (debasement trade) as it trades in line with the term premium.

Policies to address the affordability crisis could squeeze credit, with limited structural relief for housing

Beyond putting pressure on the Fed, and the tax cuts of the Big Beautiful Bill, the President recently unveiled a series of further policies to address the affordability crisis. These include a 10% cap on credit-card interest rates, a ban on institutional purchases of additional single-family homes and instructions to the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac to purchase USD200bn of Mortgage-Backed-Securities. The first move is evidently intended to ease households' interest payments – with current credit card interest rates on new loans hovering around 21%. The second and third move are intended to support housing affordability by reducing institutional investor demand and to lower mortgage interest rates (which are currently above 6% on the benchmark 30-yr) through MBS purchases.

The one-year credit-card interest rate cap is likely to limit credit availability. Prolonged caps could weaken financial stability. The unintended effect will be reduced availability of new credit from financial institutions, especially to subprime borrowers, as it becomes unprofitable. Ironically, this could counteract a recent loosening of credit-card lending standards from banks, the dominant players for this product, which is leading to a pick-up in credit-card production (Figure 4) – despite no reduction in charged interest rates. Non-bank financial institutions could step in, but this is unlikely to be enough in the short term. Besides, the banking deregulation agenda is not likely to provide much of an offset: While up to USD2600bn of overall lending capacity could be freed up, it is likely that banks use up only USD15bn for credit cards. Nevertheless, prolonged interest rate caps could incentivize more non-banks to step in to lend to subprime borrowers excluded from the banks and gain market share. As a result, the associated loosening of credit standards could weaken financial stability. The interest-rate cap would also be negative for credit card asset-backed securities (ABS), which allow a transparent view into the economics of banks' business, by compressing pool yield and, consequently, excess spread – the deal's first-loss protection and the sponsor's net interest margin. Assuming a current pool yield of ~25% (card interest plus ~4% in fees), capping the card interest rate at 10% would reduce excess spread by roughly 50%. Credit-card ABS charge-offs reached >10% after the Global Financial Crisis, showing that additional credit enhancement would be required to maintain the ability to absorb losses for credit card master trusts. Some non-prime credit card trusts experienced 15% charge-offs in November 2025, showing that for these a 10% interest cap would not cover credit losses anymore. In terms of market impact, this will likely mute new issuance until there is more clarity but also result in wider spreads for non-prime deals due to credit concerns. However, overall, we suspect the cap policy will lead to less credit-card availability for most households as weak margins in the segment deter banks from expanding volumes.

Figure 4: US credit-card loan flows & credit standards on new credit-card loans



Sources: LSEG Datastream, Allianz Research

The two headline-grabbing housing announcements sit within a broader White House effort to address affordability ahead of the 2026 midterm elections, with housing positioned as a high-salience lever. While the headlines and market reactions refocused attention on housing, this is not the first time the administration has attempted to influence affordability through administrative levers. Since early 2025, a pipeline of ideas has been floated, which broadly fall into mortgage "affordability" interventions, unlocking additional supply and restricting institutional participation (Table 1). One of the more headline-grabbing examples was the 50-year mortgage proposal, which would lower monthly payments but at the cost of higher lifetime interest costs and slower equity build, leaving borrowers more leveraged for longer and increasing vulnerability if house prices fall. While the proposal quickly lost momentum following strong expert pushback, it underscores the administration's stepped-up policy activism around housing affordability. In late 2025, Trump reinforced the agenda in a primetime address, pledging to unveil "some of the most aggressive housing reform plans in American history."

Table 1: Major ideas/initiatives floated so far by Trump administration

Intiative	Time	How does it work?	Transmission channel	Status
Convert unused federal land	Mar 2025	Identify and release suitable federal parcels for residential development (incl. affordable housing)	Increase developable land supply -> higher housing supply	Formally launched; early stakeholder engagement but unit delivery remains gated by siting, infrastructure, and local permitting
Reduce capital gains taxes on home sales	July 2025	Reduce/eliminate capital gains tax on primary residence sales	Reduce "tax lock-in" → increase resale supply	"Under review"
Pressure builders to build more homes	Oct 2025	"Carrot-and-stick" via FHFA/GSE influence to steer builder behavior and increase delivery	Increase housing supply	"Under review"; operational design and enforceability unclear
Create 50y mortgages	Nov 2025	Allow borrowers to extend amortization of their mortgages	Reduce monthly payments -> increase demand	Drew heavy pushback; appears unlikely to proceed in its original form
Allow portable mortgages	Nov 2025	Allow a borrower to transfer an existing low-rate mortgage to a new home	Reduce "rate lock-in" -> increase mobility and transactions	"Under review"; no clear standardized rollout path announced
Expand assumable mortgages	Nov 2025	Allow a buyer to assume the seller's existing low-rate loan rather than originate a new mortgage at current rate	Transfer embedded lower rates -> increase stock turnover	"Under review"; details/implementation timetable not specified
Restrict "large institutional investors"	Jan 2026	Restrict large institutions from purchasing additional single-family homes	Curb "financialized" demand -> potentially improve owner-occupier access	Announced by President Trump via social media; legislative and implementation details not yet specified
Direct agency MBS purchase	Jan 2026	Direct GSEs (Fannie/Freddie) to buy $200bn of agency MBS	Compress agency MBS spreads -> (partial) pass-through to lower primary mortgage rates	Announced; details are not yet specified
Allow access to 401(K) for down-payments	Jan 2026	Allow using 401(k) funds for home down payments	Reduce down-payment constraint → boost purchase demand	Announced by President Trump via media interview; more details are expected to be revealed in Davos

Sources: AIM-GIS-PM

Among the measures floated to date, supply-side initiatives are most aligned with the underlying imbalance, but also the slowest to deliver. Initiatives such as converting unused federal land into housing can improve long-run land availability. But much of the federal land is remote, environmentally constrained or dedicated to other uses, making it unattractive for residential development. Even where buildable, sites often lack infrastructure, pushing total delivered costs up and stretching timelines. The program has been launched and begun early stakeholder engagement, but unit delivery remains gated by siting constraints, infrastructure build-out and local permitting. Similarly, pushing builders to raise production is directionally aligned with structural supply shortages, but translating political pressure into materially higher starts is challenging because builders are already operating with tight margins, pressured by incentive-heavy clearing and elevated costs. The industry's willingness and capability to accelerate without clearer visibility on achievable selling prices and absorption is limited (Figure 5).

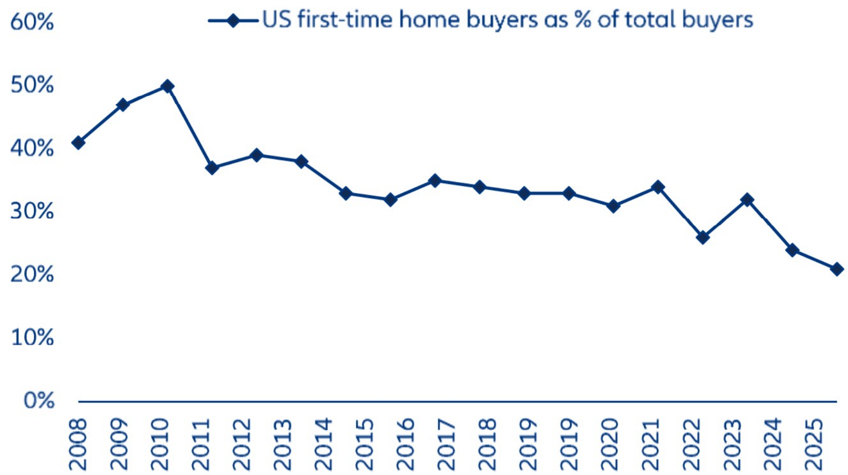
Figure 5: Subdued home-builders sentiment amid squeezed margins and low transaction activities

Sources: LSEG Datastream, AIM-GIS-PM

The mortgage-affordability intervention approaches offer more direct market transmission, but they tend to risk pulling demand forward rather than improving structural affordability. The USD200bn agency MBS purchase directive is designed to compress mortgage spreads and pull rates lower. While supportive for demand, cheaper financing can result in higher house prices, particularly in supply-constrained markets. Allowing penalty-free access to 401(k) savings for down-payments is President Trump's latest proposal to broaden homebuyer purchasing power. Easing the down-payment hurdle can unlock transactions for some households, but it is fundamentally demand-supportive, raising the risk of price reflation while weakening household balance sheets by substituting housing leverage for long-term savings.

In addition, these tools tend to disproportionately benefit those with less affordability constraints. Allowing mortgage portability, for instance, would be more "liquidity-positive" as it targets the rate-lock effect and could lift resale listings by allowing borrowers to retain their existing rate when moving. But it is operationally challenging in a highly securitized US mortgage system. It also does less for first-time buyers, who suffer the most from reduced affordability and now only account for 21% of overall home purchases, a record low (Figure 6). Likewise, assumable mortgages can ease lock-in by transferring low-rate loans to new buyers, but benefits are likely to be partly captured by sellers through higher sale prices that monetize the embedded financing advantage, skewing gains toward incumbents. The distributional impact of the 401(k) proposal is also uneven: only about six in ten Americans hold assets in retirement savings plans, with access and balances heavily concentrated among higher-income households.

Figure 6: First-time buyers as share of total home buyers dropped to record low in 2025



Sources: LSEG Datastream, AIM-GIS-PM

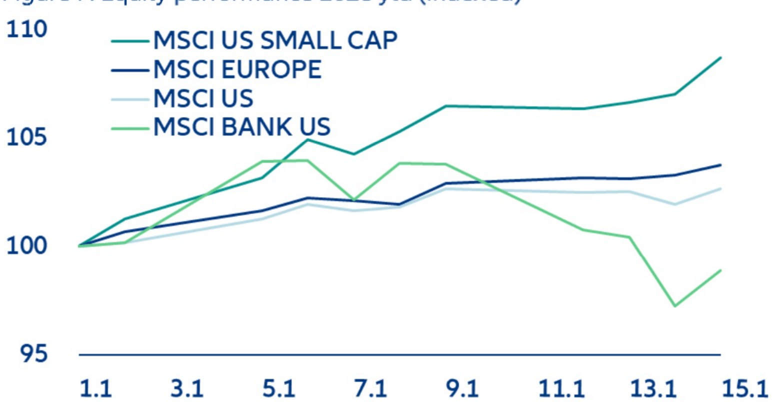
Similarly, the impact of banning large institutional investors from buying single-family homes is likely to be limited, given small institutional ownership relative to the overall stock. Institutions are estimated to own roughly 5% of the US single-family rental (SFR) market, with the vast majority still held by individual owners. The top 24 owners of single-family rentals in the US own just over 520,000 homes combined, equal to roughly 3.5% of the ~15mn single-family rental homes in the US and less than 1% of the total single-family stock. Additionally, Real Estate Investment Trusts (REITs) and most other large players in the space have engaged in minimal acquisition activity over the last few years, focusing instead on build-to-rent (BTR).

The administration is likely to bring forward a broader package of mixed measures that prioritizes near-term traction – more likely tools that can boost transaction volumes or lower borrowing costs quickly than those that resolve structural supply constraints, which take longer to scale and show up in the data. These could include targeted credit easing and down-payment facilitation. The medium-term risk is that demand-side easing puts upwards pressure on prices unless paired with credible supply delivery. In a supply-constrained market, cheaper credit and easier access to funds can lift both activity and prices, leaving affordability gains showing up more in volumes and sentiment than in sustainably lower price-to-income ratios.

The policy shift from business-friendly to regulatory intervention will add sector dispersion and may lift the risk premium for some US assets previously perceived as safe havens

President Trump is shaping up as a targeted squeeze on sectors that combine high margins, limited competition and shareholder-friendly capital returns. These are exactly the sectors that invite intervention when household budgets are under strain and affordability becomes a critical political issue. The most immediate vulnerability sits in defence: After the administration publicly pressed prime contractors to ramp up production and warning against dividends and buybacks until delivery and capability improve, investors have been forced to reprice the "cash-return" model that has long characterised the industry. In the short term, mandatory reinvestment and political scrutiny of program performance are bearish for payouts and multiples, even if higher volumes eventually support revenues. Defence is a monopsony and investors finally realize that engaging with a unique buyer (the government) is not risk-free. Consumer finance is another pressure point: threats to curb credit-card economics through fee action or explicit caps on card rates would hit a profit pool that depends on pricing power and opaque cross-subsidies. Indeed, banks, card issuers and payment networks would all face margin compression, tighter underwriting and a renewed shift towards ancillary fees. All of this could also pose second-order risks to consumer credit flows. Pharmaceuticals remains in the crosshairs as well: The administration's goal to bring down drug prices through international reference pricing and tougher procurement would directly attack one of America's richest margin structures. While implementation risks may temper the market reaction day-to-day, the strategic direction is clear: less pricing latitude, more political bargaining and a higher probability that R&D spend becomes the adjustment variable compromising long-term growth. Lastly the push for housing affordability adds headline risk for landlord REITs and institutional buyers, potentially dampening demand. Clean energy, particularly offshore wind, also looks exposed where the administration signals a preference for energy security over climate targets, raising permitting and lease risk for capital-intensive projects with long paybacks. By contrast, potential beneficiaries cluster where Trump's toolkit is supportive rather than punitive: domestic-heavy industrials and "reshoring" winners that can plausibly expand US capacity may gain from fast-track permitting, deregulation and targeted tax incentives, while sectors leveraged to lower import costs (e.g. retailers and consumer discretionary names) could benefit if tariff pressure on key supply chains is eased to cool goods inflation. In the near term, markets should discount sectors with high payout ratios, entrenched market structures and politically salient pricing, and look for relative shelter in businesses with visible domestic investment, competitive end-markets and policy-aligned narratives on jobs, production and consumer prices.

Figure 7: Equity performance 2026 ytd (indexed)



Sources: Refinitiv, Allianz Research

Investors may need to reconsider some popular equity investment strategies. For instance, income streams from dividends of cash-generating companies and the stability of quality companies are pillars pursued by many institutional investors. Global and US equity markets have become highly concentrated: MSCI World now contains 72% US exposure and almost 30% is related to US technology, but US banks and pharma also rank top of the list (JPM in top 10 with 1% and Elli Lilly at rank 11 with 1%). With an oligopolistic market structure, and high margins and cash generation, all of this may come under scrutiny, particularly for consumer products. US small-cap stocks and European equities generate less stellar Return on Equity, which combined with distance from US policy and reshoring potential may partly explain why they outperformed the broader market in 2026. Targeted policy interventions this year serve as a wake-up call for investors to diversify and reduce dependence on concentrated themes and strategies. This is also true for higher inflation, which may support real assets locally but still hit non-domestic US equity investors who usually keep currency exposure open via a weaker dollar.

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