"Countries with large current account deficits could find themselves under pressure": Eight questions to Christoph Große Steffen

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1. Dr. Große Steffen, since the end of 2008, the US policy interest rate was at the level it has only just reached in Europe, that is, at the zero lower bound. In December, the Federal Reserve decided to raise the interest rate in the US. What was the motivation for the ‘lift-off’? The reason to increase the federal funds rate is that the US economy has been experiencing strong growth for some time now and the labor market has been recovering well. Although there has been controversial debate about the labor market argument after many people left the workforce, the Federal Open Market Committee decided that prospects were positive enough and that risks for the outlook were roughly balanced.

2. Could the upswing in the US also be jeopardized again through this measure because it has been implemented prematurely? I don’t think so. The federal funds rate was raised from a corridor of zero to 0.25 percent to one of 0.25 to 0.5 percent. This is still an expansive move and if anyone claims this very moderate increase in the base rate could jeopardize the economic upswing, I would disagree. It remains to be seen what changes in interest rates are still to come and to what extent this will then also impact on the economy.

3. What effects will increasing the base rate have on the US economy? It will become slightly more expensive to borrow, and so growth in consumer spending and capital expenditure will also be moderately lower than might have otherwise been the case in this extremely expansive economic climate if the interest rate had remained at zero.

4. How did the US bond markets react? When the decision on interest rates was made on December 16, 2015, virtually no more strong reactions were observed. This shows that the markets had already factored in this slight increase.

5. What effects does the increase in interest rates by the Federal Reserve have internationally? Here, too, most of the effects had already been anticipated. Accordingly, the adjustment processes took place even before the actual increase, essentially comprising a devaluation of currencies against the US dollar. In other words, more capital is being invested in the US again because the interest rate there has increased slightly. Alongside a slight devaluation of currencies, there will be a more restrictive financing environment particularly in emerging economies.

6. Does this mean the emerging economies will have a problem now? They may well do. Depreciations are observed especially in countries with a high share of commodity exports and large current account deficits. This affects Latin America in particular, including countries such as Brazil, Peru, and Chile. Countries with large current account deficits that rely on capital imports will no longer be able to finance them as cost-effectively as before and need to adapt to this new situation.

7. Will the interest rate in the US be further increased in the future? A further increase is certainly to be expected. However, there is considerable uncertainty at present as to what steps will be taken and when. There is also a shortcoming in the current communication strategy of the US Federal Reserve here regarding how it intends to communicate these planned interest rate hikes to the markets. However, a pullback from the lift-off by a decrease in the interest rate is not expected in the current climate. The monetary policy of the Federal Reserve is focusing on domestic factors in the US economy, which is currently showing robust growth and a strong labor market.

8. What lessons can Europe learn from the US interest rate lift-off? For a start, it’s very reassuring to see that a move away from what is known as the zero lower bound can occur without any major turbulence. This should also be reassuring for European policymakers.