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PRICES AND INFLATION

Solid U.S. economy may make it harder to lower borrowing costs



People shop for Black Friday deals at a Walmart store in Rochester, N.Y., on Nov. 29. TED SHAFFREY — ASSOCIATED PRESS FILE



A pumpjack works on a pad near a housing development in Dacono. Donald Trump faces different economic conditions this term. DAVID ZALUBOWSKI — ASSOCIATED PRESS FILE

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WASHINGTON>> President Donald Trump has pledged cheaper prices and lower interest rates, but an economy transformed by the pandemic will make those promises difficult to keep.

Economic growth is solid, driven by healthy consumer spending. And budget deficits are huge and could get even larger. Meanwhile, businesses are borrowing more to step up their investments in data centers and artificial intelligence, leading to a greater demand for loans that can raise interest rates.

And if Trump follows through on his promises to impose widespread tariffs on imports and deport millions of immigrants, economists expect inflation could worsen — making it less likely the Federal Reserve will cut its key interest rate much this year.

All of these trends will likely keep borrowing costs higher, including for homes and cars.

Yet on Thursday during the World Economic Forum's annual event in Davos, Switzerland, Trump said, "I'll demand that interest rates drop immediately, and likewise, they should be dropping all over the world," though he did not provide further details.

The biggest reason for the likely persistence of higher borrowing costs is the surprising resilience of the economy following the upheavals of the pandemic, trillions of dollars of government financial support from Trump and former President Joe Biden, an inflation spike, and several rounds of recession fears.

Jan Hatzius, chief economist at Goldman Sachs, says the economy is "in the sweet spot of healthy growth."

It has expanded at an annual rate of at least 3% for four out of the last five quarters, the longest such streak in a decade. Unemployment is at a historically low 4.1%. And inflation, which soared to a four-decade high in 2022 and soured most Americans on the economy, is back down to 2.4%, according to the Fed's preferred measure.

And wages, which badly trailed prices in 2021 and 2022, have risen faster than inflation for the past 18 months, which provides the needed fuel for ongoing growth.

A healthier economy spurs more Americans to borrow to buy cars, homes, and large appliances, and businesses to invest in IT equipment and factories. Such moves are great for the economy — but more demand for loans to fund all that spending can also keep interest rates elevated.

And steadier growth could keep prices higher. Companies that see healthy consumer demand may decide they can charge more, as Netflix announced it would do Tuesday after signing up a surge of subscribers.

Such trends are a big change from the last time Trump entered the White House in 2017. Back then, the U.S. economy was slowly emerging from an extended period of sluggish growth and very low inflation that followed the painful 2008-2009 Great Recession. Millions of households held back on spending and saved more after a borrowing binge earlier in the decade that drove up mortgage and credit card debt.

"Households were shrinking their balance sheets relative to their income, and that's a very significant disinflationary force that is not present now," said Julia Coronado, president of MacroPolicy Perspectives and a former Fed economist.

Today, most households are carrying less debt and upper-income families in particular are benefiting from strong gains in home values and stock market wealth. About 40% of homes are now owned free and clear — without a mortgage. Greater wealth can spur ongoing spending on travel, electronics, and dining out.

In addition, high-tech firms are ramping up their investment in data centers to accelerate their work on artificial intelligence. Trump announced Tuesday a joint venture between OpenAI, Oracle and Japan's Softbank to invest \$500 billion in data centers and electricity generation to fuel AI research. Before the pandemic, many companies were stockpiling cash and weren't investing as much, which can keep interest rates lower.

"We are in a different world," said Joe Brusuelas, chief economist at RSM, a tax advisory and consulting firm. "Gone is the era of low inflation and low interest rates. In its place is a new framework featuring scarce capital and higher rates."

As a result, Trump's promises to stimulate the economy through tax cuts and deregulation, while also promising to impose tariffs and immigration restrictions, could keep prices elevated.

"That's going to be inflationary, and that's going to push (Fed) policymakers to adopt more stringent policies than they would otherwise," said Gregory Daco, chief economist at EY. "So you're going to be in a higher interest-rate environment."

Trump is seeking to foster more production of oil and gas in the U.S., with the goal of reducing energy prices and bringing down broader inflation. That, in turn, would enable the Fed to cut its key interest rate.

But that doesn't factor in the reaction of financial markets, which also affects the cost of borrowing for a home or car. Since the Fed began cutting its key rate in September, the yield on the 10-year Treasury note — which strongly influences mortgage rates — has actually risen substantially.

Gennadiy Goldberg, head of U.S. rates strategy at TD Securities, says investors are anticipating a continuation of stronger growth, in part fueled by Trump's proposals to cut taxes and reduce regulation. In that scenario, the Fed would be less likely to cut its key rate.

Many investors are discounting Trump's tariff threats, hoping that he intends to use them as leverage in international talks, rather than permanently impose them.

"I think there was an expectation that President Trump would bring all of the good policies and leave all of the bad policies for growth at the door," Goldberg said.

Another trend that Trump has helped spark is the rise of protectionist measures around the world, after two decades of globalization. That has led to a scramble by multinational corporations to relocate their production from countries that are the target of Trump's ire, particularly China, to others, such as Vietnam or Malaysia.

"Instead of globalization driving prices lower, or at the very least putting a constraint on them, we're now relocating supply chains and protectionist barriers are going up," Brusuelas said. Nearly all economists forecast that will push prices higher, though the increase could be modest.

Another shift is that stubbornly high yearly budget deficits threaten to lift interest rates as well, because Wall Street investors may require higher yields to buy all the Treasury securities needed to finance the debt.