# Is Trump making the dollar strong?

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The US dollar has gained significantly against other currencies since Donald Trump's election as US President. However, this appreciation will only prove sustainable if the Federal Reserve fights the inflationary consequences of the policies announced by Trump, which would, however, go against his trade policy. If the Fed were to allow higher inflation, the US dollar would ultimately suffer from Trump's policies.

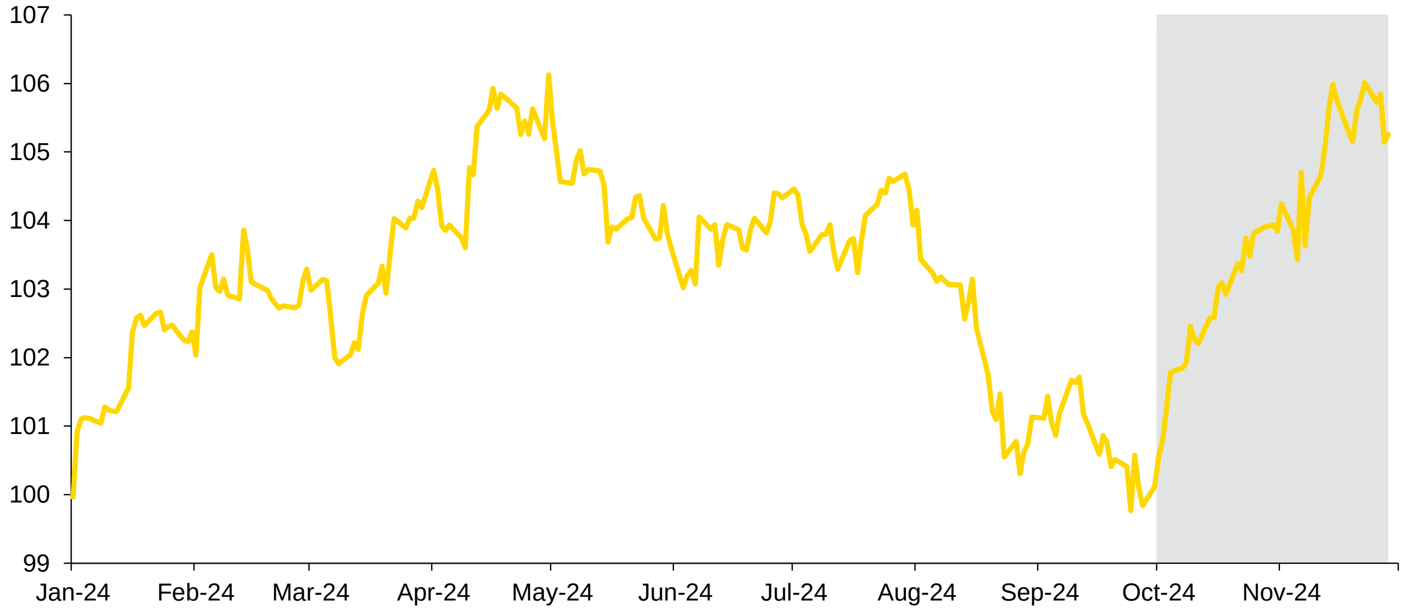
## The market expects a strong Trump dollar

Since the US presidential election, the US dollar has appreciated by around 2% on average against the other G10 currencies. Furthermore, a good portion of the appreciation of the US dollar since the beginning of October, when the polls indicated an increasing likelihood of a Trump victory, can probably be attributed to the election. Consequently, the market seems to assume that “Trumponomics” (the policies of the incoming Trump administration) will have a significantly positive impact on the value of the US currency.

Now, the market does not have any secret knowledge. The conclusion of USD strength follows from what has emerged so far from public information, in particular from statements made by Donald Trump and his team during the election campaign.

**Chart 1 - Since early October, the dollar gained significantly**

USD performance vs. G10 average, end-2023 = 100 ; shaded area: since beginning of October




Source: Bloomberg, Commerzbank-Research

## Inflationary policies…

The reason for this is likely to be that the measures announced by Trump in the fields of trade policy, migration policy and tax policy are likely to significantly increase inflationary pressure.

- Higher tariffs on US imports will cause domestic price levels to rise. This is because not only imported goods will become more expensive as a result of the tariffs, but also domestic goods that serve as substitutes for imports and for which demand will increase due to the higher prices of imports.
- The Peterson Institute estimates that 8.3 million unauthorized immigrants are employed in the US labor market. The deportation of a significant portion of this labor force would reduce the labor supply and thus cause wages to rise more sharply. In addition, stronger demand for domestic products due to tariffs would meet with lower supply.

- Low taxes are likely to further fuel domestic demand and also increase inflationary pressure.

Even if no one can currently estimate the extent to which Trump's announcements will actually be implemented, one thing seems certain: his economic policy will push up inflation.

## … is only dollar-positive with active monetary poliy

Is higher inflationary pressure now positive or negative for the greenback? For many, this is obvious: after all, the dollar usually strengthens when US inflation data is released that exceeds analysts' estimates, and weakens when it falls short of expectations. So inflation is USD-positive.

This market reaction should actually come as a surprise. After all, higher US inflation means that the dollar's domestic purchasing power is eroding faster, which would tend to suggest a lower valuation against other currencies. Higher inflation will only be positive for the US dollar if the Fed overcompensates for the erosion of purchasing power with its interest rate policy: if the Fed reacts to additional inflation of *x* percentage points with an interest rate hike of more than *x* percentage points, i.e. if it pursues an “active” monetary policy, the future purchasing power of USD positions will increase overall. They will therefore become more valuable. Since the market is obviously valuing the foreseeable inflationary policy of the incoming US administration as USD positive, it is therefore implicitly assuming that the Fed will act in this way in the future. As a rule, this assumption is correct and reasonable. Only an active monetary policy is normally suitable for preventing increasing deviations of inflation from the central bank's target.

## Will Trump try to influence the Fed's monetary policy?

However, it is not certain whether the Fed will always pursue such an active policy in the coming years. It may decide that tariff-induced inflation is inevitable and therefore ignore it. Or the Trump administration could put political pressure on the Fed to pursue a non-active monetary policy. In addition, Fed Chair Jay Powell's term in office expires at the beginning of 2026, so Trump can appoint a new Fed Chair. In the worst case, the Republican-controlled Congress could amend the Federal Reserve Act to formally give the US president formal influence over monetary policy.

There is some evidence that Trump will favor a non-active monetary policy. He would not be alone among those in government in doing so. After all, governments prefer a loose monetary policy that at least initially boosts the real economy, which the governing politicians can (unjustifiably) celebrate as a success of their own economic policy.

## Tight Fed monetary policy would counteract Trump's tariff policy

A tight Fed monetary policy can lead to quite considerable US dollar strength, especially if it coincides with a period in which other major central banks (in view of their own gloomy economic outlook) do not dare to dream of a tight monetary policy. We know from experience that in such situations the currency market tends to let the USD exchange rates “overshoot” and to make the dollar far more expensive than the fundamentals (in this case: the US tariffs on imports) would actually justify.

However, an excessively strong dollar counteracts the positive effect of US import tariffs on the US trade balance. This is because a strong dollar makes foreign goods cheaper in the US, thus reducing the effect of the tariffs. At the same time, it reduces the price competitiveness of US exporters abroad. In the end, in an extreme case, imports may hardly decline at all, but exports may collapse, so the trade balance may improve little or not at all.

In this situation, Trump would have two options: either he admits the failure of his trade policy, or he tries to force the Fed to pursue a loose monetary policy that allows higher inflation, weakens the US dollar and is likely to lead to an improvement in the US trade balance. No one knows how he will decide. He probably doesn't know himself yet.

## The market's bet on a strong Trump dollar is bold.

We believe it likely that Trump would put considerable pressure on the Fed in such a situation. He would do so publicly, making it clear to everyone that it is not he, but the central bankers, who are responsible for the failure of his trade policy. The Fed will not come out of this pressure completely unscathed. It is unlikely to react to the tariff-related rise in inflation by raising interest rates, but will “look through” it. As a result, the dollar is likely to lose some of its recent strength from mid-2025 onwards.

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