

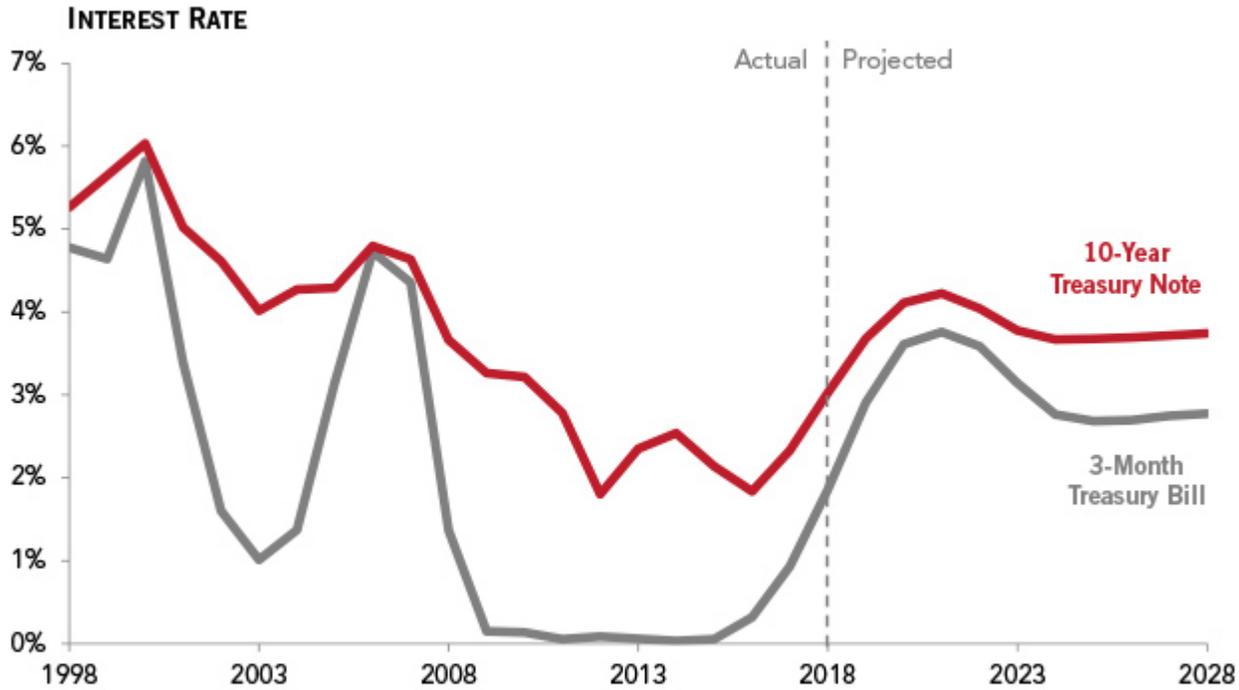
Higher Interest Rates Will Raise Interest Costs on the National Debt

Dec 19, 2018

Today, the Federal Reserve announced an increase in the federal funds rate to between 2.25 and 2.5 percent; that increase was the fourth so far this year. After a lengthy period of holding the federal funds rate close to zero in an effort to help the economy recover from the financial crisis, the Federal Reserve began increasing its target rate in December 2015. There have been seven subsequent increases since then; the most recent increase before today was in September 2018 and set a target rate between 2.0 and 2.25 percent.

The Federal Reserve sets policies to foster conditions that they believe to be consistent with achieving maximum employment, stable prices, and moderate long-term interest rates. Setting the target for the federal funds rate — the interest rate at which commercial banks lend to each other overnight — is therefore an important tool for the bank. That rate is the benchmark for Treasury bills and other short-term interest rates. Expectations about those short-term rates, combined with other factors, affect the longer-term rates that are applied to consumer borrowing such as for mortgages, car loans, and student debt.

The continued tightening of monetary policy should be viewed as a positive sign of economic strength — it demonstrates the bank's confidence in the progress the economy has made toward its economic objectives. However, higher short- and long-term Treasury rates mean that the federal government's borrowing costs will also rise, thereby generating significant consequences for the budget and the national debt.



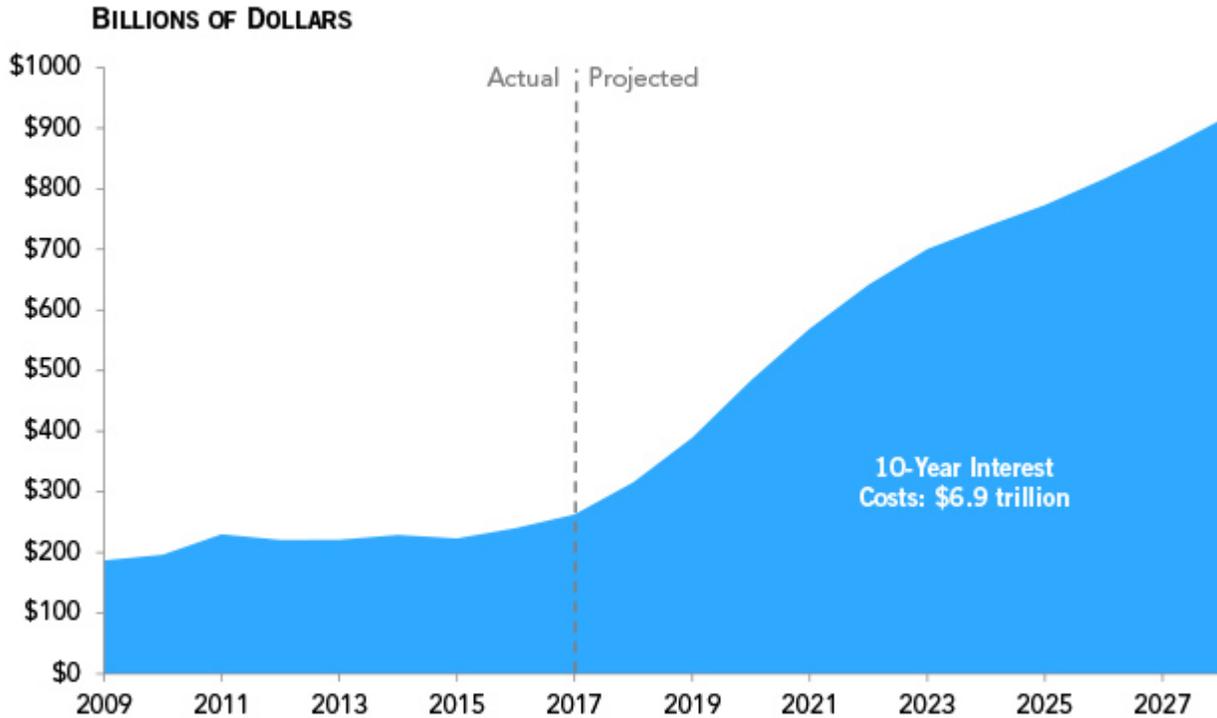
SOURCE: Board of Governors of the Federal Reserve System, *H.15 Selected Interest Rates*; and Congressional Budget Office, *The Budget and Economic Outlook: 2018 to 2028*, April 2018. Compiled by PGPF.
NOTE: Data are presented on a calendar year basis.
© 2018 Peter G. Peterson Foundation

PGPF.ORG

Under current law, CBO projects that net interest costs will nearly triple over the next 10 years, soaring from \$315 billion in 2018 to \$914 billion in 2028 and totaling \$6.9 trillion over the period. 1



Net interest costs are projected to rise sharply



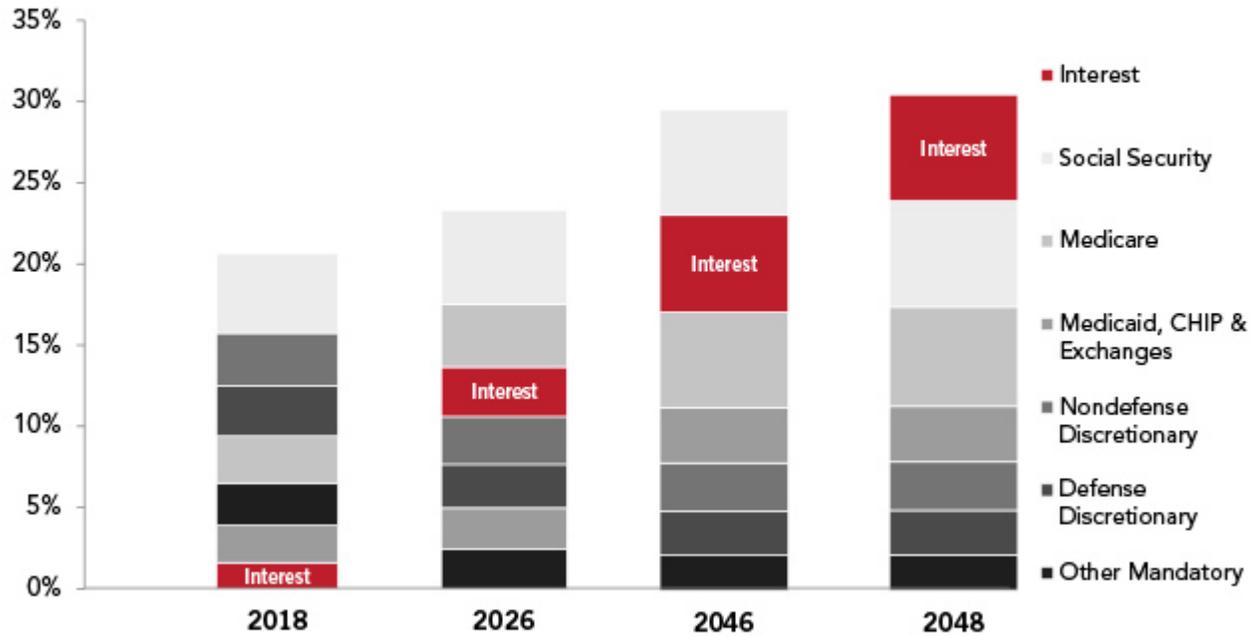
SOURCE: Congressional Budget Office, *An Analysis of the President's 2019 Budget*, May 2018. Compiled by PGPF.
© 2018 Peter G. Peterson Foundation

PGPF.ORG

Interest costs are expected to continue climbing beyond the next 10 years and are projected to be the third largest category in the federal budget by 2026 (after just Social Security and Medicare), the second largest category in 2046, and the single largest category by 2048.



BUDGET CATEGORIES (% OF GDP)



SOURCE: Congressional Budget Office, *The 2018 Long-Term Budget Outlook*, June 2018; and PGPF calculations based on CBO data. Compiled by PGPF.

NOTE: Medicare spending is net of premiums and payments from the states. In 2048, net interest costs would about equal Social Security.

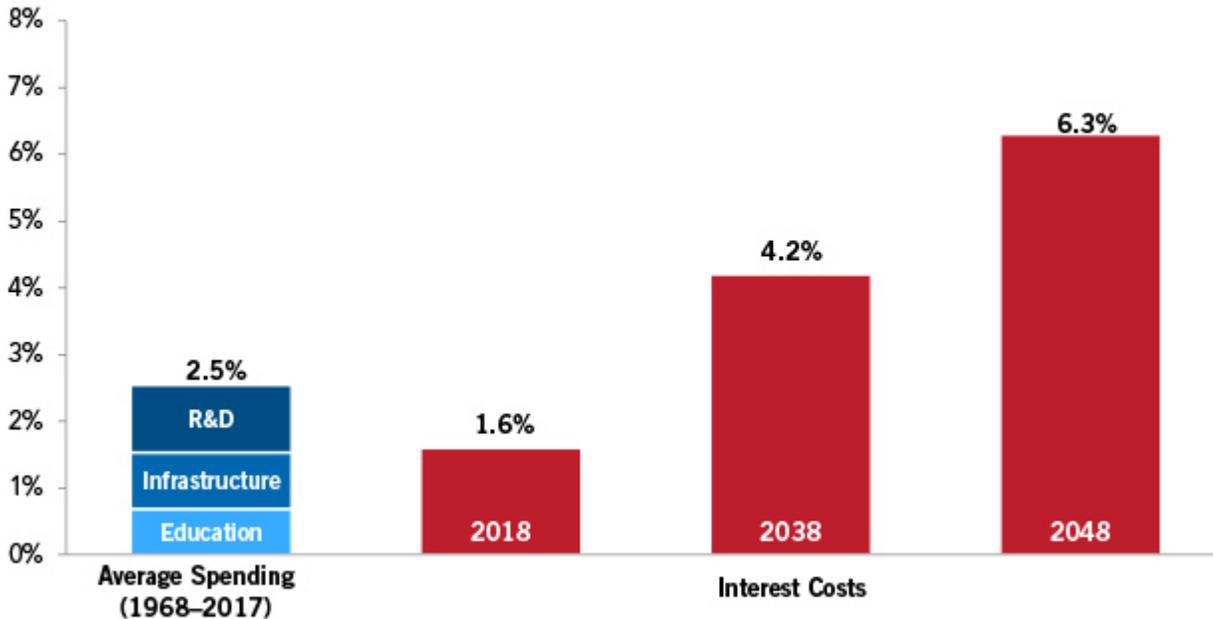
© 2018 Peter G. Peterson Foundation

PGPF.ORG

Ballooning interest costs threaten to crowd out important public investments that can fuel economic growth in the future. In its most recent long-term budget report, CBO estimates that by 2048, interest costs are projected to be more than double what the federal government has historically spent on R&D, nondefense infrastructure, and education, combined.

By 2048, interest costs are projected to be more than twice what the federal government has historically spent on R&D, infrastructure, and education combined

FEDERAL SPENDING (% OF GDP)



SOURCE: Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2019*, February 2018; Congressional Budget Office, *The 2018 Long-Term Budget Outlook*, June 2018. Compiled by PGPF.
NOTE: Infrastructure excludes defense.

© 2018 Peter G. Peterson Foundation

PGPF.ORG

The long-term fiscal challenges facing the United States are serious. Deficits are on the upswing again and therefore will be adding significantly to national debt. To be clear, the culprit is fiscal policy, not the monetary policy conducted by the Federal Reserve. Congresses and Presidents of both parties, over many years, have avoided making hard choices about our budget and failed to put it on a long-run, sustainable path. In fact, the tax legislation that was enacted in December 2017 makes it even more difficult to achieve that sustainable path. However, as interest costs rise and with the deficit slated to reach \$1 trillion as early as this fiscal year, it is vital for lawmakers to take action on the growing debt to ensure a stable economic future.

¹ Under current law, CBO projects that interest rates on 3-month Treasury Bills will increase from an average of 1.9 percent in 2018 to 2.8 percent in 2028, while interest rates on 10-year Treasury Notes will increase from 3.0 percent in 2018 to 3.7 percent in 2028. The interest rates are expressed as calendar-year averages. ([Back to citation](#))

- [Careers](#)
- [Terms of use](#)
- [Copyright policy](#)
- [Permissions](#)
- [Privacy policy](#)
- [Sitemap](#)

Source URL: <https://www.pgpf.org/analysis/2018/12/higher-interest-rates-will-raise-interest-costs-on-the-national-debt>