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Challenges ahead for US

What is the issue?

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The US Fed Reserve's moves on interest rates and the country's stand on global trade will grab much attention in the upcoming days.

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What is the relation between Inflation and Interest rate?

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- Inflation and interest rates are often linked in macroeconomics.
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- In general, as interest rates are reduced, more people are able to borrow more money.
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- The result is that consumers have more money to spend, causing the economy to grow and inflation to increase.
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- The opposite holds true for rising interest rates.
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- As interest rates are increased, consumers tend to save as returns from savings are higher.
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- With less disposable income being spent as a result of the increase in the interest rate, the economy slows and inflation decreases.
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What does the data reveal on a possible rate hike?

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- Following the financial crisis and recession of 2008-09, the US has maintained roughly zero per cent rates for a long period of time.
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- But its goal now is to return interest rates to more normal levels.

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- According to the employment cost index in US, wages and salaries for private industry are up 3% from a year earlier, marking the fastest growth since early 2008.
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- Since higher wages and salaries could pave the way for higher spending and hence inflation, the federal reserve is more likely to raise interest rates in the near future to curtail it.
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- This is also shown by the Federal Reserve raising its target for the federal funds rate, slowly and steadily over the past year.
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Is there a sign of recession in US?

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- A yield curve is a line that plots the interest rates of bonds having equal credit quality but differing maturity dates.
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- A normal yield curve is one in which longer maturity bonds have a higher yield compared with shorter-term bonds due to the risks associated with time.
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- The yield curve is now relatively flat in US, meaning that long-term interest rates are close to short-term interest rates.
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- However, if the Fed keeps tightening the interest rates, short-term rates could rise above long-term rates, thereby inverting the yield curve.
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- An inverted yield curve is one in which the shorter-term yields are higher than the longer-term yields, which can be a sign of upcoming recession.
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- Recession is a slowdown or a massive contraction in economic activities, wherein economic indicators such as GDP, corporate profits, employments, etc., tend to fall.
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What should be done?

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- The US has to get some serious concessions from China, especially to avoid the repercussions of the recent trade war.
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- Fearing worse outcomes like punitive tariffs, China might also agree to start respecting American intellectual property.
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- US should also make its trading partners to accept some minor concessions in trade agreements, like the recently updated NAFTA agreement.
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- Else, there will be escalation of global tensions and a retreat from the principles of open trade that have promoted growth in the US and abroad over the past half-century.
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- Also, US should focus on climate change from human carbon emissions at a global level and the looming fiscal imbalance at local level on account of its higher spending on Social Security and Medicare.
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- A tax on carbon emissions would address both these problems, by promoting cleaner energies and a higher revenue for the government.
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- However, this measure will not convince the general public and is more likely lead to a backlash.
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- Thus, the Fed Reserve's moves on interest rates and US government's measures on addressing concerns in the global trade will grab much attention in the upcoming year.
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Source: Business Line

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