FED FOCUS

Trump's Fed pressure could usher in rate uncertainty, faster bank deregulation

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US President Donald Trump's efforts to influence the Federal Reserve could more quickly advance the agency's deregulation agenda but could also set the industry up to deal with a tumultuous rate environment.

Trump's decision to fire Governor Lisa Cook, whose position is now in the hands of the courts, could present him with the opportunity to make another nomination to the seven-member Fed board. At the least, the president is expected to gain one more ally on the board when newly nominated Stephen Miran gets confirmed by the Senate, which is expected after the bid received Senate Banking Committee approval on Sept. 10. Miran's addition would bring Trump closer to having a majority on the board, adding at least one additional vote for his deregulation and interest rate cut agenda.

"It helps to be able to appoint as many people who sympathize with your policy position as possible," Carleton Goss, who was formerly a lawyer at the Office of the Comptroller of the Currency (OCC) and is now a partner at Hunton Andrews Kurth LLP, said in an interview.

The Fed's articulated direction for US bank regulation, spearheaded by Vice Chair for Supervision Michelle Bowman, is unlikely to shift as a result of new board members, said Barry Wides, former deputy comptroller in bank supervision policy at the OCC and now a managing director at Artisan Advisors.

However, that deregulation agenda could be fast-tracked with more Trump allies on the board, sources said.

Interest rate impact

Trump's pressure on the Fed has largely centered around advancing his belief that the federal funds rate should be around 1.25%, instead of the current target range between 4.25% and 4.50%. The Federal Open Market Committee is widely expected to cut rates by 25 basis points on Sept. 17.

If Trump secures a board majority, there could be a more dramatic shift in interest rate policy, which would be reminiscent of the sharp drop in rates during the COVID-19 pandemic and subsequent fast increase after. The rapid increase in rates put outsized pressure on securities banks bought at near-zero rates, driving up unrealized losses and threatening liquidity. The dynamic worried regulators, and eventually led to several large bank failures.

"A drastic rate cut would mirror in the opposite direction what happened when the Fed jumped-up rates quite quickly a few years ago," Joseph Lynyak, a partner advising banks and other financial services companies at Dorsey & Whitney LLP, wrote in an email. "Banks learned from that experience and likely that knowledge has not yet been forgotten."

With that experience not very far in the rearview mirror, banks are likely prepared, through models and forecasting, for a wide range of interest rate scenarios, sources said.

"Banks are comfortable working in environments where interest rates move around, and they have to change their business," Goss of Hunton Andrews Kurth said, noting that banks model up or down at least 400 basis points of interest rate changes.

Still, a dramatic shift in interest rate policy could bring more economic uncertainty for banks to wade through, sources told S&P Global Market Intelligence.

"Making dramatic changes to the interest rate ... could potentially create an economic shock where it just adds layers of uncertainty for banks, even though the

thought is that lower interest rates are generally beneficial for the consumer economy," Joseph Silvia, a Duane Morris LLP partner who advises financial institutions on M&A and other topics, said in an interview.

NIM dynamics

As rates fall, banks, eager to trim funding costs, are gearing up to bring deposit rates down immediately after the Fed's expected decision.

"We'll all be changing deposit pricing as fast as we can, trying to respond to that," Zions Bancorp. NA Chairman and CEO Harris Simmons said during a presentation on Sept. 10. The Salt Lake City-based company expects its margin will continue to expand on the heels of a rate cut, Simmons said, hoping to get the company back to a net interest margin (NIM) around 3.5%. Zions' NIM was 3.17% at June 30.

"There was a lot of damage done in the wake of the Silicon Valley failure. And it's been just kind of climbing out of the hole. And it takes some time, but we think we're on the path to get there," he said.

East West Bancorp Inc. plans to reprice deposits the same day the Fed announces a rate cut to boost its net interest income (NII) ahead of loan repricing, which usually takes place about three to six weeks after rate moves, said CFO Christopher Del Moral-Niles.

"In this current environment, we think the short-term dynamics are relatively positive, which is why we're positive on our NII guidance," he said.

BofA Global Research analysts in a Sept. 7 note named East West and several other banks, including Goldman Sachs Group Inc., Huntington Bancshares Inc., U.S. Bancorp, KeyCorp, Western Alliance Bancorp. and UMB Financial Corp., as best-positioned for NIM expansion following potential rate cuts.

Lower rates will also impact the other side of the balance sheet, hurting asset-sensitive banks with outsized floating loans and securities. An increase in lending activity could help offset some of that impact.

As interest rates decline, demand for mortgages and auto loans will likely increase, Dean Lyulkin, founder, president and CEO of San Diego-based small business lender Cardiff, said in an interview.

"A decreasing rate environment hopefully will stimulate mortgage warehouse, will stimulate mortgage originations," First Horizon Corp. CFO Hope Dmuchowski said during a conference presentation on Sept. 9. "In the near term, I actually see rate cuts as stimulating for us."

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