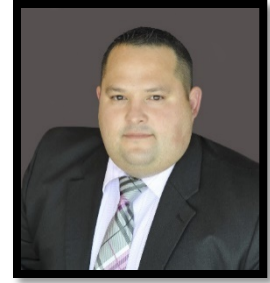


My 2 ¢

How Much Farther to the Next Exit

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I have logged a lot of miles on the interstate in my days. I am infamous for ignoring the gas gauge until I am almost empty. I have a lot of faith in my misguided understanding that when the fuel gauge is on “E”, I still have about 100 more miles to go! Once that low fuel light comes on, it is time to get off the interstate and fuel up. However, never without fail, it always seems that I find myself stressing out wondering how much farther to the next exit.

I keep the economist in me bottled up deep inside, but more times than not it finds its way out and into my thoughts. Recently, I found myself starting to dissect what the long-term effects will be on the economy and consumer habits as we continue down the path of low interest rates here in the United States. Will consumer habits change? Will mobility change? Have we entered a cycle dependent on government stimulus in perpetuity?

Let me be clear, I do not have the answers to these questions, and I think many things will need to play out over time to understand what the lasting impacts will be; however, I think there is room for concern and a need for continued analysis.

With the United States Senate preparing to pass another \$1.9 trillion dollars in stimulus funds in the coming days, I cannot help but think that this is becoming the new norm in propelling our economy forward. It has been over 12 years since the Federal Reserve (Fed) first cut rates to levels at or near zero. There was a momentary blip when rates began to rise, but with the emergence of the COVID -19 pandemic and its impact on the economy, rates have once again returned to near zero. The Fed’s ability to reach into their monetary policy toolbox and accelerate or decelerate the economy with interest rate adjustments has been severely limited over the past 12 years. Unfortunately, it appears it will remain limited in the coming years. We would need to see real growth over an extended period to see the Fed begin to take a more hawkish position. A major concern is identifying what other tools are available when the next crisis hits. A crisis which may be directly correlated with the extended period of a low-rate environment the economy has been stuck in.

A low-rate interest environment in the short run has many benefits that help to stimulate the economy. The stimulative effect of decreasing rates helps to spur on business spending in capital investment and household spending on new homes and durable goods in the short run. I am confident in my assessment however, that we have blown way past any arbitrary boundaries that we can use to identify the last 12 years as still being in the short run. I think we are soundly in that long-run period where an extended analysis needs to be done on what the long term affects of this low-rate environment will be and if those impacts will be in some instances, permanent.

In the long run, a low interest rate environment begins to have some significant negative externalities that begin to develop. The stimulative effect of low rates that incentivizes excess spending, increasing debt levels, and investing in riskier assets to maximize yield also at the same time disincentivizes savers. This long run low-rate environment is creating a melting pot of issues that could be the cause of the next crisis or at the very least exacerbate it.

How are consumer habits going to change because of the continuous low-rate environment? A person that is 30 years old today, was 18 when the 2008 financial crisis hit, and rates plummeted. That same person that is now transitioning into being a homeowner, raising kids and/or starting a small business has never experienced a rising rate environment as an adult. With mortgage rates in the sub 3 range, how will these same consumers react when rates begin to rise? I think there are huge unintended consequences on the horizon. If and/or when we do enter a rising rate environment, I think upward mobility will be limited as consumers have been conditioned over an extended period in this low-rate environment. Their desire to upgrade their home or invest in a small business may be altered which could have negative effects on economic growth in the long run.

Of a bigger concern is the debt crisis that could be looming as the low cost of increasing debt levels has been mitigated in this environment. Not only has corporate and household debt ballooned over the past 12 years, but the national debt has ballooned during the same period. Again, if and when we enter a rising rate environment in the future, will consumers and small business owners be able to service their debt loads going forward or will this be the beginning of the next financial crisis?

This leads me to my final question, have we entered a period of a never-ending cycle of government stimulus injections to stave off collapse and/or support economic growth? Recovery from the 2008 financial crisis was relatively anemic, even with substantial government intervention. Just as the economy began to pick up steam, the COVID-19 pandemic negatively impacted the economy. With the many states going into shutdown, government stimulus was needed to help support the economy, and programs such as the PPP program have been beneficial to staving off economic collapse and have helped millions of small businesses around the country endure this difficult period. But what happens when that stimulus runs out? Will the economy be able to begin to grow again without stimulus and will it grow fast enough to shift monetary policy? Lastly, if it begins to grow again, will it be able to withstand another economic crisis without drastic policy shifts or government stimulus? The real concern is if we are able to return to a somewhat normal economy with normal business cycles pre 2008 or will this be the new norm.

As the economy continues down the highway, the gas gauge seems like it has been stuck on "E" for a while. I think we are all beginning to wonder if the economy will continue to sputter along while we cautiously start to ask how much farther to the next exit.