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Rise in interest rates: Amazingly, not a sure bet, yet

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I hate to be boring and redundant, but I have written about the likelihood of interest rate rise several times over the last five years, expecting at least some slight change. But, as I read back over those articles, nothing has changed. So far, all us real estate pros, banking experts, hedge fund runners and other financial pundits have been wrong. There have been zero Federal bank interest rates, with no change, for more than six years running. The Fed has simply not had the stomach to raise rates even one quarter of a point for fear of slowing down the recovery. Is 2015 the year for liftoff, a daring move to raise a quarter of a point by the end of the year? Once again, it seems like it should be.

What has happened over the last 6+ years would support the notion:

* Unemployment is well below 6%, the target that the Fed indicated it needed in order to raise rates.
* The economy is much stronger, albeit with some weak points related to wage growth.
* The dollar is very strong, indicating faith by the rest of the world in our economy, so strong in fact that it is hurting our export economy.
* Institutions relying on safe interest rate related investments such as insurance companies and health care institutions are gasping for air, desperately needing yield for their longer term liabilities.
* Finally, the annual deficit has fallen to around $470 billion, as opposed to the over one trillion for each of Obama's first four years in office. This drop has been helped by stronger economic growth and thus more tax revenue, plus some real cuts in government spending.

All of these factors, both good and bad, would indicate it's time to raise rates. Most of the Federal Reserve members agree and expect a rate hike by year end. However not all others agree. The International Monetary Fund has urged the Fed to keep rates low until late 2016. Many of the world's other countries are just starting to lower rates in order to stimulate their slow economies. Such proponents of easy money cite low inflation, needed improvement in certain parts of the economy, and an overall feeling that any slowing of economic growth could lead to a complete standstill.

The other major factor for keeping rates low, and it is surely not missed by our banking managers, is the interest cost of our Federal debt. While the annual deficit has been reduced significantly, as stated, the total U.S. debt is still being added to and thus growing. The U.S. debt is now over $18 trillion and, depending on your source, expected to rise dramatically over the next decade or so. The recent Congressional Budget Office recent report indicates that as soon as 2016, the annual deficit will begin increasing again and by 2023 it is likely to be once again over a trillion dollars. The CBO report also points out that interest on the debt is becoming a larger portion of federal spending. "This year the federal government will pay $221 billion in interest charges. By 2024, that will rise to more than $876 billion, and not long afterwards, we will be paying a trillion dollars every year just for interest on the debt." Clearly, this is a good reason to keep interest rates low.

While enormously complicated and intertwined, the preponderance of data would indicate that interest rates will not rise until mid-2016, and then only by a quarter percent. Once started, depending upon ramifications, the Fed should continue a modest rate of annual increase. Since we in the real estate business have been expecting it for so long, it should not have a dramatic impact. However, over a decade, it could certainly change the cap rate in value of assets. Enjoy the benefits while we can, and keep a watchful eye out.

Daniel Calano, CRE, is the managing partner and principal of Prospectus, LLC, Cambridge, Mass.