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EFFECT EVALUATION AND FUTURE TREND OF FEDERAL RESERVE'S INTEREST RATE REDUCTION POLICY —— BASED ON THE ANALYSIS OF AMERICAN ECONOMIC SITUATION

Sen Wang
University of Southern California, Los Angeles, CA 90007, USA.
Corresponding Email: jasonwang190514@outlook.com

Abstract: Under the background of the increasingly close connection of the global economy, the Federal Reserve, as the leader of the financial system in the United States and even the world, undoubtedly affects the nerves of the global market with every adjustment of its monetary policy. As an important means for the Federal Reserve to cope with the downward pressure on the economy, stimulate economic growth, ease the pressure of deflation and stabilize the financial market, interest rate reduction policy has been frequently adopted in recent years. This paper aims to deeply analyze the multi-dimensional impact of the Federal Reserve's interest rate cut policy, and carefully evaluate its far-reaching impact on economic growth, inflation level, employment situation and financial market operation by comprehensively applying economic theoretical analysis and empirical research methods. At the same time, based on the current internal and external challenges facing the US economy, this paper will reasonably predict the future adjustment direction of the Federal Reserve's monetary policy and the possible economic effects, with a view to providing valuable reference for investors, policy makers and even global economic participants.
Keywords: Fed cuts interest rates; Economic analysis; Empirical research

INTRODUCTION

With the increasing uncertainty of the global economic environment, including trade tensions, geopolitical risks and the global epidemic of COVID-19, the adjustment of the Fed's monetary policy has once again become the focus of market attention. As an effective tool to cope with the downward pressure on the economy, the interest rate reduction policy's effect evaluation and judgment of its future direction are not only related to the stability and development of the American economy, but also have a far-reaching impact on the global economic structure. This paper will not only review the historical practice of the Federal Reserve's interest rate cut policy, but also focus on the current challenges facing the American economy, and deeply discuss the actual effects of the interest rate cut policy in promoting economic growth, controlling inflation, improving employment and stabilizing financial markets. At the same time, combined with the domestic and international economic situation, this paper will make a forward-looking discussion on the possible adjustment direction of the Federal Reserve's monetary policy in the future, with a view to providing useful insights for global economic participants.

1 THE HISTORICAL BACKGROUND AND THEORETICAL BASIS OF THE FED'S INTEREST RATE CUT POLICY

1.1 Historical Background of Interest Rate Reduction Policy

Since the establishment of the Federal Reserve in 1913, the interest rate reduction policy has become one of its key control measures in the economic field, especially to cope with the severe situation of economic recession and deflationary pressure. Looking back at history, in the long river of economic development, the interest rate reduction policy has played an important role many times. The global financial crisis in 2008 swept like a huge storm, which dealt a heavy blow to the world economy. After that, the Fed quickly implemented a round of quantitative easing policy that lasted for several years. In this process, through a series of measures, such as reducing interest rates on a large scale, buying a large number of government bonds and mortgage-backed securities, it is like injecting a steady stream of fresh water into the dry market, that is, injecting huge liquidity into the market. The purpose of this series of operations is clear, aiming at stimulating economic growth and building a protective wall under the haze of deflation to prevent the economy from falling into a more serious deflationary dilemma.
In recent years, the global economic structure has changed rapidly, and the uncertainties are increasing day by day, like a haze hanging over the road of economic development. At the same time, the pace of domestic economic growth in the United States has gradually slowed down, which undoubtedly brings new challenges to economic development. Under this dual pressure, the Fed had to start the interest rate cut cycle again. The logic behind this decision is clear, that is, I hope to inject new vitality into economic activities by reducing the borrowing cost, thus boosting the whole economic system and enabling the economy to return to the track of stable growth.

1.2 Theoretical Basis of Interest Rate Reduction Policy

The theoretical basis of interest rate reduction policy is deeply rooted in the two core areas of monetary policy transmission mechanism and liquidity effect. As an important means of economic regulation, monetary policy exerts influence on economic activities by carefully adjusting the interest rate level, and this influence is realized through various channels. Among them, the transmission mechanism of monetary policy mainly covers many important aspects such as interest rate channel, credit channel, asset price channel and exchange rate channel.

When the interest rate reduction policy is implemented, its impact is multi-dimensional. From the perspective of enterprises and individuals, interest rate cuts can effectively reduce their borrowing costs. This is like reducing their burden in economic activities, making enterprises have more funds for investment activities such as expanding production, R&D and innovation, and individuals are more willing to spend, such as buying real estate, cars and other commodities or increasing daily consumption expenditure. This increase in willingness to consume and invest is like injecting strong power into the engine of economic growth, thus effectively stimulating economic growth.

In addition, interest rate cuts also play a vital role in the financial market. It can significantly improve the liquidity of the financial market and make the funds flow more smoothly in the market, just like dredging the meridians of the financial market. This will not only help financial institutions to carry out their business better, but also reduce the risks faced by financial markets. In terms of the stability of the financial system, the role of interest rate cuts cannot be ignored. It can enhance the stability of the financial system and make the whole financial system more resilient in the face of internal and external shocks, just like laying a solid foundation for the financial building and providing a strong guarantee for the stable development of the economy. These rich and profound theoretical foundations have built a solid and incomparable support for the Fed to implement the interest rate reduction policy, so that it has rules to follow on the road of economic regulation.

2 EVALUATION OF THE EFFECT OF THE FED'S INTEREST RATE CUT POLICY

2.1 Impact on Economic Growth

During the period from July 2019 to March 2020, the Federal Reserve cut interest rates three times, which made the federal funds rate drop from 2.5% to the extremely low level of 0%-0.25%. In this process, although the global economy suffered the sudden and huge impact of the COVID-19 epidemic, like a storm that caused serious damage to the economic order, the GDP growth rate of the United States showed an upward trend in the short term. It climbed from 2.1% in the fourth quarter of 2019 to 3.5% in the third quarter of 2020. This data change strongly demonstrated the positive role of interest rate reduction policy in promoting economic growth to a certain extent.

The interest rate reduction policy mainly plays a role through the core mechanism of reducing borrowing costs. When the cost of borrowing is reduced, it is like opening a more relaxed door for the economic activities of enterprises and individuals. As far as enterprises are concerned, they can obtain funds at a lower cost, so they have more motivation to expand production scale, increase investment in new technology research and development, or carry out new investment projects, such as building new factories and purchasing advanced equipment. For individuals, the lower borrowing cost makes it more attractive to buy real estate, cars and other large-scale consumption, and it will also stimulate the increase of daily consumption. This increase in consumption and investment willingness is like two powerful engines, which jointly push the wheel of economic growth forward.

Many empirical studies also fully show that the interest rate reduction policy has a positive impact on economic growth. For example, in the interest rate cut cycle from 2019 to 2020, the Federal Reserve effectively promoted economic growth by lowering the federal funds rate. However, it should be noted that the effect of interest rate reduction policy does not exist in isolation, and it will be influenced by many other factors. Fiscal policy is one of the important factors, and the government's fiscal expenditure and tax policy will work together with the interest rate reduction policy on economic growth. For example, if the government increases fiscal expenditure for infrastructure construction during the interest rate cut, the promotion of economic growth may be more significant; On the other hand, if fiscal tightening, it may offset the positive effect of interest rate reduction policy to some extent. The international trade environment can not be ignored. The increase or decrease of trade barriers and the change of international market demand will affect domestic economic growth. In addition, technological progress will also have an impact on the effect of interest rate reduction policy. The application of new technologies may change the industrial structure and production efficiency, thus jointly shaping the trend of economic growth with interest rate reduction policy.

2.2 Impact on Inflation

During the period when the Federal Reserve cut interest rates from 2019 to 2020, the year-on-year growth rate of the consumer price index (CPI) in the United States showed a relatively stable fluctuation state between 1.5% and 2.5%, and there was no obvious upward trend. The appearance of this phenomenon may be the result of the joint action of many factors. On the one hand, the domestic supply-demand relationship kept a good balance during this period, and the coordination between production and consumption made the price not fluctuate greatly. For example, the production capacity of various industries can better meet the needs of consumers, and there is no serious shortage or oversupply in the market. On the other hand, international commodity prices remained stable at this stage, which also created favorable external conditions for the stability of domestic prices. The prices of international commodities such as oil and metals have not risen or fallen sharply, which makes the costs of enterprises relying on these raw materials relatively stable, thus avoiding the sharp price fluctuations caused by cost changes.

In September 2024, after the Federal Reserve cut interest rates by 50 basis points again, the inflation rate of PCE (Personal Consumption Expenditure Price Index) and core PCE declined slightly, but it still fluctuated between 2% and 3%. This situation fully reflects that the impact of interest rate cuts on inflation is highly complex and uncertain.

By stimulating economic activities, interest rate cuts may theoretically increase aggregate demand. When enterprises and individuals increase their investment and consumption due to the reduction of borrowing costs, the demand for goods and services in the market will increase accordingly, which may push up the inflation level to some extent. However, the change of inflation is not only determined by the interest rate reduction policy, but also affected by a variety of complex factors. The relationship between supply and demand is one of the key factors. When the market supply can be flexibly adjusted to meet the changes in demand, even if the demand increases, inflation may not rise significantly. On the other hand, if the supply is limited, the increase in demand will easily lead to inflation. The expected effect should not be underestimated. Consumers' and enterprises' expectations of future prices will affect their current consumption and pricing behavior. If the expected prices are stable, the promotion of inflation will be weakened. In addition, the fluctuation of international commodity prices will also have an important impact on inflation, and the rise and fall of commodity prices in the international market will be directly or indirectly transmitted to the domestic price system. Empirical research also clearly shows that the impact of interest rate cuts on inflation is very uncertain. In some specific cases, interest rate cuts may lead to an increase in inflation, such as in a market environment with less supply elasticity and strong demand; In other cases, due to the imbalance between supply and demand (such as oversupply) or the falling international commodity prices, interest rate cuts may not effectively stimulate economic activities and thus have a significant impact on inflation.

2.3 Impact on Employment

During the Federal Reserve's interest rate cut from 2019 to 2020, the unemployment rate in the United States dropped from 3.7% to 3.5%. This data change directly reflects the positive impact of interest rate cut policy on the job market.

After the interest rate cut in September 2024, although the unemployment rate forecast has increased, it still maintains a relatively strong trend from the perspective of the overall job market. Behind this phenomenon may be the result of the interweaving of many factors. The change of labor market structure is one of the important factors. With the development of economy, the composition and characteristics of labor market may have changed. For example, the rise of emerging industries may attract more labor, and the requirements of these industries for labor skills are different from those of traditional industries, which may lead to the structural adjustment of the job market. At the same time, the improvement of production efficiency brought by technological progress has also had an impact on the job market. The application of new technology may enable enterprises to increase production without increasing a large number of labor, which changes the relationship between supply and demand in the job market to a certain extent, but it may also create some new employment opportunities, such as jobs related to the research and development and maintenance of new technologies.

The positive impact of interest rate reduction policy on employment is mainly achieved by promoting economic growth. When the interest rate reduction policy reduces the borrowing cost of enterprises, the profitability of enterprises is improved. Enterprises have more funds to expand production scale or start new business, which will increase the employment demand for labor. From the perspective of empirical research, the conclusion that interest rate reduction policy has a positive impact on employment is supported by a large number of data. However, the improvement of the job market is a complicated process, which is also influenced by many other factors. In addition to the aforementioned labor market structure and technological progress, the international trade environment will also have an effect on employment. For example, international trade friction may lead to the reduction of orders of some export-oriented enterprises, thus reducing the number of employees; A good international trade environment may promote the development of related industries and increase employment opportunities. These factors are intertwined, which may lead to differences in the impact of interest rate reduction policies on employment in different regions and industries.

2.4 Impact on Financial Markets

During the Federal Reserve's interest rate cut from 2019 to 2020, the S&P 500 index of the United States rose by about 20%, which clearly reflected the positive impact of the interest rate cut policy on the financial market.

After the interest rate cut in September, 2024, the S&P 500 index and the Nasdaq index rose all the way to a new high, which further proved conclusively that the interest rate cut policy had a powerful boosting effect on the financial market. However, when analyzing the impact of interest rate cuts on financial markets, we can't ignore the possible impact of fluctuations in international financial markets on its effectiveness.

The interest rate reduction policy has a significant and multi-dimensional impact on the financial market. From the perspective of risk reduction, interest rate cuts can reduce the risk of financial markets. The lower interest rate environment reduces the debt repayment pressure of enterprises and financial institutions and the risk of default, thus enhancing the stability of the entire financial market. In terms of improving market liquidity, interest rate cuts promote the smooth flow of funds in the financial market. Investors are more willing to put money into financial markets, because lower interest rates make other investment channels less attractive. This inflow of funds has increased the liquidity of the financial market and made the trading of financial assets such as stocks and bonds more active. From the perspective of rising asset prices, interest rate cuts have promoted the rise of asset prices such as stock market and bond market. For the stock market, the lower interest rate reduces the financing cost of enterprises and improves the profit expectation of enterprises, thus attracting more investors to buy stocks and pushing the stock price up; For the bond market, the bond price is inversely related to the interest rate, and the interest rate cut makes the price of issued bonds rise. Empirical research also fully shows that under normal circumstances, interest rate cuts have a positive impact on financial markets.

3 THE FUTURE TREND OF THE FED'S INTEREST RATE CUT POLICY

3.1 Current US Economic Status and Challenges

In the third quarter of 2024, the annualized growth rate of GDP in the United States was 2.6%, which was lower than market expectations, reflecting the trend of slowing economic growth. In the third quarter of 2024, the inflation rate of PCE in the United States was 2.3%, which was higher than the 2% target set by the Federal Reserve, indicating that inflationary pressure was rising. At the end of 2024, the unemployment rate in the United States is predicted to be 4.4%, which is higher than the pre-epidemic level, reflecting the uncertainty in the job market.

At present, the American economy faces multiple challenges. On the one hand, economic growth is slowing down, inflationary pressure is rising, and the job market remains strong but uncertain. On the other hand, the international trade environment is complex and changeable, and geopolitical risks increase, posing a potential threat to the American economy. These challenges make the Fed need to weigh various factors when formulating monetary policy to ensure the maximum policy effect.

3.2 Possibility and Uncertainty of Future Interest Rate Reduction Policy

The market expects the Federal Reserve to cut interest rates by 25 basis points in November and December 2024, respectively, but there are variables. This reflects the uncertainty of the market's expectation for the adjustment of the Fed's monetary policy.

Nomura Securities economists predict that the Fed will cut interest rates only once in 2025, while Goldman Sachs economists believe that the Fed will cut interest rates by 25 basis points in June and September 2025, respectively. This further proves that there are differences in the market's prediction of the future direction of the Fed's interest rate cut policy.

The possibility and uncertainty of the Fed's interest rate cut policy in the future will increase significantly. On the one hand, the slowdown of economic growth and rising inflationary pressure provide reasons for the Fed to cut interest rates. However, on the other hand, the strong job market, the uncertainty of the international trade environment and geopolitical risks limit the Fed's interest rate cut. In addition, we also need to take into account the financial market's response to the interest rate cut policy, changes in market expectations and the development of the international economic situation.

3.3 Forecast of the Impact of Interest Rate Reduction Policy on American Economy

The impact of future interest rate cuts on the US economy is uncertain. On the one hand, interest rate cuts may promote economic growth, improve the job market and reduce financial market risks. On the other hand, cutting interest rates may also lead to rising inflation, increasing debt levels and increasing financial market volatility. Therefore, the Fed needs to weigh various factors when formulating the interest rate reduction policy to ensure the maximum effect of the policy. At the same time, it is necessary to pay close attention to the development and changes of the domestic and international economic situation and adjust monetary policy in time to deal with potential risks.

Empirical prediction and risk assessment;

If the Fed continues to cut interest rates, it may promote economic growth to around 3%, but inflation may rise to above 2.5%. This reflects the inflationary pressure that the interest rate reduction policy may bring while promoting economic growth.

If the Fed suspends interest rate cuts or interest rate increases, it may control inflation but restrain economic growth. This further proves that the Fed needs to weigh the balance between economic growth and inflation when formulating monetary policy.

4 POLICY RECOMMENDATIONS AND CONCLUSIONS

4.1 Policy Recommendations

In view of the uncertainty of the current US economic situation and the future interest rate reduction policy, this paper puts forward the following policy suggestions:

Strengthen the coordination between monetary policy and fiscal policy: by strengthening the coordination between monetary policy and fiscal policy, improve the policy effect, promote economic growth and stabilize inflation. This will help to form a policy synergy and better cope with the downward pressure on the economy.

Pay close attention to international trade and geopolitical risks: Pay close attention to the changes of international trade environment and geopolitical risks, and adjust monetary policy in time to deal with potential threats. This helps to enhance the resilience and stability of the economic system.

Strengthen financial supervision and risk prevention: strengthen financial supervision to prevent financial market risks and ensure the stability and development of financial markets. This will help maintain the healthy operation of the financial system and provide strong support for economic growth.

4.2 Conclusion

Through the in-depth analysis of the effect evaluation and future trend of the Fed's interest rate reduction policy, this paper draws the following conclusions:

The interest rate reduction policy has a significant impact on economic growth, inflation, employment and financial markets. By reducing borrowing costs, stimulating economic activities, improving the job market and reducing financial market risks, the interest rate reduction policy has had a far-reaching impact on the US economy.

The uncertainty of the future interest rate cut policy has increased significantly. At present, the American economy is facing multiple challenges, and the possibility and uncertainty of future interest rate reduction policy have increased significantly. When formulating the interest rate reduction policy, the Fed needs to weigh various factors to ensure the maximum effect of the policy. At the same time, it is necessary to pay close attention to the development and changes of the domestic and international economic situation and adjust monetary policy in time to deal with potential risks.

Policy recommendations are targeted and operable. In view of the uncertainty of the current American economic situation and the future interest rate reduction policy, the policy suggestions put forward in this paper are targeted and operable. These suggestions help to enhance the resilience and stability of the economic system and provide strong support for economic growth. At the same time, it also provides useful insights and references for global economic participants.

COMPETING INTERESTS

The authors have no relevant financial or non-financial interests to disclose.

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