

High interest rates in US starting to bite

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Higher interest rates and somewhat tighter financial conditions, coupled with the fall in real wages, are taking their toll in the US amid broader concerns about what effect the incoming Trump administration will have on the global economy and its financial system.

The mounting economic pressure on working-class families in the US, especially those in the lower part of the income scale, is reflected in the latest data on credit card defaults reported yesterday by the *Financial Times* (FT).

It said that credit card lenders “wrote off \$46 billion in seriously delinquent loan balances in the first nine months of 2024, up 50 percent in the same period in the year prior and the highest level in 14 years, according to industry data collated by BankRegData.”

Write-offs take place when banks determine it is unlikely that a borrower will make good on their debt.

The head of Moody Analytics, Mark Zandi, told the FT: “High-income households are fine, but the bottom third of US consumers are tapped out. Their savings rate right now is zero.”

The effect of wages suppression, which has been operating over many years and has been exacerbated by the surge in inflation as a result of the COVID pandemic, is seen in the escalation of credit card debt. In the years 2022 and 2023 it increased by \$270 billion and rose over the \$1 trillion mark in the middle of last year.

Those who have not been able to fully pay off their credit card debt have been hit with interest charges of \$170 billion to the year ended last September.

The effects of the higher interest rate regime are starting to show up in the US corporate debt market as well.

It was reported just before Christmas that defaults in the global leveraged loan market, according to Moody’s, were up by 7.2 percent in the year to October as interest rates hit indebted businesses.

Leveraged loans have floating interest rates and, as the FT reported, many companies that “took on debt when rates were ultra low during the pandemic have struggled under high borrowing costs in recent years. Many are now showing signs of pain even as the Federal Reserve bring rates back down.”

David Medlin, the credit portfolio manager at UBS, told the FT the default trend could continue into next year because “there was a lot of issuance in the low interest rate environment and the high rate stress needs time to surface.”

According to data from Moody’s, the default rates on junk loans have risen to decade highs and the situation will worsen because of the indication from the Fed’s December meeting that the pace of interest cuts will slow in 2025. According to the so-called “dot plot,” in which Fed policy makers chart where they think interest rates will go, there will only be two cuts in the coming year as opposed to the previous estimate of four.

Moreover, there is greater uncertainty in financial markets resulting from the potential impact of the policies of the incoming Trump administration and the reaction of the Fed.

Commenting on the market turbulence which followed the Fed’s December decision—the S&P fell 3 percent—financial analyst Mohamed El-Erian wrote in the FT that chair Powell’s press conference after the meeting “was the most confused and confusing of a series of less-than stabilising affairs in recent years” and was “full of contradictions.”

At one point, he noted, Powell said recent “sideway” inflation readings meant the Fed could be “more cautious” in its easing of monetary policy and at another said the central bank’s policy stance was “meaningfully restrictive.”

The first position implies a slowing down of monetary easing while the second implies that there is

room for more cuts.

El-Erian said the most recent decision was part of a “larger pattern of flip-flops.”

“As an illustration,” he continued, “in just the past five months, the Fed’s actions have ranged from no cut (end of July), to a jumbo 0.5 percentage point ‘recalibration’ cut (mid-September), to a 0.25-point cut amid a seemingly ‘nothing-to-see-here’ pace (early November), to the upending of earlier forward policy guidance and economic interpretations (mid-December).”

He warned that policy decisions based on whatever direction the latest data was blowing led to about turns. This excessive “data dependency” not only increased uncertainties in the US economy but had global effects because the US is currently the “only locomotive of global growth.”

Present forecasts are that the euro zone economy will barely advance at all in 2025, with its largest economy, Germany, entering its worst downturn in the post-war period. Japan which has long been out of the picture as a centre of global growth, will continue to only inch forward, while China, which has provided much of the global growth since the financial crisis of 2008, is recording its lowest growth rates in more than three decades.

And hanging over the US, the global economy as a whole and the financial system is the potential impact of Trump’s economic and tariff warfare against “friend” and “foe” alike, spearheaded by the threat of a 60 percent tariff against Chinese goods.

Here the policies of the new administration abound in contradictions. On the one hand, Trump maintains that the value of the dollar should be lower in order to boost exports and reduce US trade deficits.

On the other, he maintains that the dollar must continue to be the basis of the international monetary system and that losing dollar supremacy would be the equivalent of the US losing a war.

Commenting on these contradictions in a piece published in the FT a week ago, Cornell economics professor Eswar Prasad noted that Trump’s actions on tariffs would probably lift the value of the dollar in the short run while “its status as a reserve currency may well become shakier.”

“What it means for the world, though, is great deal of uncertainty in US trade policies—accompanied by

turbulence in global capital flows and exchange rates. Volatility in US policies and financial markets invariably spills over into other countries’ economies and markets.”

The irony in this, he continued, was that such turbulence would encourage a flight into dollars because they are still conceived as the safest investment.

That may well be the case in the short term but how long the contradictions inherent in the global economy and its financial system can be contained under conditions where the kind of chaos not seen since the 1930s is very much on the agenda is another question.



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