Tomorrow's Affairs
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By: TA | AP Insight

Broader economic trends point to higher interest rates regardless of what the Fed does

President Donald Trump has renewed his attacks on the Federal Reserve after it hiked its benchmark interest rate Wednesday, but the Fed matters less than broader economic trends when it comes to longer-term borrowing costs, economists say.

The economy is growing steadily despite being hit with repeated shocks — and may even be accelerating — while inflation remains stubbornly high.

And big tech firms are borrowing huge amounts of cash to plow into data center construction while the federal government is still running large yearly budget deficits.

All these trends point to higher interest rates regardless of what the Fed does, analysts say.

As a result, the low interest-rate, low-inflation world that lasted for nearly 15 years after the Great Recession is over and a higher-priced, higher-rate world is taking its place.

Mortgage rates fell into the 3% range in the 2010s and even lower during COVID-19, but such deals are long gone.

The average 30-year mortgage rate reached 6.95% last week, the highest in more than a year and a half.

Joe Brusuelas, chief economist at RSM, a tax consulting firm, said that a big reason for the change is a shift from the pre-pandemic economy in which consumer and business demand was weak, to the current economy in which healthy consumer and business spending is colliding with supply shocks and bottlenecks.

In addition to higher oil and gas prices because of the Iran war, the AI buildout has struggled with an insufficient supply of computer chips, electronic equipment, and workers to put it all together.

“We’ve undergone a structural transformation of the economy,” Brusuelas said. “The regime change in inflation and interest rates is the outcome.”

Companies and government are competing for bonds

The shift, in many ways, returns the economy to where it was before the financial crisis in December 2007 that lasted through June 2009.

But even after the downturn ended, consumer and business spending remained weak.

Millions of Americans in the 2010s focused on paying down outsized mortgages and credit card debt instead.

Businesses saw few investment opportunities, and many big tech firms such as Alphabet’s Google and Meta’s Facebook piled up cash.

Now those companies are using those stockpiles to build out AI data centers, and are borrowing even more money to do so.

And American consumers — despite surveys finding they are pessimistic about the economy — are still spending at a healthy pace.

A recent report showing that retail sales picked up last month led economists at Bank of America to forecast growth will reach a healthy 3% at an annual rate in the July-September quarter.

Ever-expanding pools of capital are pouring into AI-related infrastructure of all sorts - Kevin Warsh

Federal Reserve Chairman Kevin Warsh highlighted the shift in a speech at the central bank's annual conference in Jackson Hole, Wyoming last month.

After 2008, “it was a widely held view that an excess of capital would sit on the sidelines for a long, long time, because there just wouldn’t be enough compelling investment opportunities,” Warsh said. “All the good stuff had been invented. So growth would be low and slow.

“Well, times sure have changed,” he continued. “Ever-expanding pools of capital are pouring into AI-related infrastructure of all sorts.”

The additional spending and investment has contributed to higher longer-term interest rates on government bonds that are competing for lenders.

The yield on the 10-year Treasury bond topped 5% this year for the first time since 2023, even before the Fed raised its benchmark short-term rate Wednesday.

At the same time, political polling and consumer sentiment surveys continue to find that many Americans are struggling to keep up with rising prices, and affordability remains a top concern heading into the midterm elections.

Even as the economy expands, inflation has outpaced the annual growth in average wages for the past five months.

Brusuelas said the U.S. economy's expansion is “imbalanced” with growth “entirely dependent” on the AI buildout and strong spending by wealthier consumers, who have benefited from rising stock prices driven by hopes that AI will lift profits.

Higher inflation leads to higher rates

After the Fed lifted its rate to 3.9% Wednesday, Trump said on Truth Social that U.S. rates should be 1% instead.

Yet many of Trump's policies have contributed to higher borrowing costs, in particular the Iran war that has driven up gas prices.

The president can say he wants interest rates lower all he wants, and yet he continues to push the button on all the policies that raise rates - Elizabeth Pancotti

When inflation persists, investors demand higher interest rates on longer-term Treasury bonds, such as the 10-year, which strongly influences mortgage rates.

“The president can say he wants interest rates lower all he wants, and yet he continues to push the button on all the policies that raise rates," said Elizabeth Pancotti, vice president of policy, advocacy and research at the progressive Groundwork Collaborative.