

Intelligence MEMOS



From: Jerzy Konieczny and Steve Ambler
To: Interest Rate Watchers
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Re: **HOW TRUMP'S WAR ON THE FED CAN HIT YOUR MORTGAGE**

Donald Trump has a new target. It's not China, Mexico or Prime Minister Mark Carney, but Jerome Powell, chair of the US Federal Reserve. If Mr. Trump gets his way, the fallout won't stop with the United States – it will hit Canada, too.

The President has been critical of Mr. Powell since his first term in office, but recently escalated his attacks. In a meeting with lawmakers last month, he waved a draft letter threatening to fire Mr. Powell, unless the Fed slashes interest rates to 1 percent. He later walked back some of his comments about firing Mr. Powell, but there's still uncertainty about what's in store for the policy rate. If carried out, the cuts would be an economic earthquake that could send shock waves through Canada's housing market and hurt the loonie.

The Fed's benchmark policy is currently 4.25 to 4.5 percent. The Fed has only cut rates this aggressively in moments of extreme upheaval – the 1982 recession, the 2008 financial crisis and the COVID-19 shock.

But the US economy is not in crisis. Unemployment is low and inflation has fallen over the past year, from 3 to 2.7 percent. A move of this scale would be profoundly risky.

Mr. Trump says lower rates will bring down U.S. mortgage costs and reduce interest on Washington's \$36-trillion debt. That claim falls apart for several reasons.

First, market expectations have a major influence on inflation. If a massive rate cut signals rising inflation, borrowing costs could increase. That's what happened last year: The Fed cut rates, but mortgage rates and bond yields went up.

A policy rate of 1 percent would be an expansionary stance almost certain to boost inflation.

Second, most federal debt is locked in. Only \$10 trillion in debt will need to be refinanced, leaving \$26-trillion untouched.

Third, this would be a unilateral revision of the Fed's mandate. Its job is to achieve an inflation rate of 2 percent and maximum sustainable employment. Those goals don't include reducing mortgage costs or helping the government finance its debt.

Political interference is costly. If investors believe the Fed is a political tool, they will demand a risk premium, meaning higher rates.

History offers a stark warning. President Richard Nixon leaned on former Fed chair Arthur Burns to keep rates low ahead of the 1972 election. Mr. Burns complied, and Mr. Nixon won in a landslide.

Then, inflation exploded during the rest of the seventies, forcing the later-Fed chair Paul Volcker to hike rates in the early eighties. Mortgage rates soared above 18 percent, plunging both the United States and Canada into deep recessions.

The lesson? Political meddling in monetary policy brings short-term sugar highs and long-term economic pain.

Canada doesn't set US policy, but it doesn't get to opt out of its consequences either. Here's why Canadians should care: While many US mortgages are set for 30 years, terms in Canada are generally shorter. This means Canadian mortgage holders could feel the effects of rate increases more acutely than their American counterparts.

A Fed under political attack could weaken the US dollar unpredictably, affecting the loonie. For Canadian exporters, importers and investors, that adds uncertainty on top of existing trade tensions.

The Bank of Canada needs a clear and credible plan to keep the country out of Washington's drama. It should reaffirm its independence with a strong public message that monetary policy is not up for political negotiation. At the same time, it must make clear that Canada won't blindly follow US rate cuts for the sake of competitiveness. Decisions should be based on data – not Mr. Trump's whims. That clarity would help anchor expectations.

This is as much about optics as economics. Confidence is currency.

The good news is the Bank of Canada is in a strong position. Since adopting inflation targeting in 1991, it has built one of the most credible monetary policy track records in the world. It also recently pulled off the holy grail of central banking: A "soft landing." Inflation in Canada came down from post-pandemic highs without triggering a recession.

If Mr. Trump succeeds in bending the Fed to his will, it won't just be US monetary credibility on the line. His interference with Fed independence will threaten global markets and Canada's economy, too. History is screaming the warning: When politics capture the currency printing press, everyone pays.

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