Inflation Rate Hikes Could Affect Virginia Bonds, Economy

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(The Center Square) – The Federal Reserve intends to keep raising interest rates, which could have a negative effect on future state and local bonds in Virginia and a mixture of positive and negative effects on businesses, according to scholars and interest groups.

As inflation continues to be a serious problem affecting Virginia consumers and business owners, the higher interest rates are meant to stabilize the currency by disincentivizing borrowing and spending and incentivizing saving. However, cutting off the cash flow comes with problems as well, according to Norbert Michel, the director of the libertarian Cato Institute's Center for Monetary and Financial Alternatives

"I don't think it's a good idea," Michel told The Center Square. "I don't like the system that we have."

Michel said there are a variety of factors driving inflation right now. Some factors are still COVID-19 related, some are regulatory, some are due to fiscal policies, some are related to the Russian invasion of Ukraine and some are related to prices in specific markets. Slowing down credit to curb inflation could potentially work in theory, he said, but there is no guarantee that it will have an immediate impact on inflation and could lead to a bumpy downturn for anybody who is not flushed with cash.

Yet some business groups whose members have cited inflation as one of their biggest problems believe higher rates are necessary. Nearly one-third of small business owners cite inflation as their top concern at the moment, according to Holly Wade, the executive director of the National Federation of Independent Business's Research Center.

Wade told The Center Square higher interest rates should benefit the majority of businesses by curbing the impact of inflation. More than 20% of NFIB members reported that increased costs and economic conditions are the primary reason they have not seen expansion opportunities.

"Getting inflation under control would be huge," Wade emphasized.

Wade argued that raising interest rates would benefit most small businesses, but that it would not have the same effect on every sector. The housing market and businesses that export goods, she elaborated, are likely negatively impacted by higher interest rates.

Most current government bonds would not be affected by raising interest rates, but future state and local bonds would see higher rates. The state government and local governments take out bonds to pay for a variety of projects.

"[Bonds] are usually fixed rate so debt already out there won't change," Stephen Haner, a senior fellow for state and local tax policy at the Virginia-based, free market Thomas Jefferson Institute told The Center Square.

"But any new borrowing will be at higher rates," Haner said. "When rates are dropping governments like to refinance debt and capture the lower rates, but that's not working now."

Haner also warned higher interest rates could initially slow the commonwealth's economy.

"The whole point of raising interest rates is to slow economic activity by making it more expensive to do business, to buy a new house or car, and it will slow Virginia's economy," Haner added. "If it breaks the back of inflation, then the pain produces some gain. But there will be pain and perhaps a recession."

The current inflation rate is more than 8% and the national economic growth has been negative over the past two quarters. Some economists have labeled the current economy as being in a recession, but others have said economic conditions do not constitute a recession yet.