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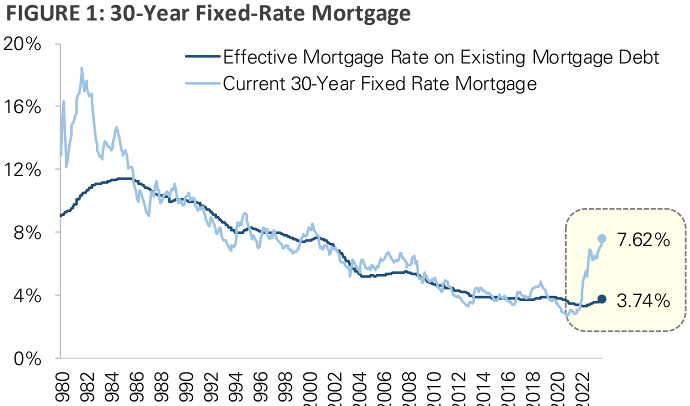
# Why Higher Interest Rates Haven't Impacted the Economy Yet

The Federal Reserve has raised interest rates by more than 5% since March 2022. It's been the fastest pace of tightening in decades, but data shows the economy has been resilient thus far. The U.S. economy grew at a 5.2% annualized pace in the third quarter, which was the fastest pace since Q4 2021, due to robust consumer spending, increased government spending, and companies restocking inventories. In the labor market, companies continue to add jobs and increase wages. Construction spending rose +10.7% year-over-year in October despite higher financing costs, with activity increasing in both the public and private sectors.

Why are the Fed's rate hikes having only a marginal economic impact? As the two charts below show, there is a large gap between headline interest rates and the effective rate on existing debt. Figure 1 shows the average 30-year fixed-rate mortgage was 7.62% at the end of September. However, the effective interest rate on all existing mortgage debt was only 3.74%, or nearly 4% below the headline mortgage rate. Figure 2 reveals a similar dynamic in the corporate bond segment. The yield-to-maturity on a broad high-yield corporate bond index currently sits at 8.4%, a proxy for what new high-yield borrowers would pay. However, the average coupon on the bonds within the index, which more accurately reflects borrowers' actual interest rate, is only 6.1%.

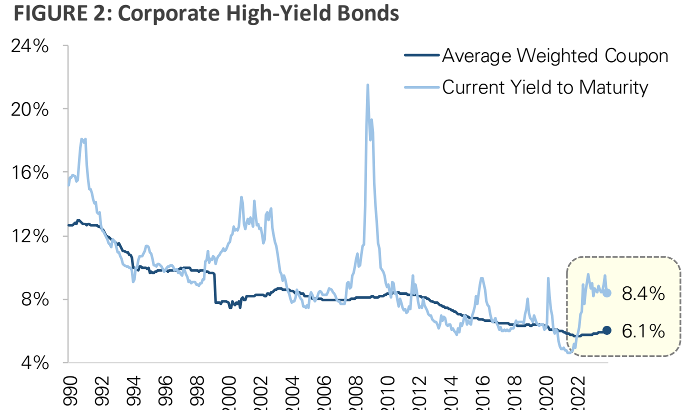
The two charts help to explain the Fed's limited impact thus far. During the pandemic, many homeowners and companies took out fixed, low-interest-rate loans. While interest rates have increased significantly over the past 20 months, these borrowers' monthly payments are unchanged, which means their financial situations and spending habits are mostly unchanged. The gap between headline interest rates and the effective rate on existing debt has shielded the economy from the immediate impact of the Fed's rate hikes. However, this does not mean the economy will be immune to higher interest rates forever. The gap will likely narrow over time as mortgages and corporate bonds mature and borrowers refinance at higher interest rates.

**FIGURE 1: 30-Year Fixed-Rate Mortgage**




Source: MarketDesk Research, Bureau of Economic Analysis, Freddie Mac. Time period from 12/31/1979 to 9/30/2023.

**FIGURE 2: Corporate High-Yield Bonds**




Source: MarketDesk Research. Time period from 1/31/1990 to 12/12/2023.