A Note on Interest Rates and Structural Federal Budget Deficits


Abstract

This paper provides evidence on the response of interest rates to Federal budget deficits. A simple model is presented that incorporates the role of monetary policy in the determination of short-run interest rates and that ascribes the effects of government budget imbalances on the term structure of interest rates to uncertainty about the expected evolution of inflation and real interest rates. Empirical results support the view that the term structure of interest rates is affected by Federal budget deficits, with a significant positive response of intermediate- and long-term interest rates relative to short-term rates in response to budget deficits.
Federal budget deficit occurs when the government expenditure exceeds the government income through revenue in a fiscal year. The problem with this deficit is that every year, it is added to the already existing Federal Debt which currently stands at over $14 trillion. Figure 1 and table 1 below show the budget deficit over the years. The table 1 elaborates the federal deficits in figures between the year 2000 and the projected deficit up to the year 2016. Figure 1. We will write a custom research paper on The costs and benefits of incurring an annual federal budget deficit specifically for you for only $16.05 $11/page Learn more. Source: usgovernmentspending .com. Table 1.