AXA Investment Managers

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Investment Institute Macroeconomics

The Central Banker and the Judge

- A Supreme Court decision – possibly coming before the summer recess – will be crucial for the Fed.
- Data-heavy week in the US, but reading the US economy will be difficult in the months ahead.
- Some resilience – from a low starting point – in European business confidence.

President Trump backtracking on earlier comments on "terminating" J. Powell at the Fed has brought some measure of calm to the market, but we do not think the issue is settled. Before its summer recess the Supreme Court may release its decision on the termination of officials in other independent federal agencies with potentially crucial ramifications for the Fed. Should the Court open the door to terminations over policy disagreements – something which since 1935 has not been possible – then the mere risk that policy conflicts could lead to dismissal would dent the central bank's independence, even if the President does not effectively act on it. However, if the Court confirms the high level of protection Fed leaders enjoy, then influence via nominations should have fewer radical implications: on top of J. Powell, only one other member of the board is due to be replaced by the end of 2028. The committee would still be dominated by "old" Governors and the Presidents of the regional Feds – who are not appointed by the President. Still, irrespective of the Court's decision, there is a shift in the US in the conception of government. The debate between "big" and "small" government" is leaving way to "free" versus "restrained" government, with consequences for policy predictability in the US and its status as the world's dominant issuer of risk-free assets.

Reading the US economy is going to be particularly difficult in the months ahead, with tactical behaviour on the timing of imports, management of inventories and margins blurring the picture. This week's release of Q1 GDP will set the scene however – we expect a positive, but soft figure (+0.5% annualised). Still, what is key for the Fed in the short run is the labour market. It seems that the impact of the immigration crackdown is already meaningfully affecting hiring difficulties: lower job creation may not ease wage pressure quickly. The Employment Report for April, out this Friday, may help to shed more light. Meanwhile, in Europe, the latest business confidence surveys suggest some resilience, especially in France, but from such a mediocre starting level that we do not think their message is that comforting.

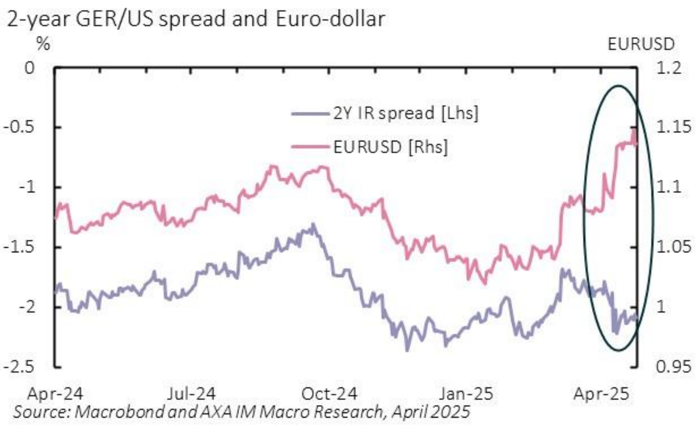
The fight over the Fed is the key test

The market is expecting significant Federal Reserve (Fed) cuts by the end of this year (85bps), reflected in the drop in 2-year yields which, together with the widening in corporate spreads, suggests that **investors take seriously the risks of a recession in the US triggered by the new trade war. However, long-term treasury yields have been resilient** (see Exhibit 1). This counter-intuitive steepening of the US curve in pre-recession times strongly hint at **the emergence of a substantial risk premium on US government bonds.** Issues of a technical nature, e.g. the growing share of US Treasuries held by Hedge Funds in the context of base trades, have magnified the tension on the long-end of the curve by triggering counter-productive gyrations in market liquidity, but the root cause lies outside the "plumbing" of the US financial system. Expectations of a further drift in fiscal deficits are probably playing a role, but **doubts on the Fed's future independence, and consequently the possibility to see the normally one-off price shock turns into persistent inflation, are dominant** in our view. A generic distrust for US assets is also manifest in the divergence between the spread between US and German 2-year yields and the exchange rate. In normal circumstances, the spread – strongly influenced by relative expectations on the trajectories of the Fed and the European Central Bank (ECB) – is a good predictor of the Euro/dollar. However, over the last few weeks, while the market expects more cuts from the ECB than from the Fed – which is logical given the absence of a conflict of objectives on the European side, since the shock there is disinflationary – the Euro has continued to appreciate (see Exhibit 2).

Exhibit 1 – Steeper curves are not always good news

Source: Macrobond, Bloomberg and AXA IM Macro Research, April 2025

Exhibit 2 – Euro stronger despite lower expected interest rates



Source: Macrobond and AXA IM Macro Research, April 2025

Tension eased on the market after Donald Trump stated last week that he had "*no intention to fire*" Jerome Powell, backtracking from his earlier comment on his *"termination."* We suspect however that this is not the end of that story. In our view, **the conflict over the Fed's independence is a symptom of a profound shift in how the government is conceived in the United States, rather than simply reflecting a divergence of views between the White House and the Fed on how monetary policy should respond to a tariff shock**. The old dividing line between advocates of "big government" and "lean government" is morphing into a divide between "free government" and "restrained government," which could put the US institutional system and political culture further away from the European approach. To explore this, we will for a bit stray away from our usual economic remit to delve into legal considerations.

Early termination of the Fed chairperson was "in principle" not on the cards under the prevailing state of US Law, and this is what prompted Jerome Powell's initial answer, when he was quizzed about this, that it was "*not permitted under the law*." Indeed, since a 1935 Supreme Court decision (in the "Humphrey Executor" case), chairpersons of independent government bodies were protected against termination for reasons of political disagreements with the White House. They could only be fired "for cause," e.g. gross negligence. This created an important limit against potential overreach by the government. At the time when, under Roosevelt's New Deal, "big government" was emerging, the Supreme Court, by curtailing the capacity of the President to influence independent bodies, re-created a form of "checks and balances" *within* the Executive branch.

Yet, the Trump administration is testing the power of this precedent and terminated officials from the National Labor Relations Board and the Merit Systems Protection Board. To quote directly from the Department of Justice in this case, *"The president should not be forced to delegate his executive power to agency heads who are demonstrably at odds with the administration's policy objectives for a single day."* This was precisely the justification for Humphrey's dismissal by Roosevelt in the 1935 case. These officials sued the government, and the case was "running its course" through the federal courts when the decision by the D.C Circuit Court to reinstate these two officials was suspended in early April by the Supreme Court, which will now examine the substance of the case. Based on Supreme Court practices when a "stay" was ordered, a decision could come by the end of June or early July (before their summer recess). This made Donald Trump's initial threat about "terminating Powell" more substantial.

Even if the US President has backtracked on his intention to fire J. Powell – probably reacting to the steep deterioration in market conditions – **the Court decision will still matter enormously**. **Indeed, even the mere *risk* that leaders of the Fed could in the future be subject to removal on political grounds would dent the independence of the central bank,** with ramifications for the credibility of the Fed in its readiness to deliver price stability.

Some concerned observers highlight the growing popularity among Justices of the "Unitary Executive" theory. This reading of the Constitution considers that *all* executive power in the US government is vested solely in the President, which entails a complete control over the entire executive branch, including the power to direct or remove officials in charge of independent bodies. Perhaps counter-intuitively, conservative members of the Supreme Court are particularly attracted to that theory even though it could be seen as opening the door to "bigger government." To some extent, this can be explained by the dominance of the originalist reading of the Constitution among conservatives: the Constitution's text makes it plain that "*the executive power shall be vested in a President*." But another reason is precisely a desire to repel the encroachment of "big government" and restore proper separation of powers and democratic accountability. Indeed, with the proliferation of independent authorities seen as unaccountable, the capacity of Congress to exert its control over the executive branch diminishes, and ultimately the capacity of the will of the people to control policy, for instance via the election of the President, erodes.

Outside the legal issues themselves, from a purely political point of view, **the temptation to reinforce the power of the President can also be explained by a reaction to the growing difficulty of getting things done via Congress as polarisation gets rife**. While the recourse to executive orders as the *primary* expression of presidential authority is specific to the Trump's administration(s), there has been a clear trend in unilateral action by US Presidents well before he came to power beyond executive orders (e.g. the proliferation of presidential memoranda or national security directives).

Yet, in the current configuration, the extension of the power of the President – which the implementation of the "unitary executive" theory would allow – would weaken checks and balances within the whole US institutional system since the legislative branch of government does not seem too keen on exercising the full scope of its constitutional power. A very recent episode illustrates this: a "simple" act of Congress would have sufficed to restrain the President's use of executive orders to conduct his trade policies, but reaching the required majority for this, despite the support of a few Republican Senators, has proved so far unsuccessful.

All this has a bearing on how the market views the status of the US as the main provider of safe assets. Investors had become accustomed to a slow and relatively predictable policymaking machine, with a large measure of checks and balances *within* the executive branch. An independent central bank would act as a natural limit to excessive fiscal shifts and unsustainable policies. Seen from the current administration's point of view, this is a recipe for paralysis, at a time when the competition with China calls for a nimbler executive branch. Yet, the cost of such "free government," with strong presidential capacity for action, is an "unrestrained government," with more radical changes and policy signals. The possibility to see – just like in the 1970s – the return of all-out accommodative policy stances, with both fiscal and monetary policy stimulating the economy despite inflationary pressure, would probably spook the market.

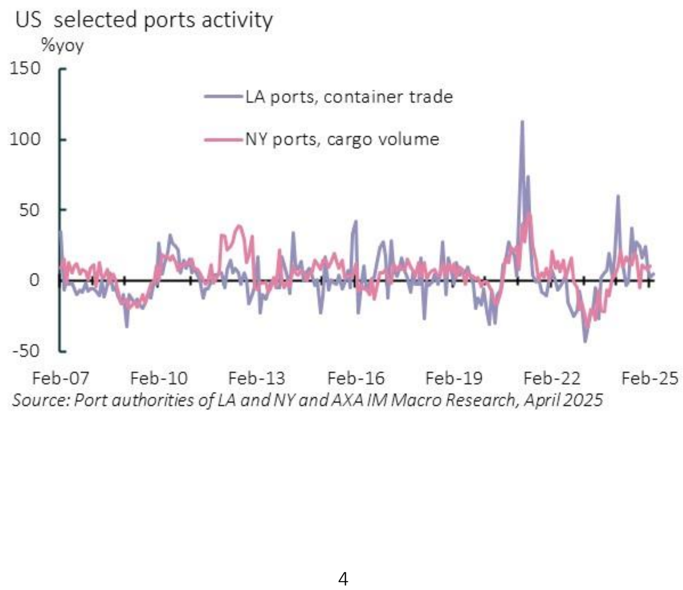
Still, it remains far from obvious that even the Justices of the Supreme Court attracted to the "unitary executive" theory will create the conditions for a "termination right" of the Fed leaders granted to the US President. True, in 2020, the Court stated that the impossibility to fire the Director of the Consumer Financial Protection Bureau (CFPB) was unconstitutional. However, the CFPB is led by a single director, not by a committee – like the Fed – and the Court in its ruling explicitly mentioned this feature as a reason to allow termination. Besides, upon ruling on the National Labor Relations Board – a committee-led body – even if it found in favour of the President's view, the Supreme Court could easily add considerations which would make it plain that, given the Fed's particular nature – independence is absolutely essential to the fulfilment of its mission – would still keep it protected.

If ultimately the Court protects the Fed's independence, the current administration will still have the possibility to affect the Fed's course when the mandate of current officials ends. Jerome Powell's mandate as Chair ends in May 2026 – even if he will remain member of the board of Governors until 2028 – and another position at the board of governors will also become vacant before the end of the current presidential term (Adriana Kugler, in January 2026). Still, influencing monetary policy via nominations at a committee-led institution is much less radical. The risk would be more that Federal Open Market Committee (FOMC) decisions become routinely split – with some damage to the central bank's predictability – rather than obviously set into a completely different direction (local Federal Reserve Banks Presidents – who are not appointed by the President – and the "old" members of the Federal Reserve Board would still hold a majority relative to new appointees). This makes the Court decision on the National Labor Relations Board and the Merit Systems Protection Board even more crucial to the White House: **if the ramifications of the case make it impossible to terminate Fed officials before the end of their term, the US administration will likely need to count with a combative Fed beyond the end of J. Powell's term as chairman**. The key issue for us is not that the Fed would refuse to ease (we expect substantial cuts in the second half of 2025, in line with market expectations) but that the FOMC could be reluctant to go very deep into accommodative territory (i.e. below 3%, currently forecasted by the median FOMC member as the appropriate long-term level of the Fed Funds rate).

When will it show?

For now, the Fed is unlikely to drop its guard on inflation as long as the adverse effects of the tariffs on activity – which would ultimately prevent the price shock from turning persistent – do not materialise in hard data. **A first signal could come in the first estimate for Q1 GDP**, to be released this week on Wednesday. Given the poor showing of consumption over the first two months of the year, a mediocre performance is likely – we expect 0.5% in annualised terms (consensus is at 0.4%) from 2.4% in Q4 2024. The decent retail sales print for March provided some measure of reassurance that GDP growth could remain positive, but a downside surprise cannot be discarded: the latest GDP Nowcast – stripping the impact from trade in gold – from the Atlanta Fed for Q1 stood at -0.4%.

Exhibit 3 – Port activity normalizing



Source: Port authorities of LA and NY and AXA IM Macro Research, April 2025

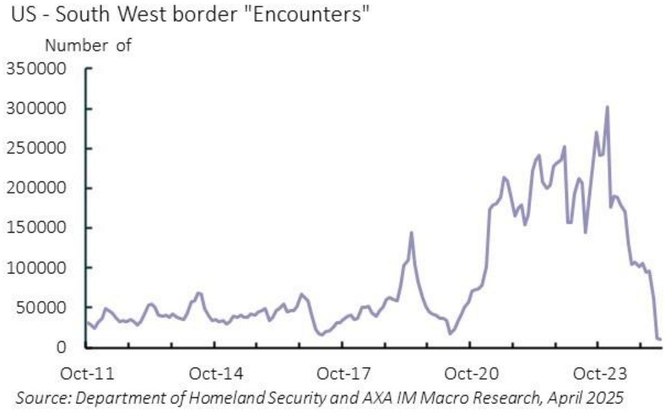
In any case**, reading the US economy is going to be difficult for a long while given the turmoil triggered by the trade wa**r. Indeed, Imports were ascending as businesses were trying to "beat the tariffs" – with as corollary a rise in inventories – but consumers also probably tried to provision for a well-telegraphed piece shock – the latter effect probably explains the rebound in retail sales in March. Yet, the latest shipping data suggests that this was already fading last month: the year-and-year change in container activity in the port of Los Angeles stood at +4%yoy in March, markedly down +24% in December, a recent peak (see Exhibit 3). Expectations of tariff cuts in the future, if negotiations appear to make better progress than currently expected, could also result in tactical timing of shipments to try to avoid a peak in tariffs – with potential disruptions to the supply lines. Reading inflation data will also be difficult. Indeed, some US producers relying on foreign inputs but now working down inventories accumulated before the tariff shock are likely to postpone the moment they have to pass the shock to their final consumers. Ford Motors for instance has stated its intention to revise its price lists for cars hitting the dealerships in early June. However, operators with less inventory capacity and faced with the particularly high tariffs on Chinese products may move fast – this is the case for Shein for instance, which has just announced steep price revisions on the US market.

To add to the complexity of the current situation, **there could be for several months a discrepancy between output and employment.** Even if the US labour market reacts faster than in Europe to changes in the pace of production, there is still a lag. Weekly data for unemployment claims have not picked up yet. We will know more at the end of this week with the publication of the Employment report for April, and we will focus on the details for the sectors which are coming under direct stress (e.g. hospitality, given the steep fall in international tourism already obvious in the airlines data), but crucially, **even if we see a slowdown in hiring, this would be only one side of the problem for the Fed, given the ongoing downward pressure on labour supply**, which could leave still quite some measure on pressure on wages.

Watch the border…

Since "Liberation Day," the market is understandably focused on the trade war, but there is another brewing supply-side shock which needs monitoring: **the crackdown on immigration**. While the "hard" labour market metrics take time to reflect demographic changes – estimating immigration numbers is notoriously difficult, hence the repeated large revisions in the available figures – Border Patrol activity can be a good proxy. According to the Department of Homeland Security, the number of "encounters" on the South-West border – basically the number of people suspected of attempting to cross illegally into the US met by Law enforcement officials – continued to collapse in March to reach their lowest level since the series was started in 2011. The crackdown had started in the second half of Joe Biden's term, but the decline since January 2025 has been impressive (see Exhibit 4).

Exhibit 4 – No-one is crossing anymore



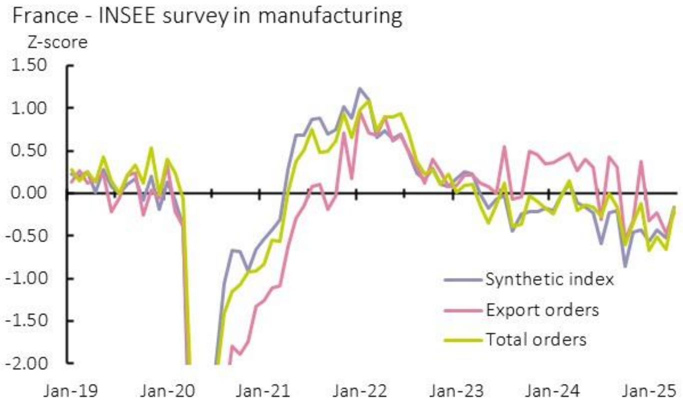
Source: Department of Homeland Security and AXA IM Macro Research, April 2025

It may well be that the drastic fall in immigration flows is already starting to re-create some tension on the US labour market. The signals are still faint, but in the survey of small businesses conducted by the NFIB (National Federation of Independent Businesses) hiring difficulties – "positions not able to fill now" – hit a recent trough at 0.3 standard deviations above their long-term average in September 2024. The rebound in February and March 2025 was noticeable (0.6 and 0.8 respectively). This is still far from the peak seen in the post-Covid reopening (1.9 in May 2022) but **the rebound in hiring difficulties, coinciding with the further drop in immigration, jars with the general observation of a cooling labour market.** This supply-side shock to the labour market is one of the reasons why it is going to be difficult for the Fed to be pre-emptive in its support.

Meanwhile, in Europe…

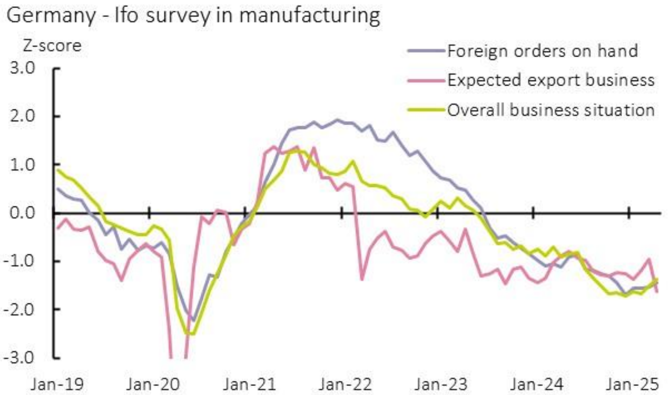
The latest European business surveys were met with some surprise, as they failed to signal a significant further deterioration despite the bombardment of bad news on the trade war front. In France, the INSEE survey for the manufacturing sector – normally the first hit by an adverse shock on external demand – even improved in April relative to March, both for the headline index and for the export orders' component (see Exhibit 5).

Exhibit 5 – Surprising rebound in France



Source: INSEE and AXA IM Macro Research, April 2025

Exhibit 6 – Lower Export orders in Germany, but within range

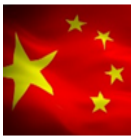


Source: Ifo and AXA IM Macro Research, April 2025

The responses were collected between 27 March and 22 April, and that according to INSEE most businesses respond within the first two weeks. Some of the specific effect of "Liberation Day" on 2 April may thus have been missed. In addition, while the precise numbers were not known, it was clear since D. Trump's re-election that tariffs would rise, and over the last few months the export orders component had already softened significantly. Besides, French manufacturing, more "Euro-centric" than in Germany or Italy, is less sensitive to developments in the US. There was a strong positive contribution to the overall resilience in business survey from the car industry, which in the French case is largely immune to transatlantic developments and which is benefitting from the success of recent new models – especially Electric Vehicles (EVs) – on the European market.

The German IFO survey for April was less surprising, since the "expected export business" component relapsed, but we note that it is still close to the range established since the beginning of 2024 (between 1 and 2 standard deviations below the long-term average, see Exhibit 6), as if there was little reaction to the very latest announcements from Washington DC.

We do not think we should take that much comfort from the relative resilience in the latest European surveys. Some of the "bad winds" blowing from American were already "priced in" in the already deteriorated level of business confidence, and even if the negotiations conclude favourably for the European Union (EU) – which we would define realistically as the permanent cancellation of the "add on" of 10% of top of the basic 10% "reciprocal tariff and some sector-specific carve-outs – the appreciation in the euro and the likely unavoidable decline in world trade would in any case dent an already mediocre outlook. We maintain our view that the French economy will be hit in a "second wave" of the tariff shock, when its exports to neighbours with stronger dependence on the US market (Germany, Italy) will suffer.

Country/Region	What we focused on last week	What we will focus on in next weeks
	• Trump's criticism of Fed Chair Powell quickly corrected after market's reacted negatively • More conciliatory tone from US over trade helped market risk sentiment recover a little • Services indices decline, PMI (Apr, p) to 51.4, Philly Fed to -42.7 and 5-year low • Home sales (Mar) diverge, new homes surge 7.4%mom, existing homes -5.9%, total -4.0% • Continuing jobless claims around 2025 lows	• GDP (Q1, p) expected weak, we f'cast 0.5% (saar), but risks of weaker with gold adj Atlanta Fed -0.4% • Labour market (Apr) upside risks to consensus 130k payrolls. Will also watch NFIB index for rebound. JOLTS vacancies (Mar) stabilised in early 2025. • Employment cost index (Q1) expt'd stable at 0.9% • ISM mfg index (Apr) mixed regionals, lower on avg • Conf Bd cons conf (Apr) – stability in sentiment? • Vehicle sales (Apr) – scale of post-March unwind
	• EMU Flash PMIs (Apr) were slightly better than expected in the Mfg sector (48, +0.1pt) with production and new export orders rising, probably boosted by front loaded purchases during 90 days pause. Svcs sector is weaker and fell in contraction territory (49.7, -1.3pt) • Ifo and Insee have similar signals: immediate near-term resilience but weak outlook (Ifo export expectation at lowest level since GFC, excl Covid)	• flash prelim GDP (Q1, EMU forecast at +0.3%qoq), Fr (0.2%) and Sp (0.7%), Ge (+0.2%) It (+0.1%) • EMU inflation (Apr) forecasted at 2.2%yoy. Falling energy prices should compensate for higher svcs prices during Easter • EC surveys (Apr) to provide details across countries and sectors after weak but resilient signal sent by other surveys. Flash consumer confidence (-16.7, lowest point since Nov 2023) to be confirmed
	• PSNB (Mar) rose £151.9bn in FY24/25, £14.6bn above the OBR's forecast made just last month • S&P Global flash PMIs (Apr) composite down at 48.2, from 51.5, driven by a drop in services • GfK cons. conf. (Apr) fell to -23, from -19 • Retail sales (Mar) rose unexpectedly by 0.4% mom, a drop of 0.4% was expected	• Nationwide house prices (Apr) look for further stalling as SDLT boost ends • BoE consumer credit (Mar) look for a slight uptick in line with stronger retail sales • Mortgage approvals (Mar) further drop likely • Final Manu. PMI (Apr) no reason to expect a material change
	• Jibun Bank flash PMIs (Apr) composite rose to 51.5, from 48.9, driven by an increase in services • Tokyo CPI (Apr) ex. fresh food up 3.4%, from 2.4% in Mar. Ex. food and energy up 2.0%, from 1.1%, reflecting base effects due to introduction of free high school tuition one year earlier	• Retail sales (Mar) look for signs real wage growth is boosting demand. IP (Mar) signs of boost in lead up to Liberation Day • BoJ rate decision and Quarterly Outlook Report, look for no change • Cons. confidence (Apr) impact of US trade policy
	• LPR (Apr) unch at 3.1% (1Y) and 3.6% (5Y)	• NBS mfg PMI (Apr) to be dragged by tariffs • NSB non-mfg PMI (Apr) watch services sentiment as strong tariff hit • Caixin mfg PMI (Apr) to reduced, reflecting SME's concerns about tariffs
	• CB: Indonesia (unch 5.75%) • GDP (Q1): South Korea (lower than expected at -0.1%yoy, -0.2%qoq) • CPI (Mar, yoy): Below expectations in Malaysia (1.4%), Singapore (0.9%), South Africa (2.7%) • Industrial production (Mar, yoy): Taiwan (13.7%)	• CB: Chile (unch 5.0%), Hungary (unch 6.5%), Thailand (25bp cut to 1.75%), Colombia (25bp cut to 9.25%) • GDP (Q1): Czech Republic, Hungary, Mexico, Taiwan • CPI (Apr): Indonesia, Peru, Poland, South Korea • Industrial production (Mar): India, South Korea, Thailand, Turkey

Upcoming events		
	US:	Mon: US Treasury Q2 quarterly financing estimates; Tue: Goods trade balance (Mar), JOTLS Job Openings (Mar), Consumer confidence (Apr); Wed: ADP emp change (Apr), GDP (Q1, p), PCE (Q1, p), Emp cost index (Q1), PCE (Q1), Personal income (Mar); Thu: Initial jobless claims (w/e 26 Apr), ISM mfg PMI (Apr); Fri: Non-farm payrolls (Apr), Avg earnings (Apr)
	Euro Area:	Tue: Sp GDP (Q1), Sp HICP (Apr), ECB consumer inflation expectations (Mar), Ez Industrial confidence (Apr); Wed: Fr, Ge, It GDP (Q1, p), Fr, Ge HICP (Apr), Ge Unemp (Apr), Ge CPI (Apr, p); Fri: Ez mfg PMI (Apr), HICP (Apr), Unemp (Mar)
	UK	Thu: Mortgage approvals (Mar), Net mortgage lending (Mar), Consumer credit (Mar), Mfg PMI (Apr)
	Japan:	Wed: IP (Mar, p); Thu: BoJ announcement
	China:	Wed: Official mfg PMI (Apr), Official non-mfg PMI (Apr)

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**All figures, as at end of December 2024*

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