Moneynews

Duke's Campbell Harvey to Newsmax TV: Fed Should Raise Short-Term Rates Now

Friday, April 11, 2014 05:16 PM

By: Dan Weil

While most analysts don't expect the Federal Reserve to raise short-term interest rates until the second half of 2015, Campbell Harvey, a professor of international business at Duke University, says it should do so now.

"What worries me most is the distortions that the Fed has introduced into the market by forcing the 'real' rate of interest to be negative for a prolonged period of time," he told "America's Forum" on Newsmax TV.

"When you induce a distortion for such a long period of time, yes, maybe it has a short-term impact on the stock market. But you get used to it, and it becomes painful to get rid of."

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So what should the Fed do?

"Forget the gradual taper" of bond purchases, Harvey said. "We should just raise those short-term rates to a point where at least the real interest rate is zero."

The Fed has kept its key short-term rate at a record low near zero since December 2008. The "real" interest rate commonly is defined as the rate of interest an investor expects to receive after allowing for inflation. If an investor locked in a 5 percent interest rate while expecting a 2 percent rise in inflation, it would yield a real interest rate of 3 percent.

The central bank's monthly purchases of bonds had been held at a level of $85 billion a month all last year. Those purchases are intended to keep long-term loan rates low to spur borrowing, spending and economic growth. Many economists think the Fed will keep reducing the bond purchases by $10 billion at each meeting this year before ending them altogether late this year.

Meanwhile, noted economist and author Robert Wiedemer sees trouble for earnings.

That's particularly true for bank earnings, which will suffer from problems in the housing market, he told "America's Forum."

"Refinancing is drying up completely, and new home mortgages are not doing well. So that's what's going to hurt banks certainly for a while," said the author of **"Aftershock: Protect Yourself and Profit in the Next Global Financial Market Meltdown."**

As for the stock market, it's a different animal than a year ago, thanks to the Fed's tapering, said Wiedemer, managing director of Absolute Investment Management.

"The Fed is obviously working very hard to keep this market up, but now it's tapering," he said. "So this first quarter is extremely different from the first quarter of last year. . . . When we're looking at the market day-to-day, we've got to recognize that."

Meanwhile, Harvey said we shouldn't exaggerate the importance of the Nasdaq Composite index' 3.1 percent drop Thursday.

"A negative 3 percent move in the Nasdaq isn't really an indication of a crash or anything particularly unusual," he said. Moves of at least that magnitude happen about five times a year, he said. "It's just not unusual, given the underlying volatility of Nasdaq."

The index slid another 1.3 percent Friday.

As for the economy, "actual growth is pretty good right now, and we need to look at private-sector growth," Harvey said. That's because the government can distort overall GDP with its borrowing and spending.

"We've seen a period where government spending has actually decreased, which is good, and that actually has drawn down overall GDP," he said. The economy expanded 2.6 percent in the fourth quarter, and many analysts expect growth of less than 2 percent for the first quarter.

But private-sector growth is running at 3.5 to 4 percent, "which is very good," Harvey said.