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Trending Report

Data Ending: 2024.03.22

Rates are too High, Yet Somehow too Low??

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ECONOMY | CENTRAL BANKING

The Fed's Conundrum: Interest Rates Are Both Too High—and Too Low

Short-term rates are sharply higher. Long-term rates are steadier. What's a central bank to do?

ILLUSTRATION: ALEXANDRA CITRIN-SAFADI/WSJ; ISTOCK

By Justin Lahart Follow

March 21, 2024 5:30 am ET

The Federal Reserve is still aiming to lower interest rates later this year, and for many U.S. households and small businesses those rate cuts can't come soon enough. But for big companies able to tap the corporate bond market, and for investors riding a rising stock market, relief from the Fed doesn't seem all that necessary.

The Fed on Wednesday left its federal-funds rate target steady at a range of 5.25% to 5.5%, the highest level in more than two decades. But it left in place plans to cut interest rates this year. Fed Chair Jerome Powell again characterized the level of rates as "restrictive," and said that "it will likely be appropriate to begin dialing back policy restraint at some point this year."

Changes in the Fed's benchmark fed-funds rate have a strong effect on a variety of short-term rates, such as those on bank deposits and money-market funds. But their influence on longer-term rates, such as those on corporate bonds, can be more tenuous.

The idea that the Fed's target rate is restrictive is driven by a variety of models, many of them versions of the Taylor rule put forth by the Stanford economist John Taylor. These calculate where the Fed should set rates based on its inflation target, current inflation, estimates of how much slack there is in the economy, and estimates of where rates will eventually need to settle. Three versions of the rule calculated by the Atlanta Fed suggest the Fed's target rate should now be 3.9% to 4.7%.

A lot of Americans probably don't need to consult the Taylor rule to conclude rates are restrictive: They can just look at the interest their credit-card accounts are charging. The average interest rate on commercial bank credit-card plans in the fourth quarter was 21.5%, according to the Fed. That is the highest in the 30 years of available data, and compares with just 14.9% in the fourth quarter of 2019, right before the pandemic hit.

Recent research from former U.S. Treasury Secretary Larry Summers and co-authors suggests that households' high borrowing costs might even help explain what has been a bit of a mystery: Why, despite a strong job market and moderating inflation, consumer moods remain so dour.

Economist John Taylor in 2012. PHOTO: TED S. WARREN/ASSOCIATED PRESS

Small businesses, too, often tap credit cards, with a recent Fed survey finding that 56% of them regularly used cards for financing—more than any other source of credit. Lines of credit, also commonly used by small businesses, are also tied to short-term rates. Constraints on small businesses can translate into less robust job growth. Companies with fewer than 100 employees account for about a third of private employment, while research has shown that young, small businesses on the way to becoming larger ones are a deciding factor in U.S. job growth.

Federal Reserve Bank *of* Atlanta

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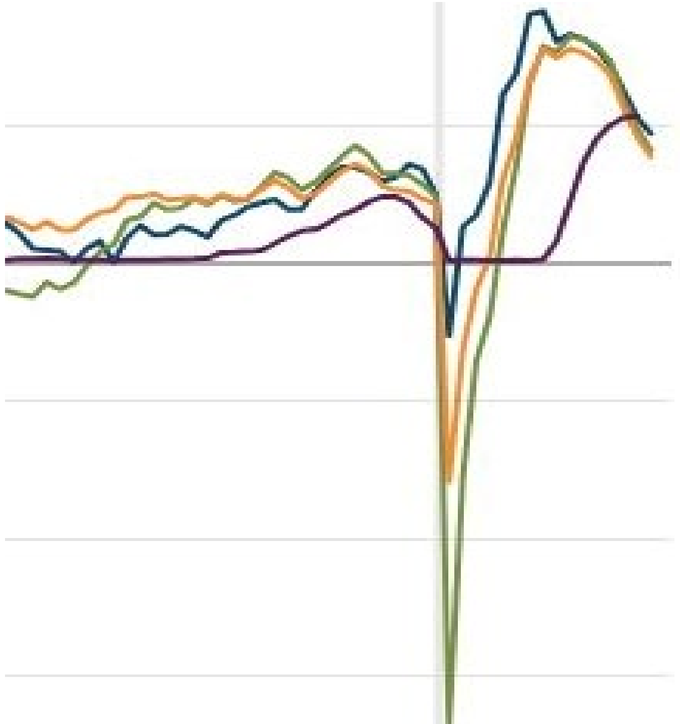
Taylor Rule Utility

Updated on March 12, 2024

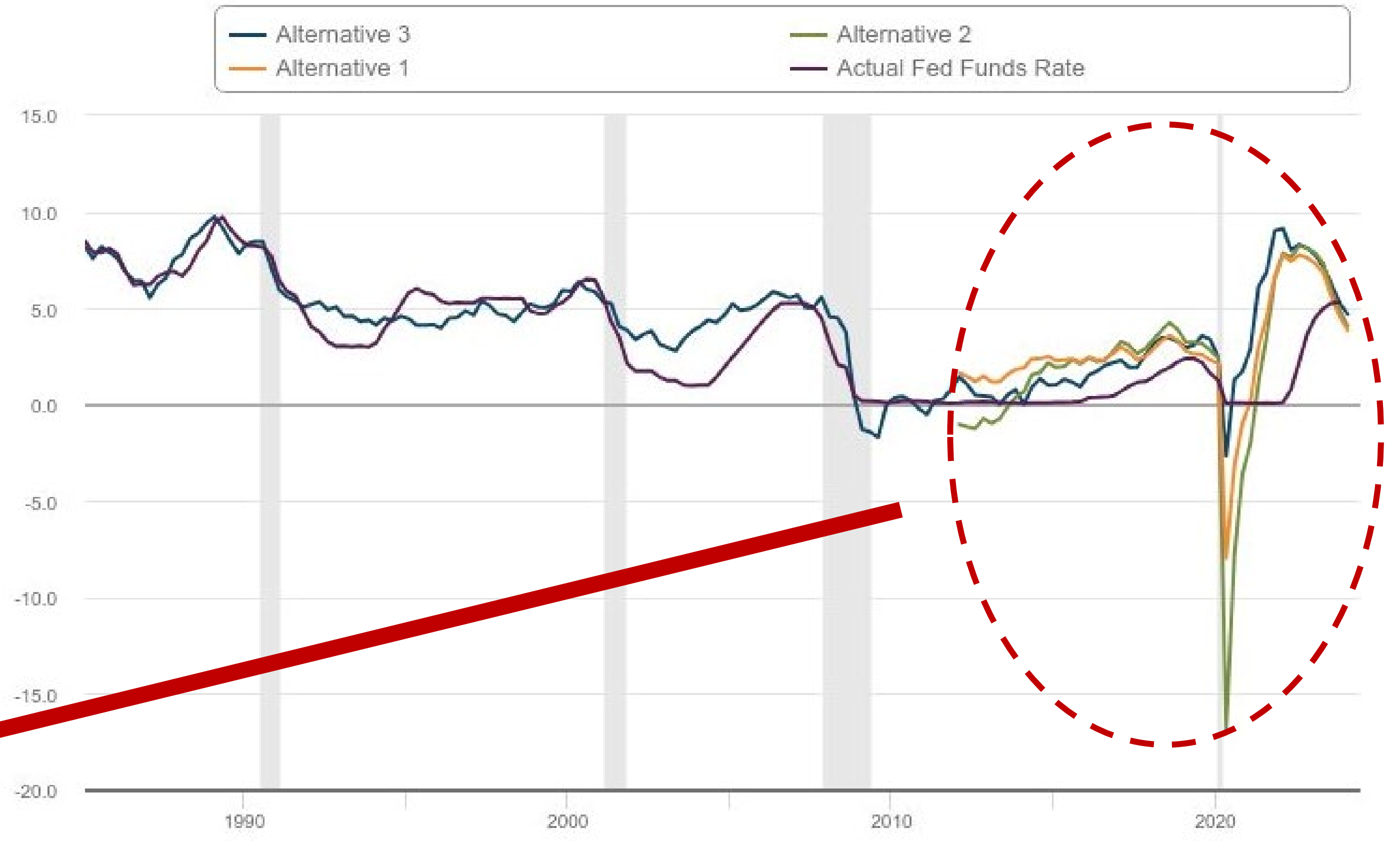
The Taylor rule is an equation John Taylor introduced in a 1993 paper that prescribes a value for the federal funds rate—the short-term interest rate targeted by the Federal Open Market Committee (FOMC)—based on the values of inflation and economic slack such as the output gap or unemployment gap. Since 1993, alternative versions of Taylor's original equation have been used and called "simple (monetary) policy rules" (see here and here), "modified Taylor rules," or just "Taylor rules." We use the last term in this web page.

This web page allows users to generate fed funds rate prescriptions for their own Taylor rules based on a generalization of Taylor's original formula:

$$\widehat{FFR}_t = \rho FFR_{t-1} + (1-\rho)[(r_t^* + \pi_t^*) + 1.5(\pi_t - \pi_t^*) + \beta \min\{gap_t, \theta\}]$$



Actual Fed Funds Rate and Taylor Rule Prescriptions



	Alternative 1	Alternative 2	Alternative 3
Inflation Target Measures:	2PercentInflation	2PercentInflation	2PercentInflation
Natural Real Interest Rate Measures:	RstarFOMCMedian	RstarFOMCMedian	LWRstar1side
Resource Gap Measures:	U3gapFOMC	U3gapFOMC	CBOGDPgap
Inflation Measures:	CorePCEInflation	CorePCEInflation	CorePCEInflation
Weight on Gap:	0.5	1	0.5
Interest Rate Smoothing:	0	0	0

Source: Atlanta Fed

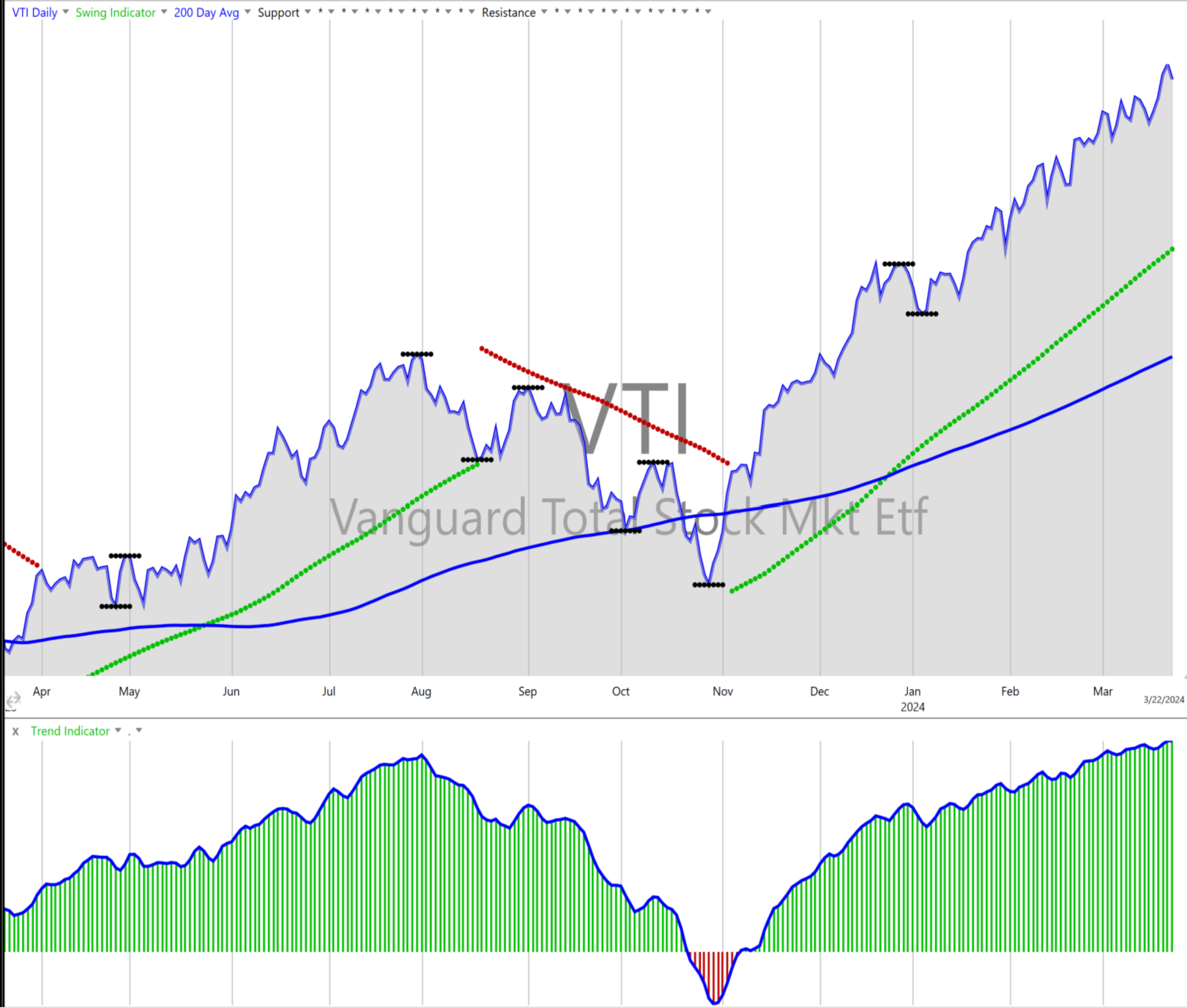
Federal Reserve Bank *of* Atlanta

Exported on: Monday, March 25, 2024

US Capitalization 1-Year Trend

Green = Tilting Bullish   Red = Tilting Bearish

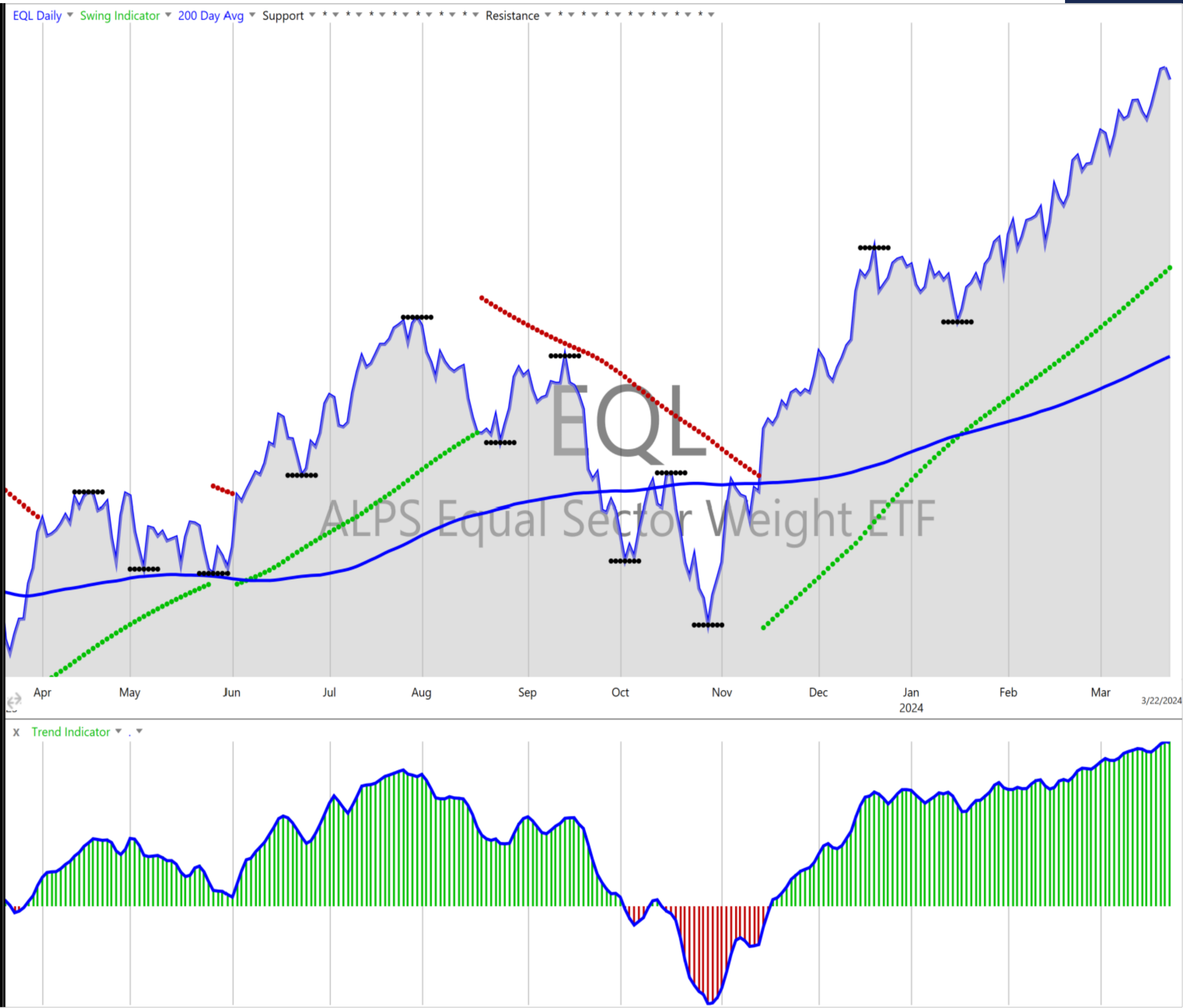
ETF	ETF Name & Market Segment	Trend	Swing	Trend
IVV	iShares S&P 500 Index Fund ETF	●	●	126
QQQ	Invesco QQQTrust Ser 1	●	●	107
DIA	SPDR Dow Jones Industrial Average ETF	●	●	96
OEF	iShares S&P 100 Index Fund ETF	●	●	90
VTI	Vanguard Total Stock Mkt Etf	●	●	90
IVE	iShares S&P 500/Barra Value Index Fund ETF	●	●	72
IJK	iShares S&P MidCap 400 Growth ETF	●	●	72
IVW	iShares S&P 500 Growth ETF	●	●	70
IWM	iShares Russell 2000 Index Fund ETF	●	●	68
IJT	iShares S&P SmallCap 600 Growth ETF	●	●	59
IJH	iShares S&P MidCap 400 Index Fund ETF	●	●	56
IJJ	iShares S&P MidCap 400 Value ETF	●	●	50
IJR	iShares S&P SmallCap 600 Index Fund ETF	●	●	48
IJS	iShares S&P SmallCap 600 Value ETF	●	●	35



US Sector 1-Year Trend

Green = Tilting Bullish   Red = Tilting Bearish

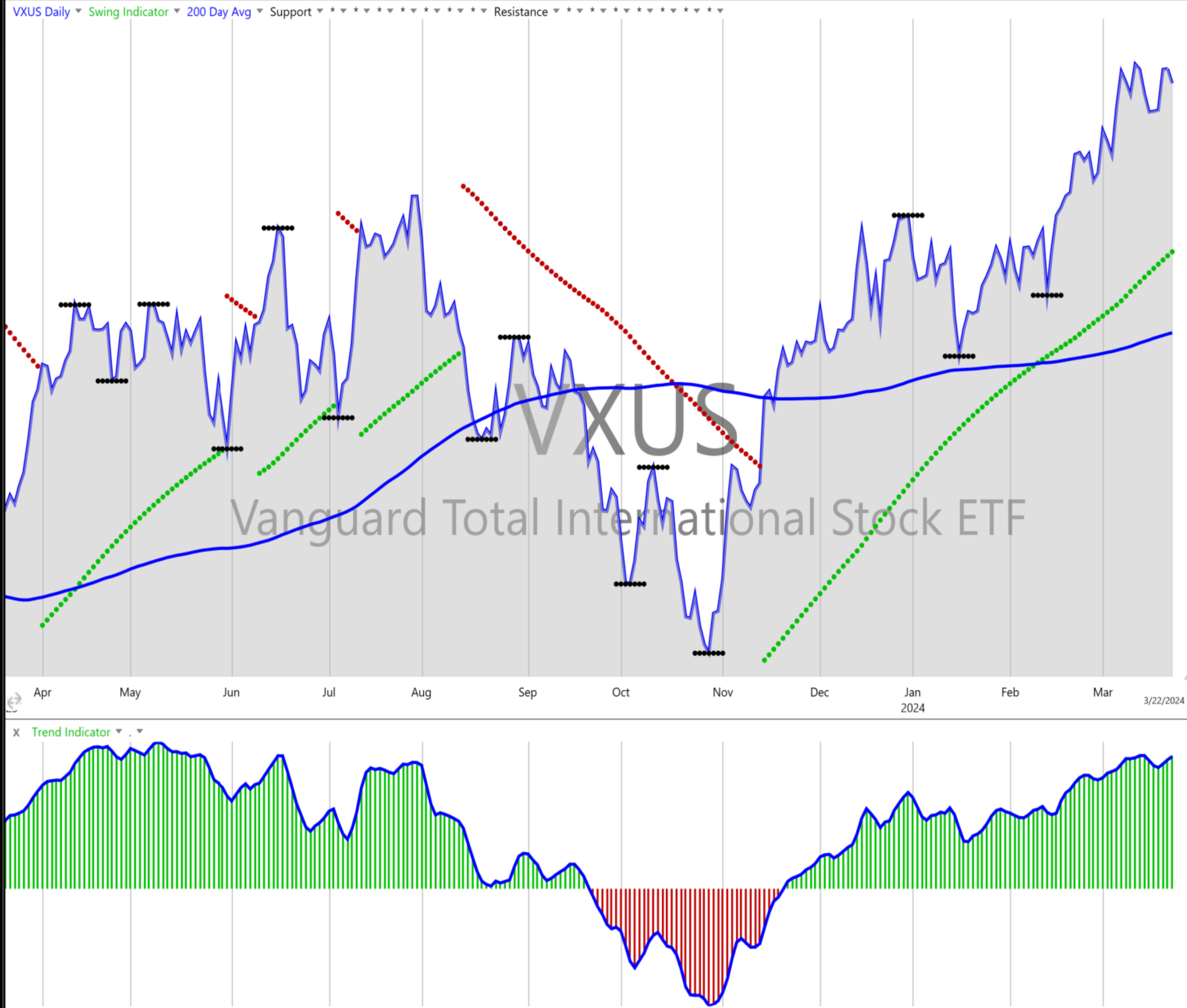
ETF	ETF Name & Market Segment	Trend	Swing	Trend
VGT	Vanguard Information Tech Etf	●	●	122
VIS	Vanguard Industrials Etf	●	●	88
VFH	Vanguard Financials Etf	●	●	78
VOX	Vanguard Telecomm Srvs Etf	●	●	77
VCR	Vanguard Consumer Disc Etf	●	●	75
VHT	Vanguard Health Care Etf	●	●	75
VAW	Vanguard Materials Etf	●	●	67
GLD	SPDR Gold Trust	●	●	61
EQL	ALPS Equal Sector Weight ETF	●	●	61
VDC	Vanguard Consumer Staples Etf	●	●	55
VNQ	Vanguard Reit Etf	●	●	30
VDE	Vanguard Energy Etf	●	●	29
SLV	iShares Silver Trust ETF	●	●	28
VPU	Vanguard Utilities Etf	●	●	24



International Equity 1-Year Trend

Green = Tilting Bullish   Red = Tilting Bearish

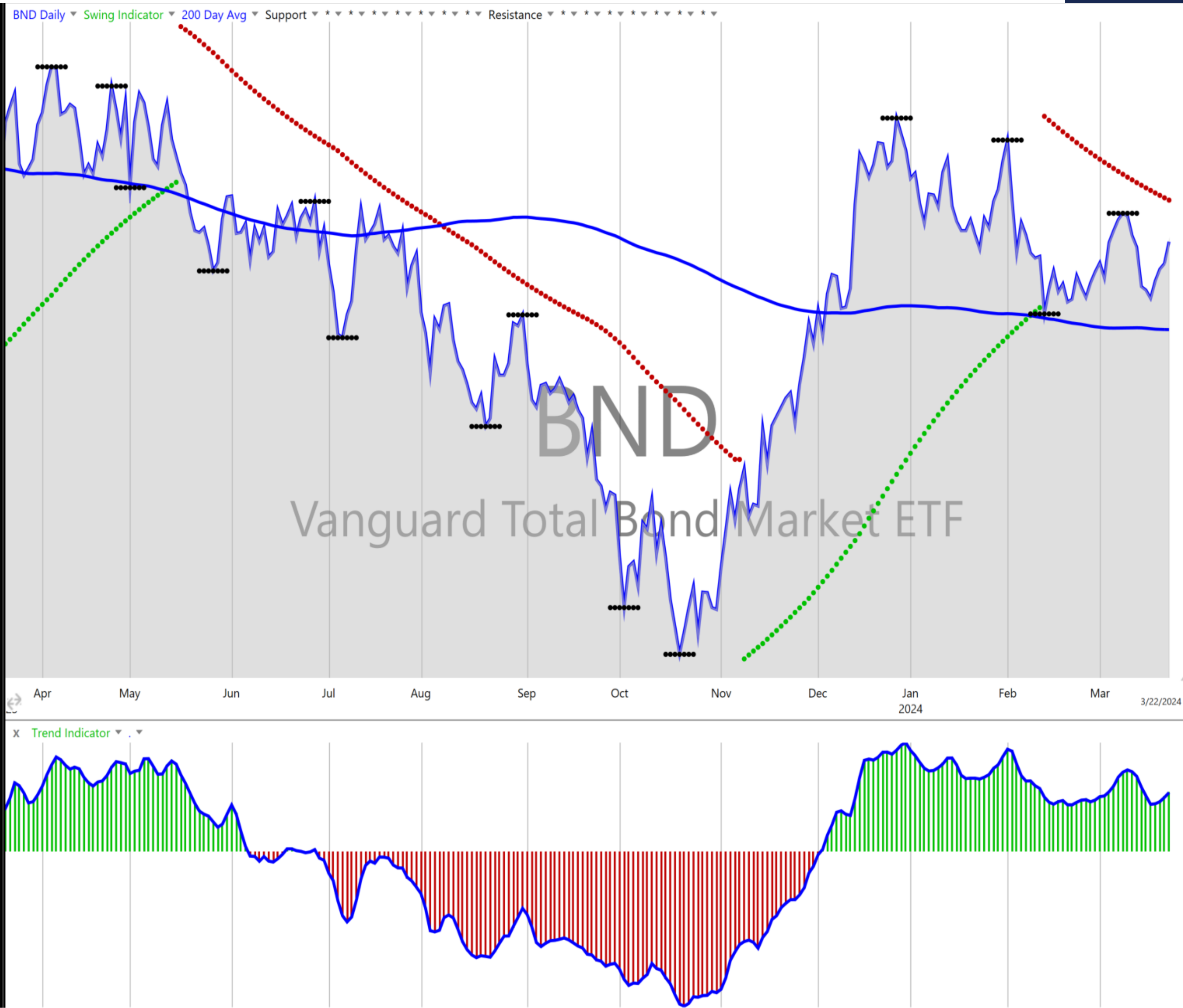
ETF	ETF Name & Market Segment	Trend	Swing	Trend
IVV	iShares S&P 500 Index Fund ETF	●	●	126
EFG	iShares MSCI EAFE Growth Index Fund ETF	●	●	62
EFA	iShares MSCI EAFE Index Fund ETF	●	●	54
VPL	Vanguard Pacific Etf	●	●	52
EZU	iShares MSCI EMU Index Fund ETF	●	●	51
VIGI	Vanguard International Dividend Appreciation ETF	●	●	50
VGK	Vanguard European Etf	●	●	46
VXUS	Vanguard Total International Stock ETF	●	●	45
VYMI	Vanguard International High Dividend Yield ETF	●	●	44
EFV	iShares MSCI EAFE Value Index Fund ETF	●	●	44
VSS	Vanguard FTSE All-World ex-US Small-Cap ETF	●	●	43
VWO	Vanguard Emerging Markets ETF	●	●	31
ILF	iShares S&P Latin America 40 Index Fund ETF	●	●	21
MCHI	iShares MSCI China Index Fund	● (red)	●	-18



US Bond 1-Year Trend

Green = Tilting Bullish   Red = Tilting Bearish

ETF	ETF Name & Market Segment	Trend	Swing	Trend
HYG	iShares IBoxx $ High Yield Corporate Bond ETF	●	●	38
MUB	iShares S&P National Municipal Bond ETF	●	●	32
VCSH	Vanguard Short-Term Corporate Bond ETF	●	●	30
VCIT	Vanguard Intermediate-Term Corporate Bond ETF	●	●	28
LQD	iShares Iboxx $ Investop Corp Bd	●	●	27
VCLT	Vanguard Long-Term Corporate Bond ETF	●	●	23
BND	Vanguard Total Bond Market ETF	●	●	19
TLH	iShares Barclays 10-20 Year Treasury Bond Fund	●	●	17
IEI	iShares Barclays 3-7 Year Treasury Bond Fund	●	●	14
TLT	iShares Barclays 20+ Year Treasury Bond Fund	●	●	13
IEF	iShares Barclays 7-10 Year Treasury Bond Fund	●	●	12
SHY	iShares Barclays 1-3 Year Treasury Bond Fund	●	●	11
GOVT	iShares Barclays U.S. Treasury Bond Fund	●	●	11
BNDX	Vanguard Total International Bond ETF	●	●	2



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