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CURRENT SITUATION OF INTEREST RATES IN AMERICA

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Since interest rates hit rock-bottom in 2009, the Federal Reserve has repeatedly made optimistic forecasts about when they would start rising, only to delay the big day again and again. If the Fed has been a bullish coach, the markets have been trusting fans, continually believing that an increase is imminent, only to have their expectations dashed. At last, however, the moment seems to have arrived. On December 16th, when the Fed's rate-setting committee meets, it seems all but certain to raise rates.

For that, thank the strength of the labour market. Unemployment, at 5%, is as low as most analysts reckon it can sustainably fall. During the recession, America lost 8.7m jobs. It has since gained 13m. In 2010 there were six unemployed workers for every job opening; today there is 1.5m.

Wages, long stagnant, finally appear to be growing again, too. The pick-up in wages could peter out, however. Since the recession hordes of workers have left the labour force altogether: labour-force participation among 25- to 54-year-olds in the third quarter of the year was lower than at any time since 1984. If some can be tempted back to work, wages will be held down.

Janet Yellen (pictured), the Fed's chair, chalks up some of the shortfall to a strong dollar making imports cheap (the greenback is up by 19% since mid-2014). That effect should dissipate if the dollar's ascent stops. There is also less scope for the oil price to plunge, having already fallen by almost two-thirds over the past year. This suggests inflation may pick up in 2016. That, in turn, argues for a rate rise soon, since monetary policy is thought to have only a delayed impact on the economy.

The Fed is in a jam, though, because it faces asymmetric risks. If it raises rates too soon, its scope to cut them, should the economy then sour, is limited by the fact rates cannot fall far below zero. If it waits until inflation is stronger, it has unlimited capacity to raise rates to tame it.

Getting this balance right will be tricky. Ms Yellen likes to emphasize that starting early keeps the journey smooth; abrupt rises later might rattle markets. Yet the Fed's forecast for rates is steeper than what the market predicts.

References

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