US Fed pushes back on interest rate cuts

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The US Federal Reserve has kept interest rates on hold with a majority of the members of its governing body indicating they expect at most only one cut before the end of the year.

With the decision to keep interest rates at their present level widely expected, the main focus of attention was the once every three months "dot plot" where Fed officials indicate where they think rates will go.

And here there was a significant change. Back in March they signalled as many as three cuts for the year.

On this occasion four members of the policy-making committee said they expected to make no cuts, seven said they thought they would make one cut and eight forecast two.

At the start of the year financial markets were pricing in as many as six rate cuts for the year. Now there are doubts there will even be one.

What was described as a "hawkish" outlook came despite data released just hours before the Fed made its decision, which showed lower than expected inflation for May, raising the prospect of rate cuts.

Fed chair Jerome Powell seemed to lean to the side of at least two cuts, describing the inflation number as "encouraging," and said the committee's forecasts of higher inflation had an element of "conservatism." He noted that 15 of the 19 had indicated one or two cuts and either option was "plausible."

In his press conference, he said the latest inflation data, which showed that the consumer price index for May was up 3.3 percent for the year compared to 3.4 percent for April, was a "step in the right direction … but you don't want to be too motivated by any single data point," and that in order to cut rates "we'll need to see more good data."

As has been the case since rate tightening began, the Fed will direct particular attention to the labour market where Powell said supply and demand had come into "better balance" and which was "relatively tight but not overheated."

While there has been no change in the Fed rate, the decision to keep rates higher for longer will have an effect. Increasing concerns are being raised that the elevated rates, which started in March 2022, will soon have significant effects on the commercial property market.

Earlier this month, the investment management firm PIMCO said it expected more regional bank failures because of what it called a "very high" concentration of problematic commercial real estate loans on their books.

The head of the firm's commercial real estate operations John Murray told Bloomberg that "the real wave of distress is just starting" for lenders in everything from shopping malls to offices.

Smaller regional banks, which piled into commercial real estate when interest rates were low, are now left with assets that are worth considerably less than they were at their peak.

"As stressed loans grow to maturities … we expected that banks will start selling these more challenged loans to reduce their troubled loan exposures," Murray said.

Earlier this year, New York Community Bancorp required a major capital injection after it had to stockpile cash for potentially bad loans.

The problem is widespread as it is estimated by property brokers, according to a recent report in the *Financial Times*, that "at least a third of the $2 trillion of US commercial property loans that need refinancing by 2026 will fail to raise money," which could spark a round of regional bank failures.

Whatever the immediate turns in Fed policy in the coming months, the fact that interest rates are going to remain high relative to the low-rate regime, which prevailed for nearly a decade and half after the 2008

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crisis, has major implications for the financing of the American state.

The total government debt is rapidly accelerating towards $35 trillion—an escalation which has already been characterised by the Treasury as “unsustainable.” On top of the increased military spending, one of the major sources of the debt surge has been the hike in the interest bill which has risen to $1 trillion a year.

FT commentator Patrick Jenkins in a recent article likened the US budget to a giant private equity deal. Under such a deal, private equity firms take over a company and load it up with debt in the gamble that future growth will pay it off.

Internationally the US is functioning as a kind of giant monetary vacuum cleaner sucking in global funds. In 2008, it accounted for around a quarter of all outstanding debt issued by the governments of the major economies. Today that figure has risen to around one half.

This means that interest rates around the world are pushed up, exerting downward pressure on global growth under conditions where, as the World Bank reported this week, it is set to remain at least half a percentage point below the period 2010–2019.

Concerns are now being voiced about the global consequences of a failure by the US to pay its mounting debt, if the leveraged gamble fails, or even before that, if higher interest rates on Treasury bonds impact the way it is financed.

The latest financial stability report of the European Bank noted that, although a technical default on outstanding debt would be an extreme tail risk—that is, an event of very low probability—“a significant rise in US Treasury bond yields or an induced economic shock could weigh on other assets globally.”

Other analysis points in the same direction.

Last month in a paper entitled “Everything you wanted to know about the US budget deficit and debt but were afraid to ask,” the UK National Institute for Economic and Social Research, Britain’s oldest economic research organisation, warned of the gathering financial storm.

“The current unsustainable fiscal position will not matter until it matters, and then it will be all that matters and will affect bonds, stock, derivatives and the FX (foreign exchange) value of the dollar,” it said.

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