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"Interest Rates: Where They Are Headed & What It Means to the Truss Industry" by Al Schuler

Demand for trusses is driven primarily by construction activity, both residential and commercial. Construction investment is influenced by several factors including interest rates, consumer confidence, income levels and inflation expectations. Of these, interest rates are the dominant force in residential construction, but what determines interest rates? In essence, they reflect the balance between demand for and supply of credit. This is no different than market price reflecting demand/supply balance of most products and services in our economy. Too many trusses mean lower truss prices; too much lumber means lower lumber prices; and too much available credit means lower interest rates. In addition, inflation expectations affect interest rates due to their impact on purchasing power of the currency (e.g., we demand higher rates to compensate for less purchasing power during inflationary times). Interest rates affect truss demand by influencing housing starts, size of homes built, level of remodeling demand, etc.

Signpost	Relation to Interest Rates	Likely Influence of Signpost on FED Funds rate over next 3 months - our forecast		
		Up	Neutral	Down
Resource Pressures				
1. GDP	+		x	
2. Capacity Util.	+			x
3. Employment	+		x	
4. Overtime Hours	+		x	
5. Order Backlogs	+		x	
Price Pressures				
1. Consumer Prices (CPI)	+	x		
2. Inflation Expectations	+	x		
3. Unit Labor Costs	+	x		
4. Employment Costs	+	x		
5. Producer Prices (PPI)	+		x	
Other Indicators				
1. U.S. Dollar Strength	-	x		
2. Credit Conditions	-		x	
3. Financial Market Stability	-	x		
4. Real Rates	+		x	

CONCLUSION: The FED will probably raise rates at least one more time by year-end in response to continuing inflation pressures from rising prices, higher employment

We have both long-term (e.g. 30- year mortgage) and short-term (less than one year) rates. The bond market determines long-term rates primarily based on expectations regarding future inflation growth. The FED (Federal Reserve Bank) influences short-term rates by adjusting the administered federal funds and discount rates in going about their mission of promoting a sound currency (minimal inflation). The FED's role is crucial because

The strong dollar has helped to keep inflation at bay despite very strong economic growth as a strong dollar has allowed interest rates to stay low and, by keeping import prices low, imported inflation was not a problem. However, the dollar is weakening as offshore

4. Real Rates	+		x

CONCLUSION: The FED will probably raise rates at least one more time by year-end in response to continuing inflation pressures from rising prices, higher employment costs & a weakening dollar.

Source: *Fed Watch*, Bank of Montreal, Sept. 9, 1999

economies strengthen (e.g. it has fallen from 145 Yen/US$ to 105 Yen/US$ in past six weeks), and this could undermine the U.S. economy rather quickly.

it is the benchmark on which many consumer loans are based—prime, credit cards, auto loans, etc. As such, the FED has a big impact on consumer spending, which represents two-thirds of the economy. The FED can slow the economy by raising rates and “kick start” the economy by lowering rates. The trick is deciding when to do what! It is difficult to predict the timing and amount of rate changes because they want to stay ahead of the inflation curve and the FED must often make changes before clear inflation signals (CPI/consumer price inflation, PPI/wholesale price inflation) are readily available.

It would be useful if we knew what the FED was going to do next. If rates were headed upward, then we should think about paring down inventories, reducing debt exposure, cutting costs, etc. On the other hand, if we felt rates were falling, then could be more aggressive in our capital expansion plans. So, what does the FED watch when deciding on the future course for interest rates? Here is a checklist based on an article authored by the Bank of Montreal’s Chief Eco-nomist—Tim O’Neill. In essence, they watch three categories for signs of increasing/decreasing inflation pressure:

- **Resource Pressures:** gross domestic product (GDP), capacity utilization, employment growth and unemployment rate, overtime hours, and orders backlog.
- **Price Pressures:** Consumer prices (CPI), Inflation expectations, unit labor costs, employment costs and producer prices (PPI).
- **Other Indicators:** Strength of the U.S. dollar, credit conditions, financial market stability, etc.

The table on page 34 shows the relationships between the signposts and interest rates. Although most of the relationships are positive or direct (move in same direction), some move in opposite directions. For example, as the CPI increases, inflation pressures increase and interest rates would move upward. Conversely, a strengthening dollar should reduce inflation pressures (make imports cheaper), and interest rates would move in the opposite direction (would fall). We have also presented our thoughts regarding the likely influence of these signposts on the FED funds rate through year-end.

Now that you understand the relationships, you can do your own analysis. Watch these indicators to guide your business decisions that are sensitive to interest rate changes. Avoid taking on heavy debt loads if you anticipate a significant up tick in interest rates. Higher rates mean problems for the stock market too, because current PE ratios don’t look so attractive in a higher rate environment. Alternatively, if you anticipate lower rates, that implies less inflation and cost/price increases will be more difficult to pass on to your customers. That means putting more emphasis on cost controls even though interest rates may be decreasing.

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