

Let's Schmooze

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Those Interest Rates

The question is on every pair of lips ~ what will interest rates do tomorrow? There is so much riding on that answer. Let's take a look at "interest rates."

Exactly what are they?

Exactly what do they do?

For starters, think of an interest rate as a type of "rent." That's right ~ "rent." When we rent something, an apartment, a tool, a vehicle ~ the "rent" is for the "time use" of the item we are renting. And, not only are we supposed to pay the rent, but at the end of the rent period we are supposed to return the item in reasonably the same condition it was in when we borrowed it.

Money is no different. When money is the "item" we are seeking to borrow for a period of time, the rent is the "interest" charged, and of course, at the end, we are expected to return the item, in this case, money, in the same condition it was in when we "rented" it.

It is the requirement to return the money in as good condition as we received it that determines in large measure the interest "rate."

Think about it. The only way that we can return the money borrowed in the same condition that we received it is if that money has the same purchasing value after as before. In other words, no inflation during the rent period. In fact, if the inflation rate is "zero," we should expect interest rates to hover near "zero" also. Any amount over "zero" would be naked profit to the lender.

If you want to really discern what the inflation rate is in our America, the best way would be to look at the interest rates of U.S. treasuries, because it is in U.S. treasuries that "risk" is minimized. "Risk" is another factor built into interest rates, along with inflation and profiteering.

That's why the Feds always try to fight inflation with interest rate increases. Of course, the more fundamental reason for federal rate increases is simply to make sure that monetary values are not eroded by rising consumer prices. A sort of "keeping up" with price increases.

Inflation, risk, profiteering ~ these are the three main components of interest rates. Lately, there has been a 4th component playing with interest rates. That's right, the awesome amounts of cash floating around.

Liquidity

We'll talk more about that another time. And, we'll have a go at the Chinese connection, and about how much of this is "economics," and how much of this is "politics."

~ *'til we meet again* ~