

# FAZ

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Interest rate turnaround is nothing to fear

*by Michael Heise*

The renewed 0.25 percentage point rate hike by the Fed is likely to have lowered the curtain on the decades-long trend of declining interest rates. Ahead of the decision, and in reaction to the election of Donald Trump, the yield on 10yr Treasuries had already risen sharply to around 2.5 percent – and is likely to climb further: The US central bank has flagged up further hikes for 2017, inflation is close to the targeted 2 percent and expectation is growing that the new administration will launch an expansionary fiscal program that will buoy the US economy at least for a while.

So will rates rise in the eurozone too, even though the European Central Bank (ECB) has just extended its bond purchasing program until the end of 2017? Two scenarios are feasible: with its divergent policy, the ECB manages to decouple eurozone bond yields from their US counterparts. This would widen the eurozone's interest rate disadvantage against the US further, resulting in an (even) weaker euro and an (even) stronger dollar. Although this would initially help eurozone exporters, we should not celebrate. The larger the US trade deficit grows, the more likely protectionist measures become. The exchange rate pendulum could then swing back sharply, threatening the existence of weak companies who have relied on a soft euro.

What is more, an overly weak currency makes imports substantially more expensive: heating oil, gas, commodities, imported consumer goods, holidays abroad et cetera. Money flows out, consumption falters. The preferable scenario would therefore be for higher rates in the US to pull up European rates as well, keeping the euro relatively stable. This is by all means on the cards. After all, higher oil prices and rising domestic demand are rekindling inflation here too. That should not give cause for concern. Although rising interest rates will trigger valuation adjustments in bank balance sheets, given high reserves these will be manageable. Heavily indebted countries would also have to cough up a little more for new loans. But this would provide the right incentives for genuine budgetary consolidation rather than relying on the ECB's permanent drip. Savers would enjoy the positive effects of a rise in interest rates, with assets growing faster again. Gaps in company pension funds would decline, companies could channel a larger chunk of their earnings into real investment. Financial stability would also benefit as investors would no longer be pushed into increasingly narrow and risky market segments (German real estate, for instance).

Finally the banks in particular would benefit from the return to a steeper yield curve, with long-term paper again yielding more than short bonds. The rise in yields would testify that the economic recovery has become more stable. Let's hope this is also the view in the new Eurotower.