The Interest Hike of Fed: How Will It Influence China And The World Economy?

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Abstract. This paper reviews the background, impact and law of the previous Federal Reserve interest rate hikes, and on this basis analyzes the impact of this interest rate hike on the world's major economies. This paper holds that the impact of us dollar interest rate hike on China's asset prices, foreign debt repayment, RMB exchange rate and monetary policy is still under control, but the world economy with an already weak recovery is facing a recession crisis.

Keywords: Fed rate hike; Yuan depreciation; Capital flows.

1. Introduction

The essence of monetary policy is counter-cyclical regulation, raising interest rates when the economy rises to prevent economic overheating, and cutting interest rates during the economic downturn to stimulate economic recovery. As the Fed's two major policy targets, employment and inflation are being replaced, so the Fed often has to trade them off. Historical experience shows that if the Fed raises interest rates when the economic fundamentals continue to improve, it will have less impact on the financial markets and the real economy; if the Fed raises interest rates at the lower end of the boom cycle, it will have a more significant negative impact on the financial markets and the real economy.

Due to the global COVID-19 pandemic, the global supply chain has suffered from a crisis. Since 2020, the US has seriously overissued money on the grounds of economic recovery after the epidemic. The money overissued by the US has seriously exceeded the total currency demand in the US market, which makes the US face the worst inflation crisis in 40 years. Since the hegemony of the US dollar in the world currency field remains stable, these overissued currencies are bound to circulate to countries around the world, and in essence, the United States is looking for other countries to take responsibilityfor its overissued currencies [1]. This has led to us domestic inflation and the global inflation crisis caused by the dollar liquidity crisis. In order to ease domestic inflationary pressure and attract capital return, the Fed is bound to make a new round of interest rate hikes. On September 21,2022, the Federal Reserve concluded its two-day monetary policy meeting andannounced that it would raise the target range of the federal funds rate by 75 basis points to between 3% and 3.25%. The hike is the Fed's third since 2022, the seventh round in U. S. History [2]. Since the 1980s, the Federal Reserve has experienced six cycles of interest rate hikes, with significant differences in the pace, duration and intensity of previous interest rates (see in Table 1).

The first round of interest rate hikes came from March 1983 to August 1984, when the United States suffered a staggering 13.5% of inflation due to the oil crisis and massive stagflation [3]. The Federal Reserve successfully suppressed super-inflation through a massive interest rate hike and achieved economic recovery.The second round of interest rate hike was from March 1988 to May 1989. Due to the "stock market crash", the Federal Reserve cut interest rates for emergency market rescue, and the stock market fall had little impact on the economy, but inflation continued to rise in 1988, the Federal Reserve began to raise interest rates and gradually tightened monetary Policy [4].

The third round of interest rate hikes was from February 1994 to February 1995, when the US economic recovery was rekindled, unemployment was still high and there was inflation panic in the market. Although this round of interest rates suppressed the rise of US inflation, bond yields fell sharply, which had a great impact on the capital market. As a result, the hike is also seen as one of factors contributing to the 1997 Asian financial crisis [2].

Table 1. Previous Federal Reserve rate hike operations, source: The Federal Reserve

The periods of interest hike	The first rate hike	Time to rise the interest rates	Cumulative rate hike	Average monthly rate hike
1983.3-1984.8	0.125%	18months	3%	0.17%
1987.1-1989.5	0.125%	29months	3.9375%	0.15%
1994.2-1995.2	0.25%	13months	3%	0.23%
1999.6-2000.5	0.25%	12months	1.75%	0.15%
2004.6-2006.6	0.25%	25months	4.25%	0.17%
2015.12-2018.12	0.25%	37months	2.25%	0.06%

The fourth round of interest rate hikes was from June 1999 to May 2000, when the dotcom bubble expanded, I T investment grew, the economy was overheating, the Federal Reserve began to raise interest rates again, and the USTreasury yields and the DOLLAR indexboth rose.

The fifth round of raising interest rates in June 2004-June 2006, due to the "911 event" to the economy and the stock market, the fed continuously cut interest rates, inspired the real estate bubble, in the second half of 2003, strong economic recovery,demand rapidly rising inflation and core inflation, this round of interest rate yields fell, and the dollar index is not as the fed raise interest rates higher, affected by higher inflation values, the us dollar is weak [5].

The sixth round of interest rate hike was from December 2015 to December 2018. As the collapse of the US real estate bubble in 2007 caused the global subprime crisis, the Federal Reserve introduced unprecedented easing. The monetary policy boosted the US economy, but also led to a sharp expansion of the Fed's balance sheet in the short term [6]. As the economy recovered steadily, and the Federal Reserve's monetary policy shifted to normalize, it announced its first rate hike in December 2015. During the current rate hike cycle, the DOLLAR index and Treasury bond yields both rose.

Through the analysis of the fed rate rise, we find that the fed rate rise is mainly divided into two background: when the economy up, in order to prevent overheating, the fed may be to choose to raise interest rates, in the cycle started in February 1994 and June 1999, when the economy accelerated in the upward stage, if inflation rapid rise, the fed may also choose to raise interest rates, in March 1983 and June 2004, the cycle of fed in the economic downturn,inflation rise [7]. In general, we clearly see that when the Federal Reserve raises interest rates, it will improve the domestic economy, but when the US economyis forced to raise interest rates, it will not only have a negative impact on theUS economy, but also cause a huge hidden danger of the global economic crisis.

It is generally accepted that scarcity of resources has forced humanity to make the most of what they have; as a result, the government must prioritize its spending by determining which demands must be met immediately and which may wait until later. Federal interest rates are set to help the government manage spending and revenue for a certain period. It must be of a nature that depicts the genuine picture of a country's economy, as the government preplanned their anticipated revenues in the approaching time and regions where such earnings required to be spent. There was a major failure on the part of the national government to properly prioritize issues. When governments don't do this, debt service ends up funding a project that wasn't needed and wasn't well thought out. Financing government spending via borrowing money from the International Monetary Fund (IMF), the World Bank, and commercial banks is known as debt servicing. Borrowing in this way almost invariably comes with onerous terms and conditions for paying it back, which further harmsthe economy of the country in question [8]. Therefore, authorities need to prioritize increasing national revenue above seeking new loans, and they should also implement measures to reduce wasteful spending on things like wars that drain resources that may be put to better use at home.

2. The Impact of The Fed Rate Hike on China

China is the largest emerging market country in the world economy and the largest and most dynamic market in the world today. Under the impact of COVID-19, China has provided a large and complete manufacturing system forthe global supply chain, a fast, efficient and interconnected logistics and transportation system to the world economy, and enabled economic recovery with large-scale and strong growing markets [9]. AsChina is increasingly closely connected with global markets, the international financial turmoil causedby the US interest rate hike is bound to affect China

(1) Lead to the depreciation of the RMB exchange rate. A sharp rate hike by the Fed will lead to a sharp rise in the dollar index, now over 110, which will lead to a small depreciation of the yuan. If the depreciation is limited to a certain range, China's export competitiveness can be enhanced. In particular, due to the repeated impact of the epidemic this year and the economic difficulties in China, major export companies have a large backlog of goods. With themoderate depreciation of the RMB exchange rate, the same US dollar can buy a lot of Chinese goods, which is conducive to the export sales of Chinese goods and transforms the overstock inventory into transferable funds[10]. But this will have a negative impact on China's goods imports, as import prices will rise, eventually affecting the price of the goods the company produces, and meaningthat residents will have to spend more money on them, and domestic inflationary pressures will increase.

(2) Lead to international hot money selling yuan-denominated assets. If a lot of international hot money selling assets flows into the United States, domestic stock markets and real estate bubbles will burst. However, as China controls capital accounts, it is difficult to see large outflows of hot money in the short term [11]. As a result, asset bubbles such as domestic stocks and housing will be partly affected by the Fed rate hike, but to less so than in other emerging economies.

(3) Increase the pressure on foreign debt repayment. After the global financial crisis, the developed countries represented by the United States conducted quantitative easing operations, which led to a sharp drop in interest rates on currencies such as the US dollar. At the same time, the yuan has appreciated more sharply, with Chinese companies taking the opportunity to integrate a large amount of dollar funds. In previous years, due to the depreciation of the US dollar and low financing costs, many countries have issued large amounts of US dollar-denominated debt, with China accounting for the largest proportion. As the Fed raises interest rates and the dollar rises, their dollar debt burden increases, and theymay face difficulties in paying back their loans [12]. At the same time, the People's Bank of China has spent a lot of its foreign exchange reserves to ensure that Chinese companies can steadily repay their foreign debts, which are also under periodic pressure.

(4) China's monetary policy is becoming more difficult to implement. Due to the scattered outbreak of COVID-19, China's real economy is relatively depressed, and there is no condition to follow the Fed's interest rate hikes. The change of interest rate spreads between China and the United States will impact the smooth operation of China's economy and financial markets from the terms of exchange rate, asset prices and capital flows, and increase the difficulty of implementing monetary policy.

(5) It is possible that China's recovery will be hampered in a number of different ways as a result of the diminished global liquidity caused by higher interest rates. If lending requirements are made more stringent, businesses would have to pay a higher interest rate to borrow money, which will reduce their earnings and discourage them from investing in the future. When borrowing rates go up, people are less inclined to make substantial purchases, particularly for expensive things such as automobiles and homes. As a result of the slowdown in the global economy, China's manufacturing and exports are facing challenging conditions.

(6) The flight of investors from most of China's economies as a result of the United States' policy of monetary tightening can be traced back to the beginning of the currency devaluation that occurred in those markets [13] .When countries' current account deficits grow, it becomes difficult for them to pay their foreign debts or import the goods they need to survive. This, in turn, makes it more difficult for inflationary pressures to be alleviated, which in turn makes it more difficult for countries to import food and energy, which both require increased spending.

(7) The rise in interest rates has the most devastating effect on persons living in poverty. If regional central banks raise their interest rates in response to a tightening of monetary policy in the United States, it will have the effect of reducing domestic liquidity and will have a negative impact on GDP. However, rapid increases in US interest rates could lead to a reversal in capital flows, decline in the value of the dollar, and the possibility of a surge in inflation; all of these outcomes would be detrimental to growth prospects[12]. In either scenario, the state of the economy as a whole would deteriorate, and those with lower incomes will be the ones to feel the repercussions most acutely. When economic activity slows, both the number of people employed and the number of people laid off both rise. Loss of employment has a disproportionately negative impact on the poor because of their lower incomes, lack of resources, and lack of skills, all of which make it harder for them to obtain new work. Their already low purchasing power would be further eroded by an increase in inflation.

3. The Impact of The Fed Rate Hike on The World

The US ' s irresponsible aggressive interest rate hike and contraction policy may lead to the global financial markets in a liquidity crisis, making the already sluggish global economy face more "stagflation" and recession risks. This is not the first and not the last. It should be clear that the Fed rate hike is a double-edged sword, and continued aggressive rate hikes are at the expense of others. Looking ahead to the current rate hike cycle, if the inflationary pressure does not subside after the US economy enters the downward period, the Federal Reserve is forced to continue raising interest rates, which may trigger a sharp correction in the US stock market and the risk of a "hard" economic landing [14]. Global economies are locked in a race to raise interest rates ". The irresponsible and aggressive rate hike in the US will lead to panic in global financial markets, leaving the already sluggish global economy with more risks of "stagflation" and recession [15]. The Fed's continued aggressive interest rates have forced major central bank around the world tofollow interest rates and tighten monetary policy, central banks in Switzerland , Britain andNorway have announced interest rates, and ECB President Christine Lagarde said the ECB will continue to raise interest rates in order to cope with rising inflation .

Emerging economies are in a liquidity crisis. From the perspective of international capital flows, the Fed rate hike will lead to a large amount of capital flight from emergingeconomies, and the capital originally flowing into emerging economies will return to the US market to pursue higher interest returns and investment returns on financial assets. Since most emerging economies rely on the US dollar hegemony system and support the free exchange of the US dollar, nothing can be done in the face of capital outflow, which will impact their own financial stability and face a liquidity crisis [16]. Some economies with insufficient US dollar foreign exchange reserves and relying on overseas capital inflow for investment will even see their financial markets collapse, and the continuous depreciation of their own currencies will eventually hit the real economy .

Continued aggressive global rate hikes could lead to a financial crisis. The combination of a sharp rise in the dollar , the European energy crisis and a surge in global commodity prices has put more inflationary pressures on the global economy. If the Federal Reserve and the global central banks fail to change inflation expectations, the global economy may face the risk of "stagflation" again, or even a worse financial crisis than in 2008. From the sovereign debt crisis in Latin America in the early 1980s, the Asian financial crisis in 1997 to the international financial crisis in 2008 , it is not the first time that the United States has abused the "US dollar hegemony" to create an economic and financial crisis [18].

The Credit Market - The availability of credit and cash can be made more limited as interest rates rise, which can have a chilling effect on the economy. According to the fundamentals of economics, when interest rates go up, the money supply goes down, and the value of the dollar goes up. Concurrently, the markets for lending and obtaining credit become more difficult to navigate. The market for Treasury bonds is considered a leading indicator for the market for global credit. Along with the increase in the interest rate, there is also an increase in the cost of credit. When you progress up the lending ladder from payday loans to mortgages, the amount of money you borrow will cost you more overall. As a result, an increase in the cost of capital may have a detrimental effect not just on consumption but also on output and manufacturing. It is anticipated that increases in interest rates in the United States will have the most severe consequences on economies in Asia, particularly by accelerating the flight of money from China and adding to the financial instability that is already evident in that nation[18]. In a bid to jumpstart its economic progress during the course of the previous six years, China has taken out significant amounts of debt from international financial institutions. A drop in interest rate serves as an incentive for more people to take out loans. However, as the likelihood of stricter credit terms increases, the amount of money that the international community lends to heavily indebted nations would drop considerably.

Treasury Bonds- The Treasury yield curve in the United States swiftly reflects changes in the national interest rate, which impacts the value of US-Treasury Bonds. The yield curve is closely correlated with the increase and fall of global interest rates. Since Treasury bonds are considered to be a risk-free asset, any other security must offer a greater yield in order to remain attractive. Furthermore, given that interest rates are likely to increase, which will cause global investors to park their money in the United States, emerging countries will face an incredible amount of pressure to maintain their attractiveness. This could, over time, have a negative impact on the levels of employment in emerging countries, as well as the value of their currency and their capacity to export commodities.

Without the use of the United States dollar, conducting business across international borders would be a very challenging endeavor. The dollar is the major currency used in international settlements. However, if the Federal Reserve continues to aggressively raise interest rates, the majority of countries whose currencies are not pegged to the dollar will find themselves in a difficult position because their currencies are likely to lose value and they risk having an interest rate gap that is inverted relative to the dollar if they do not raise their own rates concurrently with the United States [19]. Because of this, the possibility of capital flight from their economies would increase, which would put their international payment arrangement in jeopardy.

4. Summary

To sum up, as the current international economy, international rules and the biggest beneficiaries of global governance system, the United States has the responsibility and obligation together with the world for the global economic recovery after the epidemic inject more power, responsibility and obligation with the central Banks around the world, the world bank, the international monetary fund with the lender's responsibility, rather than let the world for the fed's policy mistake.Indeed, recent rate hikes by the Federal Reserve have triggered economic upheaval in various nations and areas. The only way out of the crisis caused by the dollar's rise is for many countries to improve their economic development and fortify their currency.

When making decisions, the federal government and policymakers should, according to the opinions of economists, take into account the most dire possible outcomes. After some period of time has passed, there is a possibility that the introduction of artificially low interest rates will result in negative consequences on economic activity. owing to the fact that future increases in interest rates cannot be avoided. Last but not least, the fall in interest income will have a catastrophic impact on the financial industry. In accordance with the general law of economics, the cost of loans will continue to decrease even as the total amount of money available continues to grow. When making decisions about interest rates, policymakers should proceed with prudence and solicit the advice of industry professionals. Especially in the wake of the most recent epidemic, it is extremely important for the federal government to understand that a significant amount of money has already been spent under the justification of economic recovery. Before making any significant decisions regarding the economy, it is essential to have extensive conversations with other nations and to do so before making any decisions concerning significant industries like manufacturing. This is necessary in order to have stable economic growth in significant industries like manufacturing. Interaction with other nations, such as China, which is rapidly becoming an economic superpower due to the stability of its currency and the increasing modernization of its economy, is also extremely important. Additionally, the United States Federal Reserve System needs to acknowledge that the availability of dollars currently far exceeds the demand that exists in the market for them.

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