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Blasphemy to some, but it's time for interest rates hikes

May 07, 2015 - Appraisal & Consulting

Janet Yellen and members of the Federal Reserve have done it again. Just when they have almost committed to raise short term interest rates in June, and then only by a tenth to a quarter of 1%, they lost their nerve. The unemployment rate was low enough to meet their objective, but other metrics in the economy were not quite there.

About this time last year, I wrote about how most were perplexed then as to why interest rates had not risen. The Fed was beginning (this time as promised) to reduce quantitative easing, which was meant to reduce bond demand, and thus let rates float higher. What happened? Essentially, the Eurozone ramped up its quantitative easing. Their actions drove rates so low, that Eurozone investors bought more U.S. long term bonds, thus keeping that demand high and our rates low. European rates are now so low that Denmark, Switzerland and Sweden are paying negative rates on deposits in banks, and Portugal and Spain are beginning to lend at rates below zero. Economists are pondering how rates below zero could cause depositors to pay banks to keep their money, and borrowers to be paid by banks to take out loans. But this is far too complicated, and another story altogether.

Are low rates still all good for real estate professionals like us? Not exactly true. While there are many who have benefitted in property values dramatically increase, there are others wanting to buy into the market who cannot afford to. There are also more far reaching negative impacts, specifically on the baby boom generation, which is moving towards retirement and fixed income living. Up until recently this was the largest population group and it was meant to retire and spend available dollars in our economy, boosting consumption which is approximately 70% of Gross Domestic Product. Thus, boomers were assumed to provide a support base, and younger people were meant to provide new growth, with new jobs and spending their hard earned income. This is not happening as planned.

Retirees have no place to turn for higher yield, except perhaps the stock market. Previously a mainstay, certificates of deposit have been below 1% for the last six years since 2009. Saving accounts pay nothing. It seems to me pretty evident that retired boomers, with little or no fixed income, and less need for material goods in their later years, are not going to be major factors in 70% consumption part of GDP.

There are several other ramifications from low interest rates which may be hurting the economy. Some economists believe that easy money has caused companies to invest in capital items, such as machinery and technology, and not in employees. In fact, some believe that there is an incentive to reduce employment through automation. These same companies may also be using cheap money to buy back their own stock, rather than invest in employees or machinery. This has been good for stock prices clearly, but causes partial distortion in that market, and is not necessarily any benefit to employment and GDP.

In other areas, insurance rates have been increasing because insurance companies cannot find enough yield to support the payments they may owe for catastrophes such as flood, fire, death etc. Health insurers have the same problem, not able to meet their costs because of low yields, and thus resorting to higher charges and lower reimbursements to patients and hospitals. It has also been well reported that pension funds and government entitlements promised to retiring workers are in jeopardy, for the same reason.

Isn't this complicated! It seems to me that the Fed could take what appears to them as a treacherous and giant step forward, and raise interest rates a few tenths of a percent. Yes, the stock market might tumble as they say, but the real economy just may be strong enough to move forward with better jobs, higher pay, better forms of passive income and ultimately the spending that GDP needs. Some pain for us now, but better for all of us in the long run? How big a risk can it be?

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