Rodney’s Take

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Now You Have To Ask, ‘Is Financing Worth It?’

I’m so old that I remember higher interest rates. I recall my first mortgage in 1992 having a rate in the 7.5% range, which seemed like a gift after what was going on in the 1980s. The rate for my first car loan in 1989 wasn’t far off of that, and credit card rates were more than double that mortgage rate. Every time you pulled out the plastic or signed the dotted line, you asked yourself, “Is it worth it?” We played games with money market accounts and held off on paying bills until the last day, just to squeeze a little more juice out of our accounts before mailing (with stamps) our payments to “the Man.”

I don’t miss those days.

Since the Great Financial Crisis, it’s been much easier to let the Fed manipulate rates while holding federal funds near zero, and lazily to watch long bonds drift between 2.5% and 3.5%. The only real question has been the underlying cost, because financing almost hasn’t existed. When “junk bond” rates dipped below 5% near the end of the 2010s, we clearly had crossed into financial zombie land. But that didn’t make the system better than it had been when investors set long rates, and it certainly didn’t bring out our best ideas.

Because we didn’t have to consider the cost of financing and tie up capital for years at a time, we threw cash at stupid things or pushed asset prices to the moon. If the Fed sticks to its discipline (which is highly doubtful, but possible), then we’ll get an economy-wide lesson in prioritizing by cost… and it's long overdue. People aren't moving much today, but they will as the economy morphs and favors geographical regions more amenable to the corporate structure of tomorrow, like the Southeast and Southwest, where battery plants and semiconductor fabrication plants are setting up. Millennials will want to buy the homes that others vacate, but will these homes be worth it or even affordable when financing is included?

Every day that goes by with short rates sticking higher, this reality sets in. As the Fed told us last week, the bankers expect the overnight rate to average 5.1% *next year,* and then 3.9%, or essentially 4%, in 2025. That's more than two years for lenders to push and hold their rates higher, gradually creating a positive yield curve, with consumer and commercial financing costs hanging around 7%.

This doesn't have to happen. The economy could hit an air pocket even as soon as this fall and draw the Fed back into the game of manipulating rates. But that simply would keep the financial games going. Financing is pretty straightforward. Is the purchase or investment that you propose worth it at prevailing rates, and are people willing to lend to you on that basis? This simple thesis allows us to build a solid economy with stable projects and spending as the base and a little for speculation off the top. With the Fed directing rates during the 2010s, almost all projects were the same. They cost nearly nothing, so why not roll the dice?

If the Fed steps away and stays away, we will go through a painful period of adjustment during which we learn to ask, "Is this purchase or investment worth it?" Successfully navigating this process will mean tightening our financial belts, but it will make us stronger for the future. If the Fed steps in time and again, then it's just a game that people with existing assets will win and everyone else will resent.

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