Case Study 2

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1. What are the motives or purposes for FED to lower rates?

The Federal Reserve, or the FED, is a system put in place for a country to manage its economy. The FED is responsible for keeping the economy healthy by minimizing unemployment and stabilizing inflation. The reason why the FED would lower rates is to try to stimulate more activity in the nation's market during a low time in the country’s economy. When the FED lowers interest rates, bank loans become cheaper. This would push more businesses to borrow money from the bank for their business ventures. When businesses start to spend more and purchase more things in the market, inflation can be fixed. This would also allow companies to acquire more funding to hire more workers, solving the unemployment problem. Besides that, when the FED lowers interest rates, it would be less profitable to keep money in banks. This would convince more people to start spending the money that they have been keeping in their banks. Based on events in the past, lowered interest rates or even rumors of lowering interest rates have caused the stock markets to shoot up. It is known that when the FED lowers interest rates the economy is bound to recover. Investors view this as an opportunity to invest in the stock market causing stock prices to rise.

1. What are the potential opportunities for the U.S. economics due to the decrease of rates?

The global pandemic has caused a large number of businesses to operate at a loss and has pushed many businesses into a dead end. This has also forced a higher unemployment rate in the population because businesses are forced to retrench their employees due to the inability to compensate them. Businesses are struggling to compensate for the cost of keeping their businesses open. When the FED lowers interest rates, these businesses are able to borrow money from banks at a better rate to compensate for their losses. When businesses are able to recover from their losses, they would also start hiring more employees, fixing the unemployment problem. The pandemic has forced the FED to result in drastic measures to help the economy recover its losses. Interest rates have been lowered to near zero to try and sway the public to start spending more and start borrowing money from banks. The FED is doing this in hopes that it would also accelerate the growth of stock markets so that people would start investing as well. Since it would not be a smart economic decision to keep money in the bank, people are more likely to start investing and purchasing. The FED still has a long way to go until the markets are fully recovered but it is a step in the right direction. Hopefully with the FED interest rates near zero more businesses nationwide are able to recover and stimulate more growth in the market. These rates also attract potential investors to invest more in the nation’s markets. Generally, in the past, an interest cut similar to this one has allowed the stock markets to shoot up. The FED is holding on to that hope before taking more drastic measures to decrease interest rates to a negative.

1. Do you think the decrease of rates by FED would influence other countries (e.g., European countries)? Why?

The decrease of rates by the FED would influence other countries. This is mainly because when the interest rate is lowered in the US, other countries are able to purchase US dollars at a cheaper price. Since US dollars are now at a lower rate compared to other large exporter countries such as China or Europe, their exports to the US would be more expensive while exports out of the US become cheaper. This would result in a growth in these countries' GDP. Developing countries however tend to benefit even more. This is because developing countries tend to sell commodities that are trading in dollars. The increased demand for these commodities and assets would increase the GDP of these countries by a large amount. This is because, with higher demands for these commodities, the prices of these assets would also increase. On top of that, most of these developing countries have debts that are owed to the US in dollars. So, with the decrease in value of the US dollar, these developing countries are able to clear their debts with the US much easier. Overall, the decrease in interest rates in the US would typically improve the economic situation in the nation while benefiting other nations as well. Not only would it increase the GDP of the US, but it would also attract investors to invest in the US as well because of the devalued currency rate in the US. This would make it cheaper for investors to invest in the US stock market, overall increasing prices for US stock down the road.

1. Do you think it is a wise decision for FED to lower rates at this time? Why?

In my opinion, this is the best time for the FED to lower its rates. In fact, I think that the FED has no choice. By lowering the FED rates now, it would allow businesses around the nation to recover from all the losses they had to face from the start of the pandemic until the present time. The FED’s decision to lower its rates close to zero seems like a reasonable choice of action. This is the only way to help businesses around the nation recover from the damages that the pandemic has caused them. If the FED does not lower these rates to an affordable rate, businesses would continue to retrench employees like what was going on in the past year, leading to a very large unemployment rate nationwide. With interest rates so low businesses can finally acquire bank loans at a better rate to start paying for their employees and possibly higher new ones. This would be the first step in recovering the horrible unemployment rates that we have been witnessing throughout the last year when the pandemic first hit the US. These rates would also finally convince people to start purchasing more and supporting the businesses that are barely surviving. The results of these lowered rates can be seen from the stock markets that have been growing at a good rate at the beginning of the year. Hopefully, these rates would attract more foreign investments and increase GDP from exports. The market has a long way to go to recover from the damages that the pandemic has caused but the decisions made by the FED are a good start in the nationwide efforts in recovering the economy.

References

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