The Nation

The Nation
Circulation: 68,200
Ad Rate: 2,050

Section: Business/Business
Date: Wednesday 28 December 2016
Volume: 41 No: 54996 Page: 4B(Top)
Col.Inch: 35.67 Ad Value: 73,123.50 PRValue (x3): 219,370.50 Clip: Full Color
Column: BIZ INSIGHT: Losers in Fed rate policy may include leveraged companies

BIZ INSIGHT

Losers in Fed rate policy may include leveraged companies

SPECIAL TO THE NATION

ON DECEMBER 14, the US Federal Reserve raised interest rates for the first time in almost a year, and only the second time this decade.

Justified by higher inflation expectations and an improved economic outlook, the increase had been anticipated. The target federal-funds rate is currently between 0.5 per cent and 0.75 per cent, with expectations of more rises in 2017.

However, the rate hike reflects both strength and weaknesses in the global economy.

The state of the US economy is similar to 2015's triumphant year-end run. The unemployment rate is lower, inflation is below the Fed's 2 per cent target, and global economic growth is trampling along.

On a different note, wage growth and inflation have been trending upwards. Furthermore, under a Republican administration with Donald Trump in office, policies may encourage a fiscal boost from tax cuts and higher spending. This prospect has sent Treasury yields and the US dollar skyrocketing.

A rise in rates can be beneficial in many ways. It will generate higher returns for savers, spur lending as its gives banks a greater incentive, strengthen the US dollar and higher mortgage rates could result in a stronger demand and accelerate home sales.

On top of that, it could tame inflation and reduce prices for consumer goods, boost incomes for retirees and result in the market being traded more on fundamentals.

However, the weaknesses could result in decreasing the amount of money in circulation, which should theoretically keep inflation low, making borrowing money more costly. But this limits consumer and business spending.

A 0.25 percentage point increase may not seem significant, but it will definitely affect the likes of adjustable rate mortgages, credit and credit card debts.

Nonetheless, it results in companies' expenses rising and lowering earnings for those in debt. That's why it could make the stock market less attractive.

Overall, the rate hike still paints an unclear picture of the global economic outlook. However, some parts of Fed chairwoman Janet Yellen's speech stated that the rate increase doesn't amount to a prescription to run a hot economy after projections suggest that inflation will rise, but will not exceed the 2 per cent target.

Lastly, a rise in inflation will be a problem, because it implies that the US is manipulating the global economy with less demand. Therefore, the rising US dollar will place more stress on indebted emerging markets. Together with stronger economic growth, the robust US dollar could very well crush exporters and reduce the scope for the Trump administration to start a trade war.

In conclusion, rising rates and an appreciating US dollar can drive the global economy towards worrying political and economic outcomes. Investors are advised to closely monitor market movements when considering asset allocation and strategies for balancing portfolios.

Contributed by Asset Plus Fund Management

Investment contains risk. Investors should thoroughly study prospectuses, product features, return conditions and risk before investing.