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Macro Pulse for January 20

- Benign inflation data for December, aligning with expectations at +2.7% YOY, has likely contributed to the market's muted reaction to the Justice Department's criminal investigation into Fed Chair Jay Powell. One of the ultimate stakes of the Fed's independence is its inflation-fighting credibility; as long as inflation avoids an upward trend, the market is unlikely to view Fed independence as an immediate issue. Our note today discusses this topic in detail.
- As public markets putter along at elevated valuations, investor caution is mounting: over $7.6 trillion in cash is sitting on the sidelines. But investors focused solely on "safety" face reinvestment risk and limited yield pickup. We see both short-duration municipal bonds and short-maturity high yield corporate credit as strong steps out of cash.

A full guide to Fed independence

Federal Reserve independence has moved sharply into the spotlight.

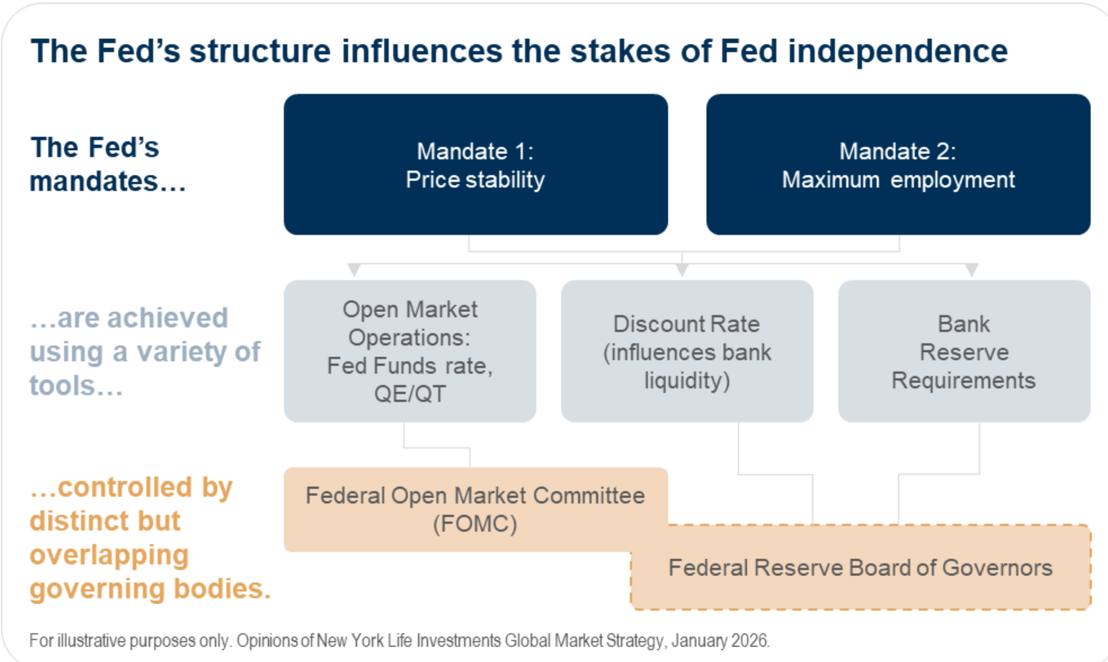
On January 9, the Trump administration threatened to sue the Federal Reserve, and the Justice Department launched a criminal investigation into Federal Reserve Chair Jerome Powell relating to the refurbishment of the Fed's office buildings. While no one is above the law, these actions follow longstanding efforts by the administration to remove key Fed officials (Chair Powell and Lisa Cook) to achieve more dovish Fed policy. Taken together, they represent clear and escalating threats to the independence of the Fed.

Fed independence is a sticky subject, not only because it is inherently political, but because the Fed's role in U.S. (and, arguably, global) economy and market functioning is so systemic. Given the stakes, we're sharing our full "policy wonk" perspective, while keeping the key takeaways as clear as possible.

For a high-level summary, read only the **headlines in bold**; indulge the *getting wonky* sections if you'd like more comprehensive details.

Why does Fed independence matter?

Most would agree that sustainable economic growth and financial stability are good things. It's good when the banking system works well, when prices are stable, and when the economy is a neutral backdrop to our daily lives. This is why central banks, including the U.S. Federal Reserve, exist.
Getting wonky: As prescribed by Congress, the Fed operates under a dual mandate: keep prices stable and promote 'maximum employment'. By contrast, most other central banks are tasked solely with maintaining price stability. To achieve these goals, the Fed uses a variety of tools, each controlled by distinct governing bodies. We provide an overview of this structure below, which will inform our discussion of how shifts in Fed independence at different levels of oversight would affect policy.



Monetary policy goals and political goals aren't always at odds with one another.
Getting wonky: During wars and crises, the Fed has not been fully independent, leveraging its policy tools – and expanding its policy tools to include Quantitative Easing (QE) during the Financial Crisis and pandemic – to soften the extremes of the economic cycle.

Kevin Warsh, on the short list for the new Fed Chair position, said "The Fed is not independent from government. It is independent within government." In many ways, Warsh is right. The Federal Reserve Act of 1913 makes clear that the Fed is accountable not to the White House, but to Congress – and therefore to the American people.

But sometimes, long-term economic needs and political goals are at odds. For this reason, central banks generally need to be able to operate monetary policy independently from politics.
Getting wonky: If the Fed was not independent, monetary policy would always be pro-cyclical: no politician would allow for tighter monetary policy during their tenure. Chronically easy policy would increase the risk of economic overheating, stoking inflation. Over time, rising inflation would erode purchasing power, harming consumers and the broader economy.

Why are today's actions different from past political critiques of monetary policy?

Past administrations have criticized Fed policy, and past leaders have met with central bankers in order to try and influence their decisions. While it is reasonable to consider the cost, effectiveness, and mandate of the central bank, past actions have stopped short of attempted control. Today's actions look worrisome in this regard.
Getting wonky: Truman. Johnson. Nixon. Carter. H.W. Bush. It's a long tradition for presidents to criticize Fed policy that is running counter to their goals. It is not, however, tradition for a White House to instigate criminal investigations or fire a governor for "cause" for the clear purpose of forcing turnover in key Fed positions (Powell and Cook, respectively).

Today, the Trump administration's desire for more dovish policy isn't enough to spark market concern.
Getting wonky: The good news is that economic conditions are sufficiently mixed (strong growth, weak hiring, above-target inflation) to allow for ample debate around policy without raising the stakes of Fed independence. Should labor data surprise to the downside, we could certainly see policy move meaningfully more dovish. Similarly, benign inflation prints, such as the December CPI, allow the market to remain calm around any near-term inflation risks associated with dovish policy.

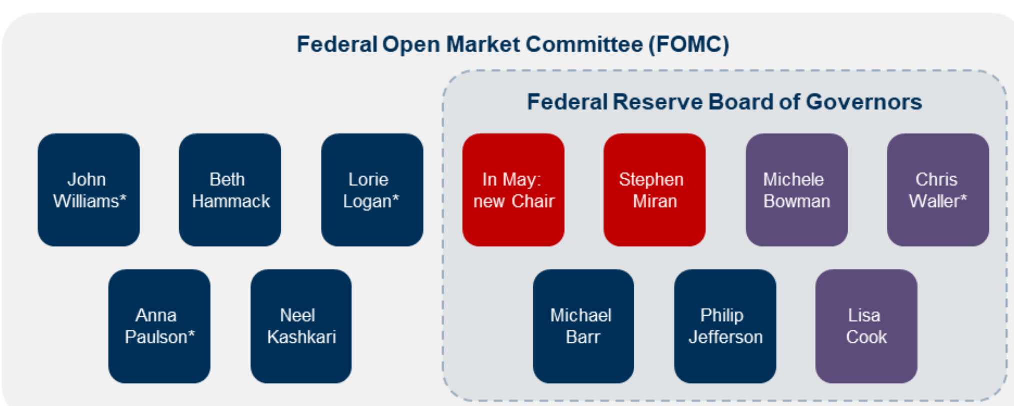
Going forward, however, a loss of Fed independence represents the loss of a key market anchor, creating more uncertainty for consumers, businesses, and investors.
Getting wonky: If policy became overly dovish due to a loss of independence, the market would rightly lose faith in the Fed's inflation-fighting credibility. As discussed above, this "threshold" will depend on the macro environment, but we believe interest rate cuts amid any upward inflation trend would be a clear signpost for the markets to price in a greater degree of risk and uncertainty. We discuss the market avenues for this impact, and how to play such a scenario, at the end of this note.

How would a loss of Fed independence impact monetary policy and the economy?

Let's start from the biggest decision-making body and work our way down. Simply put, it is not our base case that the FOMC – the committee that sets the policy rate – will lose independence.
Getting wonky: The Fed has two central decision-making bodies: the 7-member Board of Governors and the 12-member Federal Open Market Committee (FOMC), which includes the Board plus 5 rotating regional Fed presidents. The Fed's Chairman, currently Jerome Powell, is one of these 12 votes and helms both the Board and the FOMC. We will return to the stakes around a new Fed Chair later in this note.

In December 2025, the Board unanimously voted to re-confirm all of the regional Fed presidents: good news for Fed independence to keep career Fed technocrats in-seat. Because these governors comprise 5 of the 12 FOMC seats, we believe the FOMC, along with its policy tools, including the Fed Funds rate and QE/QT, are relatively protected from political influence.

Fed independence comes down to the independence of its governors



Blue: Likely to follow traditional policy.
Red: Likely to pursue more dovish policy.
Purple: Policy preference uncertain. Bowman and Waller: previously appointed by President Trump; have supported traditional policy thus far. Cook: position pending Supreme Court ruling.
*Long time Federal Reserve staff.
For illustrative purposes only. Opinions of New York Life Investments Global Market Strategy, January 2026.

However, the *most probable near-term risk* would be a loss of independence at the Board of Governors level – not the FOMC as a whole.

Getting wonky: Relatively speaking, we are more concerned about the independence of the Board of Governors. Several factors could drive a loss of Board independence.

It is standard practice for the Fed Chair to also resign their "regular" governor seat when their term expires. Assuming Powell keeps with this norm and departs the Fed altogether in May, the Board will have a majority of Trump appointees by the middle of this year. This does not, however, necessarily mean that the Board would then be considered "non-independent":

- *Will governor Lisa Cook, a Biden appointee and advocate of traditional policy, keep her job? The Supreme Court will rule on this matter, likely in the coming months.*
- *Will existing Board members previously appointed by Trump – namely Michele Bowman and Chris Waller – change their assessments of monetary policy as a result of political pressure? Notably, these governors have not dissented along with fellow Trump appointee Stephen Miran in recent meetings, suggesting they may maintain a traditional policy approach.*

Dates to watch for Fed independence

H1 2026	President Trump to announce his nominee for Fed Chair.
January 21, 2026	The Supreme Court will hear arguments involving Fed Governor Lisa Cook, who the President fired for cause over allegations of mortgage fraud. She remains on the Fed Board while the Court considers the case. A decision is expected in mid-2026.
January 31, 2026	Stephen Miran's term as Fed Governor ends (President Trump had appointed Miran to serve the remainder of a governor's term who had resigned). The President may delay naming a replacement until it is clear whether Jerome Powell will leave the Board when his term as Chair ends.
May 13, 2026	Jerome Powell's term as Fed Chair ends. He may remain on the Board as a governor until January 2028, though historical norm would be to depart.
Mid-2026	The Supreme Court is expected to rule of whether Lisa Cook can be removed. If she is dismissed, the President can appoint a replacement, subject to confirmation by the Senate.

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If the Board loses independence, the impact on policy could be significant. The Board has broad control over many policy tools, meaning a non-independent Board can heavily influence policy even without changes to the policy rate or balance sheet (QE).

Getting wonky: On its own, the Board could choose to make changes to the policy tools under its sole discretion: the interest rates used for the bank discount window, and oversight of bank reserve management. These tools give the Board the power to change mathematical incentives for how banks manage their reserves and liquidity. The Board also oversees the network of 12 regional Federal Reserve branches: it could choose to collapse (or add) these branches, which could alter the Fed's ability to operate.

In sum: investors hear about changes in the policy rate frequently, but they are far from the only tool influencing monetary conditions. Shifts in Board-specific policy tools could create discord in the overall policy stance, forcing the market to price in greater uncertainty.

Can a new Fed Chair individually determine how "independent" the Fed will be?

The President will nominate, and Congress will confirm, a new Fed Chair in May. The most important thing to understand about this leadership change: the Chair will not be able to bring interest rates down on their own.
Getting wonky: A Fed Chair cannot make changes to interest rates or any other of the Fed's policy implementation tools on their own; they are one vote in a larger operating committee. For example, they would need a majority of the FOMC to change the policy rate or embark on QE. If the Chair wanted to adjust reserve requirements, they would need a majority of the Board of Governors.

However, the Fed Chair does control how the Fed communicates. Changes to add or reduce transparency may have an impact on market pricing.
Getting wonky: The FOMC press conference and the Dot Plot – communication tools now anxiously awaited by market participants on "Fed Day" – haven't been around forever: Bernanke and Yellen implemented these tools in the aftermath of the Financial Crisis. A new Fed Chair could end, or add to, these practices.

Less transparent communication could reduce the predictability of Fed policy, including the projected rate path, forcing markets to price in greater uncertainty, and amplifying volatility around policy announcements.

The Fed Chair can also influence how "loudly" and disruptively dissent and debate within the Fed reaches the market.
Getting wonky: The Fed, and more specifically the FOMC, operates as a consensus-driven group. Disagreements that traditionally happen behind closed doors are now becoming public; a new Fed Chair could heavily influence how "loud" this dissent becomes.

Today, this dissent and debate seems reasonable: as discussed previously, there is ample room for debate around the appropriate policy path without any implications for Fed independence. Should dissent become more contentious, however, a perception of a disorderly Fed could cause the market to price in greater uncertainty.

How would a loss of Fed independence be felt in the markets?

A loss of Federal Reserve independence is unlikely to reveal itself through a single, dramatic market event. Instead, it would more likely emerge as a gradual shift in investor behavior – a slow drip rather than a shock.
Getting wonky: Investors may begin to hedge U.S. exposure more aggressively, or slowly price in structurally higher inflation expectations, or require a higher term premium for U.S. Treasuries. Below, we outline the market movements that we will be watching.

- **U.S. Dollar: Rising concerns about Fed independence would likely show up first through increased dollar hedging.**
  Getting wonky: As seen post–Liberation Day, investors adjusted risk by hedging currency exposure rather than selling U.S. assets outright. In the near term, heavier hedging would pressure the dollar lower. Over time, a true loss of Fed independence could drive sustained depreciation as the U.S. dollar's safe-haven appeal erodes and investors price in higher inflation and lower real rates.

- **Curve steepening: A less independent Fed would likely lean toward stimulating the economy. The most likely outcome would be a steeper yield curve – at least initially**.
  Getting wonky: Higher yields are an "obvious" side effect if the market no longer believes the Fed will credibly fight inflation. However, in the scenario in which the Fed has truly lost independence, the Fed would likely counter higher yields by aggressively purchasing long-duration debt, marking a return to QE.

- **Inflation: Ultimately, the Fed's actions (lowering rates and quantitative easing) or inaction (reluctance to raise rates or tighten financial conditions) would lead to higher inflation.**
  Getting wonky: An independent Fed can tighten policy even when doing so is unpopular, helping to anchor inflation expectations. If independence erodes, policy may become biased towards supporting growth or allowing the economy to overheat, increasing inflation risks. In this environment, both asset price inflation and consumer price inflation become more likely, particularly as a weaker dollar amplifies price pressure.

How to play a less independent Fed

While not our base case, a less independent Fed would skew risks towards more procyclical policy. In the near term, stronger growth and easier policies could support a risk-on backdrop, but that regime would likely prove unstable once inflation pressures build.

In such an environment, risk management becomes critical, as inflationary surprises are associated with tighter stock-bond correlations which erode the diversification benefits of traditional portfolios. Against that backdrop, commodities and other real assets would likely outperform, playing an important role as an inflation hedge.