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Large budget deficits won't send interest rates up, says new EPI report

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Contrary to claims that rising federal budget deficits will lead to higher interest rates and endanger economic recovery, the fact is that economic fundamentals are putting *downward* pressure on interest rates, and they will continue to do so until a robust recovery is underway, as a new Economic Policy Institute report explains.

The report, *Federal Budget Deficits and Rising Interest Rates*, shows that there is no evidence that large increases in the federal budget deficit during recessions are associated with rising interest rates. Examining data since 1954, the report finds that large increases in the deficit have actually been associated with large declines in interest rates.

The reason for this relationship is clear: During recessions, declining borrowing by the private sector generally offsets rising public borrowing (which increases budget deficits). As a result, there is little upward pressure on interest rates in the markets for savings and investment.

In fact, the private sector (including households and businesses) tends to boost its savings during recessions, which can increase the pool of funds available for borrowing and put downward pressure on interest rates, while both households and businesses tend to reduce their demand for new debt.

"One baseless argument making the rounds today is that interest rates can 'turn on a dime' – that today's low interest rates could suddenly and significantly spike, choking off any potential recovery," says EPI economist Josh Bivens, the report's author. "This claim is an utter fiction. Today's low interest rates are not a fluke; they reflect the fundamental condition of the economy, and they will remain low until a robust recovery has firmly taken hold."

A separate EPI report released last month found that, so far, there is little hard evidence that creditors have changed their assessment of the value of U.S. federal debt. Click here for that analysis.

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